MISSION CREEP FROM WITHIN AT THE IRS: WHY CRIMINAL INVESTIGATION SPECIAL AGENTS WILL NOT SHRINK THE TAX GAP

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Abstract

Tax evasion on legal source income costs the U.S. Treasury an estimated $1 trillion annually. The tax gap is the difference between what is owed and what is collected. The Internal Revenue Service (IRS)'s Criminal Investigation Division (CI) is the sole law enforcement agency responsible for combating tax evasion and IRS managers prefer that CI criminal investigators (special agents) pursue such cases. However, evidence suggests that only about a quarter of the cases investigated by special agents are tax gap cases, while the bulk are more exotic cases involving narcotics-related money laundering, Ponzi schemes, and identity theft. The authors surveyed 348 current and former special agents about their case preferences in order to determine the causes of this discrepancy, and then compared this data to statistical data obtained from the United States Government (USG) and prior qualitative research. This paper suggests several possible causes of the difference between the CI's stated mission and its results. The closure of the tax gap is critical to the solvency of the USG and this is, to the authors' knowledge, the first academic paper to address the problem of non-tax gap case selection by special agents and related consequences.

Keywords: Tax Gap, Internal Revenue Service, Criminal Investigation, Special Agent.

1. INTRODUCTION

Tax evasion on legal source income costs the United States Government (USG) an estimated one trillion U.S. dollars annually (Hansen, 2021). The rate of non-compliance has held steady at about 19% since 2006 (Black et al., 2012; Internal Revenue Service [IRS], 2016, 2019a). This chronic failure to close the discrepancy between what should be collected and what the USG actually collects is called the tax gap (IRS, 2019a). It is more critical than ever to eliminate, or at least narrow, the tax gap as the United States' national debt held by the public stood at $24.2 trillion as of May 2022 (Congressional Budget Office [CBO], 2022).

The IRS is the federal agency responsible for enforcing the tax laws codified in the Internal Revenue Code (IRC) (Department of the Treasury, IRS, 2019). The IRS operates a small unit, called IRS-Criminal Investigation (CI), which investigates criminal violations of the IRC (IRS, 2022, 9.1.3). The 2,030 CI special agents are sworn law enforcement officers who are authorized to conduct traditional law enforcement activities. These activities include carrying firearms, arresting suspects, serving search warrants, and seizing property (IRS, 2021). In existence since the early days of the income tax, the CI is the agency famous for bringing

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Chicago mobster Al Capone and former Vice-President Spiro Agnew to justice (Breinholt, 2005).

In accordance with the general philosophy of law enforcement, CI special agents are granted wide latitude in respect of the cases they pursue and the amount of time that they allocate to these cases. However, only about 25% of their cases relate to legal source income, such as cases involving business owners who have failed to report all of their revenue (J. Austin, personal communication, November 8, 2017; IRS, 2022, 9.5.3; D. Nimmo, personal communication, January 20, 2021). CI special agents are heavily involved with cases pertaining to other statutes under their jurisdiction, including narcotics-related money laundering, currency structuring, and terrorist financing (J. Austin, personal communication, November 8, 2017; D. Nimmo, personal communication, January 20, 2021). As a result, their contribution toward their primary mission of closing the tax gap is diminished. CI management, although aware of this departure, has not acted forcefully to remedy the situation. This paper explores the nature of this "mission creep" by exploring the nature of special agent non-tax gap case selection. Specifically, the authors conducted a quantitative survey of 348 current and retired CI special agents, and then used quantitative multivariate analysis, employing structural equation modeling, to determine the factors that influence the special agents' non-tax gap case selection. This survey builds upon the work of a qualitative research project involving semi-structured interviews with 30 current and former CI special agents which explored their extraordinary autonomy to identify, pursue, and recommend the prosecution of cases within the agency's domain (Warren et al., 2022). In that study, the special agents interviewed indicated a strong preference for cases involving illegal activity (such as narcotics trafficking) rather than traditional tax cases involving legal source income, because there was a greater likelihood of prosecution and longer jail terms, and they derived satisfaction from protecting vulnerable taxpayers. On an agency level, the CI received $371 million in extra funding from FY 2010 through FY 2020 for delegating agents to non-tax gap cases, so CI managers had an incentive to turn a blind eye to the tax gap (P. Hatcher, personal communication, December 17, 2017; Treasury Inspector General for Tax Administration [TIGTA], 2011, 2017).

This is not the most efficient or effective use of agents' energies, however, since professional criminals' general behaviors are far more harmful to society than their tax evasion. If such criminals are successfully prosecuted and imprisoned, tax consequences are usually forgotten and the tax gap is not reduced. When CI special agents take the opportunity to work with the Federal Bureau of Investigation (FBI), Drug Enforcement Administration (DEA), and local police forces to catch career criminals, they forgo the opportunity to pursue pure tax cases (cases which usually involve legal source income incorrectly reported to the IRS, resulting in underpayment by a person who has not otherwise engaged in criminal activity). This is clearly an example of "mission creep": attention and effort has departed from the CI's original purpose and its potentially more prosocial value. Indeed, the current direction of special agents' activity runs counter to official agency priorities (IRS, 2022, 9.5.3).

Given that CI special agents should be trying to reduce the tax gap but pursue primarily non-tax gap cases, the research question addressed in this paper is: Why do special agents choose cases that do not close the tax gap? Four main motivating factors appear to influence an agent's decision on which case they select. These factors were developed based on 30 qualitative interviews with current and former CI special agents (Warren et al., 2022). Factor one is the desire to achieve the maximum results for an investigation as defined by the length of incarceration and amount of tax assessed or assets forfeited compared to the effort expended

on the investigation. Factor two is the action orientation of the agent and includes an agent's desire to engage in typical law enforcement activities, such as arresting subjects, serving warrants, and engaging in other hands-on police tactics not typical of other types of accounting jobs. Factor three is the priorities of management. CI superiors are responsible for authorizing the cases selected by special agents for investigation. Without authorization to conduct an investigation from front line or upper management, the agent is prohibited from engaging in any investigative activity relating to the case. This should prompt the agent to move to another case. Factor four is job satisfaction and is a mediation factor. One may expect that the factors outlined above would affect job satisfaction, which would, in turn, affect the types of cases selected by agents.

2. GAP IN THE LITERATURE

The IRS is a favorite topic for oversight groups, such as the United States Government Accountability Office (GAO), the CBO, and TIGTA. Reports from these agencies focus on detailing the efficiency and effectiveness of the IRS's operations, and how to improve them (CBO, 2020; Letter from Phillip L. Swagel, 2021; TIGTA, 2020a, 2020b, 2020c; GAO, 2018a; 2018b; 2019, 2020a). Some practitioners have provided a vision of what the IRS should become in the future (Rossotti, 1999). Most academic articles focus on identifying the causes of tax evasion (Allingham & Sandmo, 1972; Damjanovic & Ulph, 2010; Posner, 2000; Sandmo, 2005) and measuring the deterrent effect of enforcement efforts (Dubin, 2007; Dubin et al., 1990). Some literature from the early 2000s attempts to link job satisfaction with turnover or empowerment (Nayak, 2002). However, there is no literature that addresses how CI special agents select cases for investigation. It is this gap in the literature that is filled by this article.

3. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The CI comprises approximately 2,030 special agents distributed among 22 field offices in the United States, as well as representatives in eleven foreign countries, in order to facilitate domestic and international investigations (IRS, 2021). Special agents are recruited in a variety of ways, including directly from colleges and universities. The people hired are often formally trained in accounting—many are Certified Public Accountants (CPAs)—and have strong knowledge of tax laws. However, unlike their associates on the civil side of the IRS, CI special agents are trained in a similar way to law enforcement agency recruits. For example, CI special agent recruits must complete a 24-week training program at the Federal Law Enforcement Training Center (FLETC) in Brunswick, Georgia, where they take courses in firearms training (including the use of sidearms and shotguns), self-defense, arrest procedures, interviewing, pepper spray countermeasures, and surveillance tactics (IRS, 2022, 9.2.1). Once trained and in the field, special agents carry semi-automatic .40 caliber handguns with 13-round magazines (each gun also has a round in the chamber), wear bulletproof vests during enforcement actions, and drive unmarked government cars equipped with sirens and police lights (IRS, 2022, 9.2.1). They participate in mandatory quarterly defensive tactics and firearms refresher training, during which they must demonstrate that they can shoot a stationary target in the head twice at the seven-yard line after an "emergency reload" (IRS, 2022, 9.2.1-5). Since their physical safety may be at risk on the job, CI special agents are permitted to devote three hours during the work week to staying in good physical condition in order to meet whatever challenges arise (IRS, 2022, 9.2.2).

If money laundering, fraud, or currency structuring is suspected, CI special agents may become involved in investigating a wide range of criminal offenses, such as narcotics trafficking, terrorism, identity theft, human trafficking, public corruption, bankruptcy fraud, and unlawful flight to avoid prosecution (IRS, 2022, 9.1.3; 9.5.5). These investigations necessitate close cooperation with other law enforcement agencies, as well as the wider judicial system (federal prosecutors, judges, and grand juries).

When pursuing cases involving only a tax law violation (tax gap cases), special agents have wide latitude regarding the types of cases they select and can engage in routine law enforcement activities, such as conducting surveillance and accessing tax return data, even if no specific case related to these activities has been opened (IRS, 2022, 9.4.10).

CI special agents' work is primarily investigatory and thus highly idiosyncratic. The special agent is expected to do whatever it (legally) takes to build a case that will result in a successful prosecution and enforcement. Typically, special agents spend most of their time outside the office interviewing witnesses (IRS, 2022, 9.4.5), cultivating confidential informants (IRS, 2022, 9.4.2), conducting undercover operations (IRS, 2022, 9.4.8), or observing human activity (IRS, 2022, 9.4.11). They frequently obtain and execute warrants, serving 5,993 warrants from fiscal years 2017 through 2020 (IRS, 2018, 2019b, 2020, 2021).

Such work is inherently difficult to manage and, accordingly, special agents have a high degree of discretion over their activities. This self-direction extends to case initiation. Agents are expected to be alert to early signs of activity which point to likely non-reporting of taxable income. Such signs range widely, from a suspicious valuation of assets in a divorce proceeding to violence-steeped gang behavior.

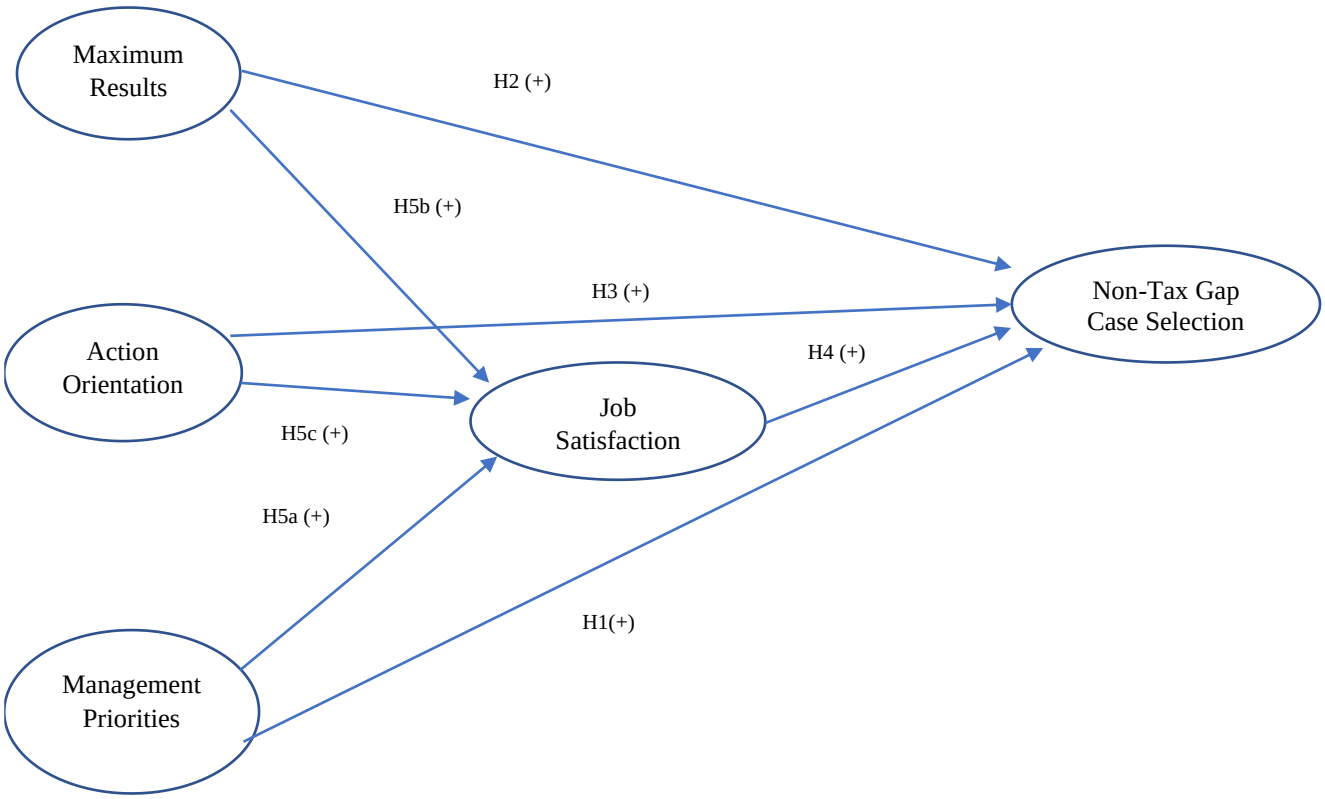
In short, not only do CI special agents have the opportunity to do work unlike any other IRS employee, they also have a remarkable amount of autonomy with regard to choosing which kinds of cases and which individual cases to pursue. In considering their motivations for choosing certain cases over others, we need to adopt an effort-based view of performance since success, as conventionally defined, is not within their control. Furthermore, we need to examine agents' aspirations. Whereas most organizations exert a powerful socialization influence on employees (Van Maanen, 1975), law enforcement agencies in general, and the CI division in particular, do not.

The authors developed four categories that help explain the motivations for CI special agents' preference for non-tax gap cases: the logic of authority, the logic of achieved results, the logic of excitement, and the logic of happiness at work. Recent qualitative findings (Warren et al., 2022) indicate that special agents pick cases that will result in the highest possible jail sentence and tax liabilities, i.e., maximum results, and that are most likely to result in enforcement actions, such as search warrants, i.e., action orientation, rather than other cases available for selection (Warren et al., 2022).

As shown in the initial model (Figure 1), maximum results and action orientation are two of the direct effects tested. The third effect—management priorities—tests management's directions to employees regarding the types of cases that managers want them to select. As stated earlier, the primary focus of CI agents is supposed to be tax gap cases, so one would suppose that to be management's focus as well. However, 75% of the cases chosen by special agents from FY 2010 to FY 2020 were not tax gap (legal source income) cases (J. Austin,

personal communication, November 8, 2017; IRS, 2022, 9.5.3; D. Nimmo, personal communication, January 20, 2021), so management's priorities would seem to have little bearing on the special agents' identification of cases for investigation. Job satisfaction, then, must also be considered in terms of its influence on non-tax gap case selection.

Figure 1: Initial Hypothesized Model



The Logic of Authority

What role does authority, or management preference and directives, play in the CI agents' non-tax gap case selection process? It is useful to look at how bureaucracies work as we consider this question. Max Weber described the modern bureaucratic organization as having official rule-based jurisdictions for roles and a hierarchy of authority-based positions—both operated with a spirit of formulistic impersonality (Gerth & Wright Mills, 1958). This description reflects the conventional wisdom of organizations as predictable and orderly entities that are able to execute managerial plans and protect subordinates from supervisory whims. Walton's (2005) meta-analytic evidence supports the theory that Weber's description is still a common bureaucratic model. A possible problem within bureaucracies is identified by Merton (1940), who suggests that the values that must be instilled in employees in order to maintain a functioning bureaucratic structure could create a "bureaucratic personality" (p. 560): subordinates who want to follow rules and reap a reward for doing so might justify rules as

ends in themselves, resulting in an incapacity to respond to change. However, most would agree that people who join organizations expect to follow the rules set by those with the authority to make them. This statement definitely applies to public sector operations (Oberfield, 2014), but is slightly more problematic for law-enforcement type professionals (Thornton, 1970).

Using a construct called "rules rigidity," Wulfert et al. (1994) have studied how closely subordinates follow the rules they receive (p. 664). Evidence suggests that, in static environments, most people will follow instructions, in part because the instructions appear to be aligned with reality, i.e., they make sense. However, when conditions change and instructions appear to be inaccurate, employees who are less rigid will depart from such tight governance (Wulfert et al., 1994).

Sociologists suggest that organizational culture is the primary influence on rule-following. Bureaucracies, even those under governmental auspices, are not homogeneous but instead engender unique patterns of thought and responsiveness (Oberfield, 2014). Bordieu (1977) indicates that bureaucracies are a habitus characterized by durable sets of predispositions and taken-for-granted propositions for action. Adherence to rules could therefore reflect employee career orientation (Schein et al., 1965), the projection of employee interests on the population being served (Oberfield, 2009), or the attributes of the rules themselves (Borry et al., 2018).

The extent to which an individual follows rules is more consistent than it is variable (Oberfield, 2009), which suggests that rule-following behavior is infused with personal motives. Most people do not believe that bureaucracy per se has eliminated their individual personalities but, at the same time, they would not even think of transgressing a rule (Kohn, 1971; Wilson, 1989). Since looking only at rules does not capture the complete truth of a situation, it may be unsurprising that employees who follow rules regularly and those who do not follow rules regularly have approximately equal levels of performance (Foster, 1990). Furthermore, neither group identifies more with the organization as a whole (Rotondi Jr., 1975).

In discussing rule-following in the public sector, Chen (2012) provides evidence that more comprehensive sets of constraints erode positive work attitudes. An abundance of rules may result from an effort to be responsive to more constituents and situations which, in turn, causes less flexibility in the alignment of incentives (Oberfield, 2014). Wilson (1989) posits that higher-level government employees are able to transcend rule-based alienation with a disposition toward action, and DeHart-Davis (2009) suggests that this type of employee shows a willingness to be proactively uncooperative with questionable rules.

Given the nature of their training and the granularity of CI management direction, one might expect special agents to scrupulously follow management direction. As stated earlier, CI special agent recruits undergo an intensive 24-week residential training program at FLETC. During this training period, recruits can be removed at any time for failure to follow directions or for perceived poor performance (IRS, 2022, 9.2.1). If they make it to graduation day to receive their badge and credentials, they then report to their assigned field, where they are given an on-the-job instructor (OJI) who is responsible for the rookie agent's field training (Internal Revenue Service, 2022, 9.2.1). After about a year, assuming that the OJI and the new agent's first line supervisor—the supervisory special agent (SSA)—believe that the rookie agent has demonstrated adequate vocational skills and the necessary deference to management direction,

the rookie agent is released from on-the-job training and becomes a fully autonomous special agent (IRS, 2022, 9.2.1).

CI management evaluates special agents frequently throughout the year with a written mid-year evaluation, a written end-of-year evaluation, and three annual reviews of each special agent's cases (IRS, 2022, 9.1.4.9). In the reviews of special cases, there is a written record of the progress of the case as well as the SSA's directions. Once a case is completed, the SSA may provide a written critique of the special agent's performance on that case (IRS, 2022, 9.5.12).

As we have seen, the CI has implemented an arduous training program, near-constant feedback, and frequent evaluation of special agents. In the Internal Revenue Manual, CI management prioritizes legal income tax cases (tax gap cases) above all other investigations (IRS, 2022, 9.5.3), and the priority of investigating and prosecuting tax gap cases is reinforced in an annual memorandum sent by the CI Chief to the field (IRS, personal communication, November 18, 2018). This emphasis is communicated to the public in the CI's annual reports (IRS, 2017, 2018, 2019b, 2020). Therefore, one could assume that management wants special agents primarily to pursue tax gap cases and a logical baseline expectation (our Hypothesis 1) could be stated as follows:

> **H1:** Special agents will follow management preferences with regard to their selection of tax gap cases.

The Logic of Achieved Results

Having considered the importance of authority in employee decision making, we now turn to the influence that achieved results may exert on CI special agents. To do this, we will look at some differences in the way that tax gap and non-tax gap cases are pursued, as well as differences in the outcomes of these pursuits.

One difference between tax gap and non-tax gap cases is the amount of time that must be invested in order to bring about a successful conclusion. A tax gap case is investigated using only IRS resources, utilizing administrative summonses to gather documents and testimony. If a witness refuses to comply with an IRS summons, the CI must undertake a lengthy court battle to compel the witness to produce the documents or testimony. If the special agent's tax gap investigation results in a report that recommends prosecution (and such a report would be have to be reviewed by at least four levels of CI management, as well as a trial attorney at the United States Department of Justice Tax Division), the case is forwarded to the local United States Attorney's Office (USAO) and reviewed by a front-line federal prosecutor called an Assistant United States Attorney (AUSA), who knows nothing about the case and has no vested interest in seeing it prosecuted.

Non-tax gap cases, on the other hand, are investigated in partnership with an AUSA. By working directly with federal prosecutors during the course of the investigation, special agents can issue federal grand jury subpoenas to compel the production of documents and testimony of witnesses. If the recipient of a grand jury subpoena refuses to comply, that person may be held in contempt of the grand jury and jailed until compliance is forthcoming—which is clearly a stronger and more expeditious incentive than simply waiting to see how the CI's efforts in court turn out, as happens in tax gap cases. Another advantage of working a non-tax gap case

is the investigative direction provided throughout by the AUSA. The AUSA tells the special agent what evidence is necessary for a successful prosecution, reviews the evidence, provides feedback as the investigation progresses, and informs the special agent when sufficient evidence is collected. Alternatively, the AUSA can pull the plug on the investigation early on if the case is not prosecutable.

Other federal agencies, such as the FBI and the DEA, are also involved in non-tax gap cases. The participants interviewed in recent qualitative research on this topic (Warren et al., 2022) provided numerous examples of cases during which other federal agencies provided resources that the CI lacked (for example, the FBI provided six Arabic speakers on short notice for an organized crime investigation on the East Coast and, in another case, the FBI traveled internationally so that the CI did not have to expend travel funds). This additional help allows CI special agents to reach successful case outcomes quicker in non-tax gap cases than in tax gap cases, where outside agencies are not involved.

Perhaps the speedier case closure rate and the coordination with other federal agencies associated with non-tax gap cases contribute to CI special agents' clear preference for them. Data from Fiscal Years (FYs) 2010 through 2020, obtained from the IRS through a Freedom of Information Act (or FOIA) request, shows that during this period, the CI initiated 42,394 subject criminal investigations (SCIs) (J. Austin, personal communication, November 8, 2017; D. Nimmo, personal communication, January 20, 2021). An SCI is an active criminal investigation in which an individual has been identified as a possible lawbreaker (the subject) and active measures, such as interviewing the subject and issuing subpoenas, may commence. Of these 42,394 SCIs, 10,512 (24.8%) were non-grand jury investigations and thus probable tax gap cases. Of the 10,512 probable tax gap cases, only 7,413 (17.5%) were primarily Title 26 tax cases.[4] This means that the percentage of tax gap cases actually initiated by CI special agents from FY 2010 through FY 2020 could have been as low as 17.5%, and could not have been higher than 37.0% if one assumes that all of the 8,253 grand jury cases in which a tax charge was the primary charge were for legal income source tax evasion (J. Austin, personal communication, November 8, 2017; D. Nimmo, personal communication, January 20, 2021).

The USAO and the law enforcement agencies with which the CI works on non-tax gap cases also appear to influence CI special agents in terms of non-tax gap case selection. From FY 2010 through FY 2020, 50.7% of CI's cases were referred by either the USAO or other federal agencies, whereas only 10.1% of the CI's new cases during this time were referred by IRS units responsible for audits and tax collection (J. Austin, personal communication, November 8, 2017; D. Nimmo, personal communication, January 20, 2021). As for indicted cases, from FY 2010 through FY 2020, the Department of Justice indicted 29,743 of the CI's cases, of which only 7,526 (25.3%) had a Title 26 charge as the primary offense, while the primary offense in 9,525 cases (32%) was money laundering. Considering that 56.4% of the indicted cases came from either the USAO or another federal agency, the relatively high percentage of non-tax gap cases is not unexpected (J. Austin, personal communication, November 8, 2017; D. Nimmo, personal communication, January 20, 2021). Of the indicted cases, only 2,639 (8.9%) originated in another (i.e., non-CI) IRS division (J. Austin, personal communication, November 8, 2017; D. Nimmo, personal communication, January 20, 2021).

[4] Title 26 of the United States Code (USC) codifies the United States Internal Revenue Laws.

The disparity in sentences for those convicted in tax gap and non-tax gap cases may provide a clue as to why special agents select non-tax gap cases. According to the CI's 2019 annual report, 22% of people convicted of not filing a federal tax return serve no jail time and those who do serve an average of 26 months (IRS, 2020). A money launderer, on the other hand, serves an average of 74 months in jail (if s/he is one of the 87% of defendants who serve jail time) (IRS, 2020). The punishment in non-tax gap cases may seem to better fit the crime and appeal more to a sense of justice.

When examining the role that achieved results play in CI special agents' non-tax gap case selection, in addition to looking at external factors such as referrals of cases, we should consider internal psychological factors, such as self-efficacy. Self-efficacy means that those who believe they can be successful tend to engage in behaviors proven to be more conducive to success (Sadri & Robertson, 1993) and, as a result, they perform better (Stajkovic & Luthans, 1998). In other words, self-efficacy is a motivational theory of belief in one's own capacity that stirs one toward greater levels of effort (Wongpinunwatana & Panchoo, 2014). Bandura (1993) has shown the important role that emotional control plays in performance, and has described the confluence of distinct processes and levels pertaining to performance that are aided by self-efficacy. Although we should not necessarily presume that all special agents are fully aware of self-efficacy, since outcomes may be affected by skill and complexity gradations (Gist & Mitchell, 1992), we can conclude that self-efficacy does, in some way, motivate special agents' choices and behaviors.

Expectancy theory is also pertinent when examining special agents' choice of cases. This theory requires one to estimate the probabilities of success before embarking upon a plan of action, taking into consideration one's value preferences (Vroom, 1964). If multiple parties share the right to take action, role clarity is important as well (Organ & Greene, 1974). Goal clarity also underlies the ability to achieve results (Anderson & Stritch, 2015).

Self-efficacy and expectancy theory partly explain why CI special agents might be more likely to choose some cases than others. However, perhaps more importantly, people have an affinity for work that is not only successful but also significant, as Hackman and Lawler (1971) show in their Job Characteristics Model. According to Hackman and Lawler (1971), one of the five elements that people seek in their work is task significance. Workers place a higher value on doing a job that has a positive benefit for others; indeed, people will work harder if they believe they are helping others (Grant, 2008b). This kind of perceived connectedness to others creates the meaning that people crave in their work (Morse & Weiss, 1955). Interestingly, the prosocial consequence of a job successfully completed only matters to the worker when it is combined with a corresponding intrinsic motivation (Grant, 2008a).

Work in the public sector would seem to be ideal for this attainment of broader significance. By definition, there is a population to be served or a malady affecting a population that needs to be cured. In the non-profit world, Perry and Hondeghem (2008) identify a salient motive to serve what could be called the public good. It seems reasonable that CI special agents could be moved by a desire to punish those who commit crimes (non-tax gap cases) and those who fail to pay their fair share of the tax burden (tax gap cases). What principally differentiates the two types of cases is that criminal activity (non-tax gap) usually has specific victims, whereas the victim in tax gap cases is the government, a more nebulous entity. Consideration of all the varying aspects of special agents' achieved results can lead us to make our second hypothesis:

H2: Special agents who are more interested in achieving tangible results will be more inclined to accept non-tax gap cases.

The Logic of Excitement

We have discussed the importance of authority and achieved results in CI special agents' decision making vis-à-vis choice of cases to pursue, but the excitement that the case is likely to provide is a factor as well. As mentioned earlier, many special agent recruits are accountants and are probably all too familiar with unflattering stereotypes of the profession. According to these stereotypes, accountants have deficient personalities and find spreadsheets more interesting than people. This image negatively affects recruitment into the field (Cory, 1992) and is perpetuated by depictions of accountants in the mass media (Dimnik & Felton, 2006; Friedman & Lyne, 2001). If one were to accept that stereotypes contain a grain of truth, it follows that accounting tends to attract people who desire stable, predictable work that offers little in the way of what most people would call excitement. They may, however, enjoy seeing how the numbers play out. Novelist David Foster Wallace (2011) suggests that being able to endure and even transcend boredom makes tax students unique and particularly valuable.

However, while stereotypes may contain some truth, they are also limiting and misleading, and we should certainly expect that some people working in the accounting field crave excitement. The CI would seem to be a logical home for those who do not fit the "bean counter" persona, since this unit allows accountants to pursue work that takes them far away from ledgers and green eyeshades. The work of a CI special agent is a role amalgamation that provides a better role-person fit for some than, for example, a job as a CPA (West, 1987). Some accountants are "absorbers"—people open to a wide range of experience and activities, who are often labeled "sensation seekers" (Zuckerman et al., 1978). These individuals are intolerant of boredom and tend to be risk-takers, even to the point of fantasy fulfillment and an unwillingness to avoid situations where personal harm is possible (de Vries et al., 2009). Tellegen and Atkinson (1974) suggest that such personality types will even undergo self-alteration in the pursuit of novelty. Sensation seekers, who Zuckerman et al. (1978) claim are more likely to be young men, prefer unstructured work that is less well-defined and less detail-oriented (Kish & Donnenwerth, 1969).

We have seen that the work of CI special agents can be very stimulating. As noted above, special agents undergo extensive training in firearms, defensive tactics, search warrant execution, arrest procedures, surveillance, and chemical agent (pepper spray) deployment (IRS, 2022, 9.2.1). They routinely investigate cases side by side with the FBI and DEA, and special agents with specialized training can go undercover, posing as underworld crime figures (J. Austin, personal communication, November 8, 2017; IRS, 2022, 9.4.8). CI special agents were embedded with the U.S. military in Iraq during the Second Gulf War, where they interviewed suspected terrorist financers and served search warrants on locations suspected of harboring terrorist activity (U.S. Department of the Treasury, 2005). From FY 2017 to FY 2020, special agents served 5,993 warrants (IRS, 2018, 2019b, 2020), presumably in full raid gear with ballistic vests. Special agents who show particular promise may serve at one of eleven overseas postings, in places such as Barbados, Australia, or England (IRS, 2020). Sensation seekers would definitely prefer the exciting work of pursuing a non-tax gap case to laboriously extracting, then painstakingly examining, the voluminous financial records involved in a tax gap case. It is logical, then, to hypothesize the following:

> **H3:** Special agents who demonstrate an action orientation will express more enthusiasm for sensation-seeking work and are more likely to select non-tax gap cases.

The Logic of Happiness at Work

Thus far, we have considered the roles that authority, achieved results, and action orientation might play in CI special agents' selection of non-tax gap cases over tax gap cases. Another factor is job satisfaction, or happiness at work. Any job that has many attributes will yield different degrees of satisfaction to people for different reasons (Caldwell & O'Reilly, 1982). One must look at whether satisfaction is determined by a hierarchy of need fulfillment (Herzberg, 2005). It is also worth considering whether job facets are independent or additive (Rabinowitz & Hall, 1977).

Several meta-analytic efforts, including that of Petty et al. (1984), have firmly established that there is a positive relationship between job satisfaction and performance. Some analysts have quantified this relationship in terms of stimulating vs. non-stimulating work. For example, Baird (1976) found that higher job satisfaction was positively related to higher performance in the case of stimulating work. However, Ivancevich (1978) posited that the intrinsic satisfaction derived from stimulating work more likely results from satisfactory performance, rather than the stimulating nature of the work itself. Interestingly, in public sector work, the most consistent finding is that the work environment drives job satisfaction variables, rather than worker attributes driving job satisfaction (Zhao et al., 1999).

Traditional measures of job performance do not apply to CI special agents, since successful prosecution of cases (which would reflect the most satisfactory performance by agents) is subject to enormous vagaries that are completely outside the agents' control. There is some precedent for connecting non-tax gap case selection to job satisfaction, but Stone et al. (1977) found that satisfied workers tend to have a larger scope of work. It is not a leap to suggest that workers would choose to do the work that makes them most satisfied, hence the following hypothesis:

> **H4:** Special agents will tend to select the type of cases that yield the largest job satisfaction.

In terms of the elements necessary for job satisfaction, the literature highlights employee engagement. Overall, the more intensely employees are involved in their jobs, the more satisfied they are (Kanungo, 1979; Saleh & Hosek, 1976). It stands to reason, therefore, that job satisfaction is a mediating variable for the selection of cases by CI special agents; authority, achieved results, and action orientation are only consequential if they trigger job satisfaction. Let us consider each of our previous hypotheses in this light.

The first hypothesis, H1, stated: "Special agents will follow management preferences with regard to their selection of tax gap cases." When we interpose job satisfaction, however, the need for a well-functioning interpersonal climate may take priority over obedience to authority. Research has found that employees with high social needs tend to have high job satisfaction (Downey et al., 1975). In law enforcement, though, job satisfaction was more likely when the employee was well suited to their immediate supervisor (Ingram & Lee, 2015). This would

seem to suggest that following managerial directives should result in high job satisfaction for CI special agents, hence the following hypothesis:

> **H5a:** Special agents who follow supervisor non-tax gap case selection guidelines will be more satisfied with their jobs.

The second hypothesis was concerned with achieved results: "H2: Special agents who are more interested in achieving tangible results will be more inclined to accept non-tax gap cases." When considering the importance of job satisfaction in connection with achieved results, we need to consider the characteristics of the work environment that underlie law enforcement officer job satisfaction (Johnson, 2012). For police officers, autonomy was the most important part of the work (Miller et al., 2009), so we might conclude that being trusted to produce acceptable results matters to CI special agents. With regard to what might be considered acceptable results, achievement can be measured in various ways: by length of jail sentence, restitution amount, or value of assets forfeited, to name a few examples. A high-achieving special agent may be rewarded with promotions, small cash awards, letters of commendation, or exclusive use of the newest government vehicle ("G-Ride") in the fleet. Such recognition may lead to an increased sense of job satisfaction (Herzberg, 2005). We may then hypothesize this:

> **H5b:** Special agents who consider the achievement of tangible results as very important will be more satisfied with their jobs.

Finally, we hypothesized that "H3: Special agents who demonstrate an action orientation will express more enthusiasm for sensation-seeking work and are more likely to select non-tax gap cases." Bowman et al. (2006) assert that local law enforcement agencies lose officers to the FBI, in part, due to the fact that the officers do not feel adequately engaged because they are not as active on the job as they would like to be. As stated earlier, greater action is often connected with greater excitement, and Bruffey (1997) finds a positive relationship between work excitement and job satisfaction. On the other hand, according to Judge et al.'s (2002) meta-analysis, the relationship between job satisfaction and openness to active experience is positive but not strong. It is certainly plausible that CI special agents derive personal satisfaction from higher sensory activation:

> **H5c:** Special agents with an action orientation who desire sensation-seeking work will have higher job satisfaction.

4. METHOD

Since no definitive archival record of investigations by special agents exists, we designed and administered a survey focusing on non-tax gap case selection. Even if such a record were available, our central aim was to discover special agents' rationale for their choices. Although survey methods rarely attain the depth that interviews do, we opted for the heightened degree of generalizability afforded by surveys.

Subjects

We collected data with the assistance of two organizations, the Association of Former Special Agents of the IRS (AFSA-IRS) and the Federal Law Enforcement Officers Association

(FLEOA). Both organizations endorsed the survey in email correspondence to their members. In addition to this email solicitation, we sent a direct request to 525 people who self-identified as IRS special agents in their LinkedIn profiles and/or people that one of the authors knew personally. Since special agents may retire as soon as 20 years after starting the job and must retire no later than the age of 57, the retirees surveyed tended to be relatively young, with their active careers in the recent past.

Survey Development, Administration, and Analysis

Due to the particular variables and effects involved in this research, we chose not to use pre-established survey instruments or scales. Instead, we designed original questions, keeping in mind previously validated scales on related topics, and thus questions were adapted where relevant to fit this inquiry. During the creation of the survey, an interactive process helped us to refine the survey instrument. In five "talk alouds", former special agents read the proposed survey instructions and questions to the lead author in person in order to assess understandability and completeness (each time, a different retired special agent known personally by the lead author participated). These "talk alouds" resulted in the rewording of questions which either did not flow well or contained grammatical errors. After completing the five "talk alouds", the authors were satisfied that the survey would be understandable.

Once the survey questions had been clarified, the complete list was subject to ten rounds of question-sorting (Q-sorting) involving 36 different participants (Q-sorters), all of whom were current or retired CI special agents and were known by the lead author and/or were doctoral students in the same program as the lead author. The Q-sorters did all Q-sorting remotely, using Qualtrics software (directions for the Q-sorting procedure were communicated via a 2:45-minute video using Screen-O-Matic software). Once the Q-sorting "hit ratio" of the final five Q-sorters reached 80% on all questions, testing was considered complete (Nahm et al., 2002).

A beta version of the survey instrument was administered via a Qualtrics link to seven current or retired CI special agents known by the lead author. The authors crafted the final version of the instrument based on the outcome of the beta test (see the appendix). The dependent variable was non-tax gap case selection, which included respondent preferences for both tax gap and non-tax gap cases. Tax gap preferences were reverse coded to create the singular case type variable.

The survey uses a 5-point Likert scale to measure responses, with the following range: "Strongly Disagree" (1), "Somewhat Disagree" (2), "Neither Agree nor Disagree" (3), "Somewhat Agree" (4), and "Strongly Agree" (5). Modified scales were used to measure demographic information such as age, gender, years of service, and race.

Emails were sent to prospective respondents from the AFSA-IRS and the FLEOA, and the lead author sent 525 personalized LinkedIn invitations to current and former special agents. The emails and LinkedIn messages included a link to the survey through Qualtrics. Data collection began in late August 2018 and ended in mid-November 2018; one reminder message was sent from FLEOA during that period in order to stimulate responses. Qualtrics was used to manage data requests and returns, and the results were sent directly to the lead author. Since many current and retired special agents may be members of both AFSA-IRS and FLEOA and also have LinkedIn accounts, calculating an accurate respondent rate was not possible and this is a limitation to the study. Survey responses were initially exported into IBM SPSS Statistics, and

IBM SPSS-AMOS was used to determine the factor structure of the data and to test the hypotheses depicted in Figure 1.

5. RESULTS

Of the 429 responses received, 81 were deleted for failing to complete at least 90% of the questions, leaving 348 responses. The AFSA-IRS has approximately 1,100 members and FLEOA has 1,600. Many potential respondents belonged to both organizations and maintained LinkedIn profiles. However, the response was large enough to warrant using a structural equations approach. Following Hair et al.'s (1998) example, we replaced missing answers on otherwise valid responses with the median responses for those questions, which produced the same result as deleting the responses altogether.

Factor Structure

Exploratory factor analysis was conducted using the principal axis factoring extraction method (Costello & Osborne, 2005) and the Promax rotation method (Hu & Bentler, 1999). This produced five identifiable factors and allowed for the deletion of measured items that had low factor loadings or high cross-loadings (Hu & Bentler, 1999). The resultant pattern matrix is summarized in Table 1.

Acceptable sampling accuracy was evidenced by a KMO of .788. The five factors explain 68.90% of the variance. Cronbach's Alpha for each factor is reported in Table 1. All but one factor has a Cronbach's Alpha above 0.60. Ordinarily, this measure of reliability should be 0.70 but we have found literature where the acceptable threshold was 0.60 (Peterson & Kim, 2013). Maximum results has a Cronbach's Alpha of 0.54, which the authors considered sufficiently close to the minimum threshold. Adequate convergent validity was achieved by virtue of sufficiently high loadings. Discriminant validity was adequate based on the absence of significant cross loadings (Hair et al., 1998). Table 2 contains the correlation matrix for the latent factors. Sufficient distinctiveness across constructs has been achieved with no correlation greater than 0.51. Maximum results demonstrated slightly less construct reliability (AVE= 0.408) but was determined sufficient for this model.

The confirmatory factor analysis produced four statistics that exceeded or approached acceptable levels (CMIN/df=2.237, CFI=.942, RMSEA=.060, PClose=.070). We also tested for multicollinearity using a variable inflation factor test and found no issues.

Common Method Bias Testing

Surveys should measure the constructs under review without interference or bias from the way in which the survey is written, tested, or administered (Podsakoff et al., 2003). Such a distortion of the variance in the response data is referred to as common method bias (Podsakoff et al., 2003). For example, wording a question in a way that would elicit a socially desirable answer ("Is it wrong to beat your wife?") may damage the validity of results due to a social desirability bias (Thomas & Kilmann, 1975, and Nederhof, 1985, as cited in Podaskoff et al., 2003). In our survey, common method bias was tested using a common latent factor (CLF) that was added to the confirmatory factor analysis in accordance with MacKenzie and Podsakoff's (2012) study. We found evidence of method bias in our data, as per Hair et al. (1998). We then created three models—Model 1 (unconstrained), Model 2 (weights constrained to equal), and Model 3

(weights constrained to zero)—and ran the nested models. After running all three models, acceptable model fit was achieved (see Table 3).

Table 1: Pattern Matrix

	Factor					
	Job Satisfaction	Non-Tax Gap Case Selection	Management Priorities	Maximum Results	Action Orientation	Model Total
Eigenvalue	3.991	2.952	1.752	1.241	1.087	
% of Variance Explained	24.95%	18.45%	10.95%	7.75%	6.80%	68.90%
Cronbach's Alpha	.838	.814	.754	.544	.680	.662
AA3					0.876	
AA4					0.586	
CS4		0.886				
CS5		0.600				
CS6		0.836				
CS7		0.567			0.226	
JS1	0.912					
JS3	0.805					
JS4	0.871					
JS5[b]	0.445			0.225		
Max1				0.746		
Max2				0.634		
Max4				0.490		
RMP1			0.486			
MP2			0.761			
MP3			0.933			

Extraction method: Principal axis factoring.
Rotation method: Promax with Kaiser normalization.
a. Rotation converged in 6 iterations;
b. Note that JS5 was used to measure job satisfaction only, despite the small cross load depicted above with maximum results.

Table 2: Factor Correlation Matrix

Factor	CR	AVE	MSV	Job Satisfaction	Non-Tax Case Selection	Mgmt. Priorities	Maximum Results	Action Orientation
Job Satisfaction	0.861	0.617	0.333	1.000	-0.176	0.275	0.075	0.002
Non-Tax Gap Case Selection	0.821	0.538	0.263	-0.176	1.000	-0.370	0.385	0.510
Mgmt. Priorities	0.778	0.555	0.142	0.275	-0.370	1.000	0.037	-0.135
Maximum Results	0.672	0.408	0.325	0.075	0.85	0.037	1.000	0.422
Action Orientation	0.717	0.564	0.325	.002	0.510	-0.135	0.422	1.000

Table 3: Model Fit: Model Fit with Common Latent Factor

Description	M1: Unconstrained	M2: Constrained to Equal	M3: Constrained to Zero	Comments	Reference
CMIN/DF	1.334	1.634	1.796	Acceptable	(Hu & Bentler, 1999)
CFI	.987	.972	.964	Acceptable	(Hu & Bentler, 1999)
RMSEA	.031	.043	.048	Acceptable	(Hu & Bentler, 1999)
PCLOSE	.985	.830	.602	Acceptable	(Hu & Bentler, 1999)

When we compared the nested models, significant differences between the three models were evident. Since common method bias was indicated, we imputed the CLF into the model when analyzing the structural equation model.

Hypothesis Testing

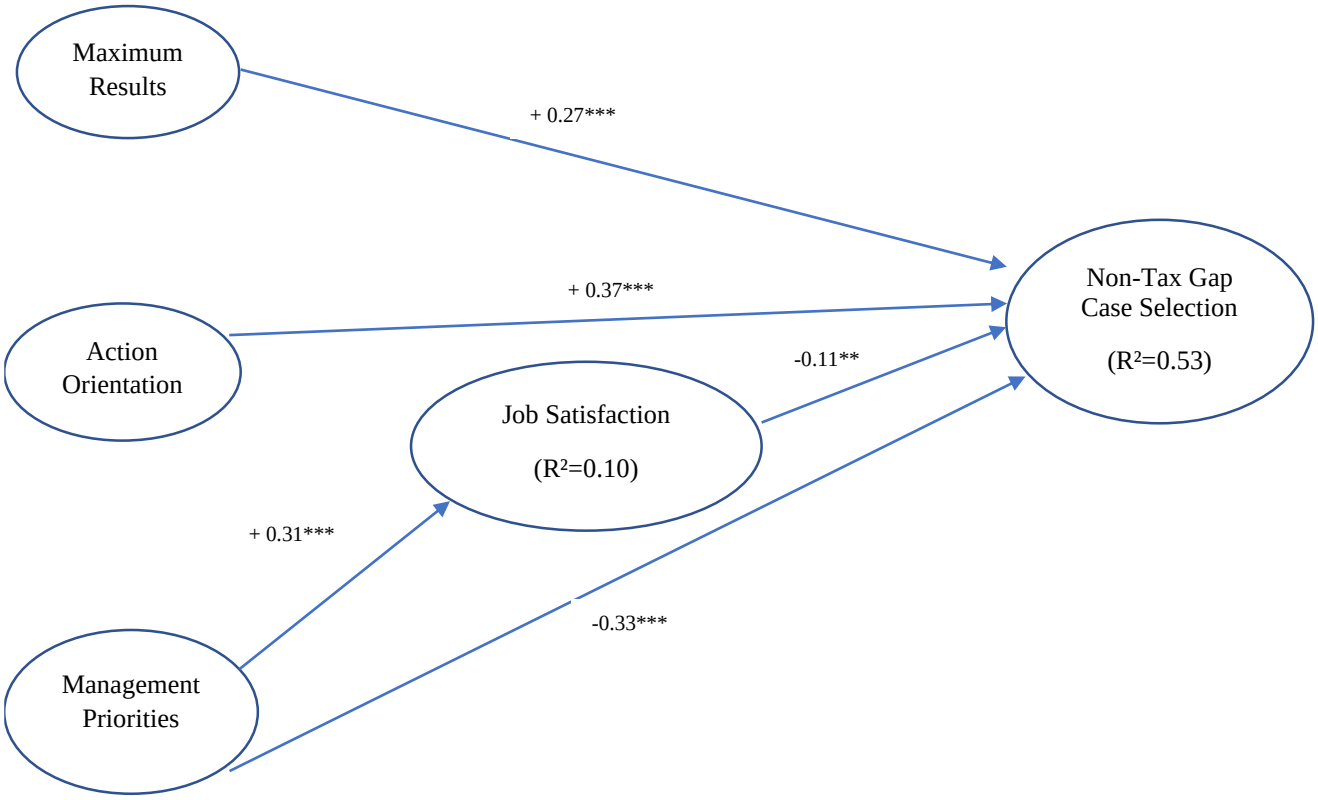
The hypothesized model (Figure 1) was analyzed using structural equation modeling techniques with AMOS and the results of these tests are depicted in Figure 2. One can see that Figure 2 departs from what we originally hypothesized (depicted in Figure 1) by virtue of the two indirect paths designated for H5b and H5c which had to be referenced in H6.

Direct Effects

The results of hypothesis testing for H1 indicate that case type selection by special agents is not aligned with management priorities. This counterintuitive result is revealed by the significant beta coefficient of -0.33, significant at the $p<0.001$ level. As it turns out, special agents do not choose cases suggested by their managers (tax gap cases) but, rather, choose the opposite type (non-tax gap cases). H1 is not supported.

The results of hypothesis testing for H2 indicate that the perception of higher criminal penalties and potential forfeiture leveraged in a case significantly impacts a special agent's preference to select that case. This is indicated by the beta coefficient of 0.27, significant at the $p<0.001$ level. Agents who express interest in achieving maximum results tend to select non-tax gap cases. H2 is supported.

Figure 2: Results of Hypothesis Testing



**p<0.01; ***p<0.001

The results of hypothesis testing for H3 indicate that the preference for sensation-seeking opportunities significantly impacts special agents' case preferences. This is indicated by a beta coefficient of 0.37, significant at the p<0.001 level. H3 is supported.

Indirect Effects

The results of hypothesis testing for H4 indicate that job satisfaction has a significant negative mediation effect on management's ability to influence special agents in respect of non-tax gap case selection. This is indicated by a beta coefficient of -0.11, significant at the p<0.01 level. H4 is not supported.

Of the three indirect effects that comprised H5, two—H5b (Maximum results to job satisfaction) and H5c (Action orientation to job satisfaction)—were deleted in the process of identifying the best model. Whereas the desires to maximize results and to have an action orientation directly influence non-tax gap case selection (H2 and H3), they do not also act indirectly through a connection with job satisfaction (H5b and H5c).

The results of hypothesis testing for H5a indicate that management priorities have a significant effect on a special agent's job satisfaction, which suggests that special agents who follow management's priorities have higher job satisfaction. This is indicated by a beta coefficient of

0.31, positive as expected, and significant at the $p<0.001$ level. The evidence supports Hypothesis 5a.

In sum, two of the hypotheses positing direct effects (H2 and H3) were supported by evidence, as was one of the three indirect effects (H5a). One hypothesis positing an indirect effect (H1), was unsupported by the evidence but exhibited a significant negative effect. Two hypotheses (H5b and H5c) exhibited insignificant results, so they were culled based on Hayes (2009).

6. DISCUSSION

The objective of this paper was to explore the motivations of CI special agents in terms of the cases they choose to pursue, since they are key employees of an organization whose work is critical to the public interest. The issue is urgent, given that the agency no longer seems to be taking the most economically rational approach to fulfilling its mission.

In their pursuit of non-tax gap cases, which are perhaps saturated with higher penalties for criminals and with more at stake for victims, CI special agents forgo investigations that would bring in more tax revenue. The consequence of this in the real world is that potential tax evaders are less deterred because there are fewer negative consequences to such behavior. In other words, tax evaders get away with this behavior more often than they should, as evidenced by the annual tax gap. CI special agents are the only criminal investigators responsible for bringing tax evaders to justice. Our results indicate that they are focused on non-tax gap cases to the detriment of the primary mission of the IRS. It is still of societal benefit for CI special agents to work on other types of criminal investigations (i.e., non-tax gap cases), but this decision creates tensions between CI management and special agents. Our data indicates that, despite these tensions, the special agents continue to prefer non-tax gap cases, and this ultimately decreases their job satisfaction because of the misalignment of the priorities between the special agents and management.

Our study suggests that special agents pursue the outcomes that they value, i.e., the results which enable them to engage in the activities that they prefer. Given the choice of acting according to management preferences or their own personal values, special agents are willing to oppose managerial priorities when selecting cases, even to the detriment of their own job satisfaction.

Perhaps the most surprising result of our survey pertains to job satisfaction which, unexpectedly, is not an important element of non-tax gap case selection. The types of cases that special agents select has little to do with making them feel happy with their work or with satisfying the IRS. Each case is judged on its own terms, which causes special agents to choose cases that are at odds with stated managerial preferences, despite the fact the agents know, at some level, that selecting such cases will put them into conflict with CI management.

Although the mission of the IRS is straightforward and mostly unchanging, the agency must navigate the challenges that were uncovered in this study regarding the desire to preferentially choose non-tax gap cases. If the CI division is any indication, the IRS appears to exert little organizational control over its employee practices. It may be important to understand that every member of CI management is a former special agent who has been promoted to a leadership role. As such, they are likely to be hesitant to do anything to hamper the initiative and enthusiasm of the special agents they now oversee, many of whom are their former peers.

Therefore, management is often not uniform in pushing special agents to pursue tax gap cases. As protected civil servants, special agents will neither advance nor derail their careers based on case selection alone. Thus, they end up going against managerial directives to pursue work that they find more meaningful, even if it (ironically) reduces job satisfaction due to the fact that it causes increased tension with management. The implication of these outcomes is that there is a need to increase alignment between a renewed focus on the primary mission of the CI to close the tax gap and the fulfillment of the desire of special agents to achieve maximum results for the cases that they investigate. Once the CI can realign these factors, the tax gap will narrow and special agent job satisfaction will increase.

Another important aspect clearly emerges from the study data, which is that CI special agents definitely want to be action-oriented in their roles and responsibilities. Tax gap cases, by definition, are less action-oriented than non-tax gap cases because they involve legal source tax evasion that occurred in the past. This is in direct opposition, for example, to narcotics-related money laundering cases, which occur in real time, and are associated with more action and potential violence. Action orientation is an admirable quality in special agents, as indicated by study data but, without a realignment of management and special agent priorities, it is often squandered when working at the IRS. The relatively quiet, or non-action-oriented, invisible tax evasion by otherwise upstanding citizens often gets overlooked, especially within an agency and a division in which the number of special agents employed has been shrinking over time.

Limitations and Future Research

The research summarized here has limitations, some of which pertain to additional influences on survey responses from agents that were not included. For example, the results could have been influenced by physiological differences among the special agents surveyed, which would render some of their normative statements less objective and more contingent. Furthermore, there are unspecified demographic variables. Although we found no differences between the active and retired special agents as groups, this does not mean that age plays no role. In addition, the sample included special agents from across the United States, indicating that we did not control for the size of the practice city. This may have influenced the types of cases that special agents had the opportunity to pursue. Finally, we had no reasonable measures to control for special agent ability or differences in training.

In the methods section, we noted a limitation related to our inability to calculate an exact response rate due to the fact that the survey was distributed through multiple channels. Additionally, we recognize the low reliability coefficient for the maximum results construct. We now recognize the cumbersome construction of items used in that construct which indicates that we would have to simplify those items if and when used for future research.

Finally, in retrospect, the scales used in this study should have included more established scales for some constructs and some of the scales used should have been developed further in order to be less cumbersome. We did conduct five "talk alouds" and ten rounds of Q-sorts in an effort to capture the uniqueness of the specialized population under study. Future research will include previously validated scales and revisions to the scales used.

In very uncertain areas, such as law enforcement, an atypical approach and realignment of performance is needed, moving from tangible accomplishment to goal setting (Korman, 1971). Along similar lines, our research calls into question whether job satisfaction plays a dominant

role when employees operate similarly to independent contractors. A connected area which bears further study is the relationship between tepid job satisfaction and the enhanced sensory stimulation that some work offers. One might argue that workers who prioritize heightened sensory stimulation over job satisfaction are overinvolved with their work (Rabinowitz & Hall, 1977). Our research also highlights the unique motivations that CI special agents may have. Blocked from career elevation and prestige increments, they fiercely protect their autonomy and self-determination. The genuine prosocial orientation in their choices complicates evaluation of their motives. All of these areas offer directions for future research, perhaps involving other government entities.

Conclusions

The research summarized in this paper offers several contributions to the sociology of work literature. First, it is concerned with a division of a government agency, about which little is known when compared to for-profit organizations. Surprisingly, government work is not more formalistic than work in for-profit enterprises and our research aligns with field studies on highly unstructured decision making (Mintzberg et al., 1976).

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APPENDIX

Construct Code Book

Factor	Question #	Re-Label	Question
Maximum Results with Investigative Resources	Q10	Max1	All else being equal, when evaluating potential cases for investigation, I normally select the case with the highest dollar amount of fraud.
Maximum Results with Investigative Resources	Q11	Max2	I find that working on grand jury cases with other agencies enables CI special agents to gather evidence more quickly, and in greater volume, than using administrative summonses.
Maximum Results with Investigative Resources	Q12	Max3	All else being equal, I believe selecting cases which will most likely result in the longest jail sentences is important because it shows a good use of investigative resources.
Maximum Results with Investigative Resources	Q13	Max4	All else being equal, I believe selecting cases which will result in the maximum amount of asset forfeiture possible is a good use of investigative resources.
Maximum Results with Investigative Resources	Q21	Max5	All else being equal, investigating a case referred by the U.S. Attorney's Office is a better use of investigative resources than a case referred by an IRS civil division because a case referred by the U.S. Attorney's Office is more likely to get prosecuted.
Action Orientation	Q22	AA1	I readily volunteer for enforcement actions such as arrests and search warrants.
Action Orientation	Q24	AA2	I would rather play sports than watch sports on television.
Action Orientation	Q25	AA3	The chance to participate in enforcement actions was one of the primary reasons I became a law enforcement officer.
Action Orientation	Q27	AA4	If given a choice between opening two cases, I would choose the case that offered the best chance to engage in enforcement actions such as search warrants or arrest warrants.
Job Satisfaction	Q29	JS1	My job as a special agent is very satisfying.
Job Satisfaction	Q30	JS2	I do not mind working more than 40 hours a week as a special agent.
Job Satisfaction	Q31	JS3	Most parts of the job of a special agent are enjoyable.
Job Satisfaction	Q57	JS4	I believe my job provides me with ample intrinsic rewards, such as pride in being a law enforcement officer.
Job Satisfaction	Q33	JS5	I believe my job provides me with ample extrinsic rewards, such as good pay and benefits.
Social Identity	Q34	SI1	Being a CI special agent is an important part of who I am.
Social Identity	Q50	SI2	I perceive myself as a protector of the voluntary tax system.

Social Identity	Q35	SI3	I proudly identify myself as a special agent to those outside of law enforcement.
Social Identity	Q51	SI4	I proudly identify myself as an IRS employee at social functions if asked where I work.
Social Identity	Q36	SI5	I think it is important to be involved in law enforcement professional associations.
Tax Gap (Case Selection)	Q37	CS1	I believe investigating legal source income (Tax Gap) cases should be the primary focus of a CI special agent
Tax Gap (Case Selection)	Q39	CS2	I believe that legal income source (Tax Gap) cases should be given a high priority even if they take longer periods of time to investigate than other crimes under CI's jurisdiction.
Tax Gap (Case Selection)	Q40	CS3	Legal income source (Tax Gap) cases provide less opportunity for enforcement actions than other types of cases under CI's jurisdiction.
Non-Tax Gap (Case Selection)	Q38	CS4	If given the option, I will choose to work a Non-Tax Gap (illegal source income or money laundering) case involving a vulnerable victim rather than a traditional legal income source (Tax Gap) case.
Non-Tax Gap (Case Selection)	Q14	CS5	If given the option, I will choose to work a Non-Tax Gap (illegal source income or money laundering) case through the grand jury instead of using the administrative case process.
Non-Tax Gap (Case Selection)	Q43	CS6	If given the opportunity, I will choose to open a Non-Tax Gap (illegal source income or money laundering) case involving other law enforcement agencies over a traditional legal income source (Tax Gap) case.
Non-Tax Gap (Case Selection)	Q44	CS7	I try to select Non-Tax Gap (illegal source income or money laundering) cases for investigation where the primary charge is a non-tax crime, such as public benefits fraud.
Management Priorities	Q61 (Reverse Coded)	MP1	CI management's investigative priorities have little influence on the cases I select for investigation.
Management Priorities	Q62	MP2	It is important to me to select cases for investigation that support CI's Annual Business Plan.
Management Priorities	Q63	MP3	I rely on the Annual Business Plan to guide me on what types of cases to develop for investigation.
Management Priorities	Q65	MP4	I make sure that the cases I select for investigation meet the Law Enforcement Manual (LEM) criteria because my manager will not approve the case if it doesn't.
Demographic Information	Q45	Employed	Are you currently employed by IRS-CI as a special agent?
Demographic Information	Q47	Gender	What is your gender?
Demographic Information	Q48	Race	I identify as (select one):
Demographic Information	Q50	Experience	How many years of experience do you have as a CI special agent?

Demographic Information	Q52	Retirement Yr.	If you are not currently employed by CI, please select the time frame of your departure (Leave blank if still employed by CI).
Demographic Information	Q53	CPA	Are you a certified public accountant (CPA)?

A CRITICAL PERSPECTIVE OF "SUBJECTIVE VALUE" ACCORDING TO THE CJEU TO DETERMINE THE VAT TAXABLE AMOUNT IN BARTER TRANSACTION – A NEW SOLUTION

Wei Zhang[1]

Abstract

The decisions made by the Court of Justice of the European Union (CJEU) in respect of the Value Added Tax (VAT)-taxable value of barter transactions (consideration in kind) (van Doesum et al., 2016) in cases where the consideration has no market price (one-time and unusual service) have been considered to be incompatible with Article 73 of the VAT Directive[2] (see Englisch, 2021b; HMRC, 2021). The CJEU has justified this incompatibility by introducing the term "subjective value".[3] Before 2018, the Bundensfinanzhof (BFH)— the German Federal Fiscal Court—followed these CJEU judgments by referring to "subjective value" and referring to Section 162 of the Abgabenordnung (AO)—the German General Fiscal Code—thus producing a solution compliant with the law. In 2018, the BFH waived its position and went in an incorrect direction. The view of the U.K.'s H.M. Revenue & Customs (HMRC) department is that the question "has not been considered by the VAT Tribunals or Courts and that any cases of this kind should be submitted to the VAT Supply team" (HMRC, 2021). From a predominantly German perspective, the author demonstrates that the "subjective value" is not a satisfactory solution and suggests, de lege ferenda, the introduction of a new Article 42a into Council Implementing Regulation (EU) No 282/2011 as a new solution by which to ascertain the taxable amount in barter transactions in cases where the consideration has no market price.

1. INTRODUCTION

A. Overview of VAT in the European Union (EU)

More than 160 countries and regions in the world levy VAT, although this is not the case in the United States (Schenk et al., 2015). VAT is levied in all EU member states (van Doesum et al., 2016). The VAT Directive "establishes the current common system of VAT" in the EU [4], and provides that "the supply of goods" and "the supply of services for consideration within the territory of a member state by a taxable person acting as such" shall be subject to VAT.[5] The European Union (EU) defines the term "taxable person" as "any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity".[6] It states that "on each transaction, VAT, calculated on the price of the goods

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[2] Englisch (2021) Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ EU L 347, 11.12.2006, at 1–118, last amended by COUNCIL DIRECTIVE (EU) 2021/1159 of 13 July 2021. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02006L0112-20210701

[3] UK: CJEU, 23 Nov. 1988, Case C-230/87, *Naturally Yours Cosmetics*, para. 16, ECLI:EU:C:1988:508. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61987CJ0230

[4] Supra, fn. 2, article 1(1).

[5] Ibid., article 2(1)(a).

[6] Ibid., article 9(1).

or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components".[7]

It also states that "the taxable amount" of the supply of goods or services "shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party".[8]

In the Case of *Costa v. ENEL*, the CJEU confirmed that EU law takes precedence over the national law of member states—the doctrine of primacy of EU law (van Doesum et al., 2016. p.20. The main sources of the primary law of the EU are the Treaty on European Union (TEU)(EU, 2012a) and the Treaty on the Functioning of the European Union (TFEU) (EU, 2012b). With respect to VAT, the most important component of primary EU law is the TFEU and the most important secondary EU laws are the VAT Directive and VAT Regulation (van Doesum et al., 2016). According to Article 288 of the TFEU), the VAT Directive "shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods" (EU, 2012b). Therefore, as van Doesum et al. note. it "must be transposed into national law in order for the rules to have effect" (p. 22). Meanwhile, according to Article 288 of TFEU, the VAT Regulation is "directly applicable in all Member States" (EU, 2012b). This is the reason why I suggest the introduction of a new provision in the VAT Regulation, rather than in the VAT Directive. According to Article 13(1) of the TEU (EU, 2012a), the CJEU is one of the EU's institutions. According to Article 19 of the TEU, the CJEU "shall ensure that in the interpretation and application of the Treaties the law is observed" (EU, 2012a). In the field of VAT, the CJEU has already ruled in approximately 850 cases.[9] Indeed, according to Schenk et al. (2015), "the EU model has the most extensive case law on VAT issues" (p. 47). According to Article 4(3) of the TEU, the "Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union" (EU, 2012a). Therefore, the national court should interpret the VAT Directive in accordance with the CJEU (Englisch, 2021a).

The United Kingdom introduced VAT as a replacement for Purchase Tax on 1 April 1973, as a consequence of joining the European Economic Community (EEC). VAT is administered and collected by HMRC. The Value-Added Tax Act 1994, which currently applies in the United Kingdom, provides that:

- "VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him" (Value-Added Tax Act, 1994, s. 1.4.1). A taxable supply is defined as "a supply of goods or services made in the United Kingdom other than an exempt supply" (Value-Added Tax Act, 1994, s.1.4.2).

- "If the supply is for a consideration in money its value shall be taken to be such amount as, with the addition of the VAT chargeable, is equal to the consideration" (Value Added Tax Act, 1994, s.19.2). It adds that if "the supply is for a consideration not

[7] Ibid., article 1(2)(2).
[8] Ibid., article 73.
[9] CJEU (2022), Subject matter = "Taxation". Listing preferences = Dates in descending order Documents = Documents published in the ECR: Judgments Documents not published in the ECR: Judgments, Court = "Court of Justice", Case status = "Cases closed", only Taxation- Value added tax, (accessed on 7.10.2021).

> consisting or not wholly consisting of money, its value shall be taken to be such amount in money as, with the addition of the VAT chargeable, is equivalent to the consideration" (Value-Added Tax Act, 1994, s.19.3).

On 31 January 2020, the United Kingdom withdrew from the EU. This means that the United Kingdom now essentially has supremacy over its own laws. This article deals with only the legal status that existed before Brexit.

Germany remains a member of the EU. The relevant provisions of the German Value Added Tax Act (Umsatzsteuergesetz-UStG) will be given in this article, as it is written mainly from the German perspective.

B. Starting Point[10]

A meat company and a manufacturing company exchange beef and a machine. The market price for beef is 700 euros, while the market price for the machine is 800 euros. In barter transactions, there are two taxable supplies (Englisch, 2021b) if the two parties are entrepreneurs. Here, in Supply 1 (the initial supply[11]), the meat company sells beef to the machine company; in Supply 2 (the return supply[12]), the manufacturing company sells machines to the meat company.

It should be made clear that there are two values within barter transactions: the value of supply (delivered goods/services), and the value of consideration (obtained goods/services). From the perspective of the meat company, the supply is the beef (market price: 700 euros), and the consideration is the machine (market price: 800 euros). From the perspective of the manufacturing company, the supply is the machine (market price: 800 euros) and the consideration is the beef (market price: 700 euros).

There is no specific rule regarding barter transactions in the VAT Directive, as it is not necessary (Korn, 2019). The CJEU judgment in the case of *Serebryannay vek EOOD*[13] provides that:

> barter contracts … and transactions for which the consideration is in money are … two identical situations. … [T]he consideration for a supply of goods may consist of a supply of services, and so constitute the taxable amount within the meaning of Article 73 of the VAT Directive.

Consequently, barter transactions are taxable, and the taxable amount is the same in transactions for which the consideration is money. Regarding the taxable amount in barter transactions, Annex A 13 of the Second Council Directive of 11 April 1967 (67/228/EEC)[14], which refers to Article 8(a), already provides that:

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[10] See Lippross (2017).
[11] See Doesum et al. (2016).
[12] Ibid.
[13] BG: CJEU, 26. Sept.2013, Case-C283/12, *Serebryannay*, ECLI:EU:C:2013:599. https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62012CJ0283
[14] Second Council Directive 67/228/EEC of 11 April 1967, OJ EU 71, 14.4.1967, 1303–1312. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31967L0228&from=EN

> The expression 'consideration' means everything received in return for the supply of goods or the provision of services, … that is to say not only the cash amounts charged, but also, for example, the value of the goods received in exchange or, in the case of goods or services supplied by order of a public authority, the amount of the compensation received.

Article 73 of the VAT Directive[15] provides that "the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party".

This means that the taxable amount of supply is what the supplier obtains: the value of the received goods/services (the consideration). For instance, if a fruit dealer sells one kilo of apples for five euros and the customer pays five euros, the taxable amount of the supply of apples is what the fruit dealer obtains: i.e. the value of the consideration is five euros less VAT.

In the barter transaction mentioned above, from the perspective of the meat company, the value of the delivered good is beef priced at 700 euros, while the obtained good is a machine worth 800 euros. According to Article 73 of the VAT Directive[16], the taxable amount of the supply is what the supplier obtains: the value of the consideration. Accordingly, the taxable amount of the supply of meat is 800 euros less VAT, since the good which the meat company has obtained is a machine priced at 800 euros. From the perspective of the machine company, the delivered good is a machine priced at 800 euros, and the good obtained is the beef priced at 700 euros. Consequently, the taxable amount of the supply of the machine is 700 euros less VAT, since the good which the machine company has obtained is the beef priced at 700 euros less VAT.

To summarise: in barter transactions, if a supplier exchanges his goods/services for goods/services with another party, his taxable amount is the value of what he obtains. The taxable amount of supply is the value of the consideration (the goods/services received by the supplier), and not the value of the supply (the goods/services which the supplier has delivered).

If the value of the consideration has a market price, such as beef or a machine, it is no problem to ascertain the taxable amount, since the price is the taxable amount. However, if the value of consideration has no market price, as in the case of a one-time service or an unusual service, a problem arises with regard to what the taxable amount should be.

For example, the meat company now supplies beef to the machine company in exchange for the machine company printing the beef company's logo on every machine that it sells that year. In this case, the consideration for beef is not a machine, but the action of printing a logo (the supply of a service provided by the machine company according to Article 2 (1) (c) of the VAT Directive[17]). However, there is no market price for the printing of a logo by a machine company, since this is not the company's normal business and it will only undertakes this action once.

In this circumstance, for the sake of simplicity, the tax authority would determine that the taxable amount is the value of the supply of the beef (700 euros less VAT), since the market

[15] Supra, fn. 4.
[16] Ibid.
[17] Ibid.

price of beef (700 euros) is something that the tax authority can easily obtain. However, 700 euros is the value of the supply. Apparently, this approach infringes Article 73 of the VAT Directive, according to which the taxable amount is the value of the consideration.[18] What the meat company has now obtained is a service (the printing of the meat company's logo by the machine company), so the taxable amount should be the value of this service. However, this service has no market price. This article will try to solve the problem of how the value of this service should be determined.

The CJEU's judgments with regard to the taxable amount in barter transactions can be divided into two groups: firstly, the decision that has been made in cases where the consideration has a market price; and secondly, the decision made in cases where the consideration has no market price. For the first group, the CJEU has decided, according to Article 73 of the VAT Directive[19], that the taxable amount of the supply is the value of the consideration which the supplier receives from the exchange partner in return for his supply. However, for the second group, the CJEU has ruled that the taxable amount is one of the values of the supply, and has introduced the term "subjective value". These judgments for the second group are considered to be incompatible (Englisch, 2021b; Reiß, 2018) with the wording of Article 73 of the VAT Directive[20], which has led to amendments to two successive phases of the relevant case law of the BFH. In the first phase (before the BFH decision of April 25, 2018)[21], the BFH reached a solution compliant with the law, but, in the second phase in 2018, it made a radical change and went in an incorrect direction. In this article, the author seeks to determine what "subjective value" really means, whether this term presents an acceptable solution, and what the taxable amount should be in barter transactions.

2. SUBJECTIVE VALUE IN CJEU CASE LAW

A. The Development of the Term "Subjective Value"

In CJEU case law, the definition of the term "subjective value" was developed successively by four CJEU decisions.

The term first appeared in the CJEU judgment in the 1981 case of *Coöperatieve Aardappelenbewaarplaats* (Case C- 154/80).[22] This case concerned a cooperative association which ran a cold storage depot storing potatoes for its members. Each grower that owned shares was entitled to deposit 1,000 kilograms of potatoes per year for a fee. For a financial reason, namely the pending sale of the cold storage, the association did not ask for any payment for two years. The Dutch tax authority was, however, of the opinion that "the cooperative had nevertheless charged its members something in return for a reduction in the value of their shares".[23]

The CJEU decided that "such consideration is a subjective value since the basis of assessment for the provision of services is the consideration actually received and not a value assessed

[18] Ibid.
[19] Ibid.
[20] Ibid.
[21] BFH 25. 4. 2018, XI R 21/16, BStBl. 2018 II at 505.
[22] NL: CJEU, 5 Feb.1981, Case C-154/80, *Coöperatieve Aardappelenbewaarplaats*, ECLI:EU:C:1981:38. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:61980CJ0154&from=EN
[23] Ibid. II. A, p. 448.

according to objective criteria".[24] It noted that "consequently, a provision of services for which no definite subjective consideration is received does not constitute a provision of services 'against payment' and is therefore not taxable within the meaning of the Second Directive".[25] This means that the cooperative association did not make a taxable delivery and the storage service was not taxable.

As stated previously, the Second Council Directive provides that the "expression 'consideration' means everything received in return for the supply of goods or the provision of services" (see Section 1. B), but does not explain how "everything received" should be determined.[26]

The CJEU decided that "consideration is a subjective value since the basis of assessment for the provision of services is the consideration actually received and not a value assessed according to objective criteria.[27] It stated that, "consequently, a provision of services for which no definite subjective consideration is received does not constitute a provision of services 'against payment'".[28]

Later, the CJEU clarified this interpretation in the case of *Elida Gibbs* (C-317/94) , and ruled that "consideration is the 'subjective' value ... the value actually received **in each specific case**".[29,30]

In the case of *Argos* (C- 288/94), the CJEU stated that "that consideration is thus the subjective value, **that is to say**[31], the value actually received, **in each specific case**[32], and not a value estimated according to objective criteria".[33]

This formulation of "subjective value" was considered to be most unfortunate (Reiß, 2018, p. 827), since it can be misunderstood as "a subjectively assessed value" in its normal sense in English as the opposite of an "objective value", which represents a value assessed according to objective criteria in the market, with no direct connection to the concrete barter transaction. In this context, the word "subjective" cannot be applied in its normal sense in English, but is used instead to describe the value determined by the parties in a concrete barter transaction (Terra & Kajus, 2017, p.808).

The consideration actually received by the specific supplier is not dependent on the market price according to an objective criterion in the market, but rather on what is actually received by the concrete supplier (a subject) in the specific barter transaction. This is why it is called a "subjective value". A "subjective value" in this context can be understood as "a value actually received by the supplier in a specific barter transaction".

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[24] Ibid., p.454, para. 13.
[24] Ibid., p. 455, para. 14.
[26] Supra, fn. 14
[27] Supra, fn. 22, p. 454, para.13.
[28] Ibid., p. 455, para. 14.
[29] Bolded by me.
[30] UK: CJEU, 24 Oc. 1996, Case C-317/94, *Elida Gibbs*, ECLI:EU:C:1996:400, para. 27. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:61994CJ0317&from=en
[31] Bolded by me.
[32] Bolded by me.
[33] UK: CJEU, 24 Oc. 1996, Case C-288/94, *Argos Distributors Ltd.*, ECLI: EU:C:1996:398, para.16. https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:61994CJ0288

"subjective value" in the normal sense in English	a subjectively assessed value
"subjective value" according to the CJEU	a value actually received by the supplier (a subject) in a specific barter transaction
an objective value	a value assessed according to objective criteria in the market

Indeed, in the case of *Coöperatieve Aardappelenbewaarplaats*[34], the CJEU did not explain how the taxable amount (the subjective value) was to be determined, since it was not necessary for it to do so. This was completely logical: if the CJEU held that the storage service was not at all taxable, then there was no need to determine the exact taxable amount.

In the case of *Naturally Yours Cosmetics* (Case C-230/87)[35], the CJEU tried, for the first time, to determine the taxable amount in barter transactions. The case concerned the taxable amount of an article delivered by *Naturally Yours Cosmetics* as a wholesaler at a lower price to beauty consultants as retailers in return for a sum of money and the arrangement of sales by the beauty consultants (a service, according to Article 24 (1) of the VAT Directive). The problem was not whether *Naturally Yours Cosmetics* received the service from the beauty consultants;[36] rather, it was how the taxable amount of the supply of the article should be ascertained.

The CJEU held that the value of the article must be "the sum of the monetary consideration and the value of the service provided by the retailer" and that "the value of that service must be regarded as being equal to the difference between the price actually paid for that product and its normal wholesale price".[37] It reached this decision by referring to "a subjective value"[38] in the CJEU decision in the case of *Coöperatieve Aardappelenbewaarplaats*.[39] The CJEU concluded that the taxable amount was a part of the wholesale price, as it was part of the value of the supply.[40]

This was apparently an infringement of Article 11(A)(1) of the Sixth Council Directive[41], according to which the taxable amount is the value of the consideration, and hence the value of the obtained service, in this case the service provided by the beauty consultants in their capacity as retailers. The taxable amount should, in my judgment, be assessed according to the time and effort invested by the beauty consultant to arrange sales. Just because there was no market price for the service of the beauty consultant (the arrangement of sales), the CJEU took the value of the delivered goods, the wholesale price, to be the taxable amount. The CJEU acted only for the sake of simplicity and only achieved a pragmatic solution (see Englisch, 2021b; see also Rothenberger, 1995).

[34] Supra, fn. 22.
[35] Supra, fn. 3.
[36] Ibid., paras. 11 and 14.
[37] Ibid., para 18.
[38] Ibid., para. 16.
[39] Supra, fn. 22.
[40] Supra, fn. 3.
[41] Sixth Council Directive 77/388/EEC of 17 May 1977, OJ EU L 145, 13.6.1977. https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex:31977L0388

Indeed, it made no sense that the CJEU referred to "a subjective value" in the case of *Coöperatieve Aardappelenbewaarplaats*[42], since it had not explained in that case how the taxable amount was to be determined. In the case of *Naturally Yours Cosmetics*, it did not justify why the taxable amount should be part of the wholesale price.[43]

In the *Empire Stores* case[44], a mail-order company offered an article to its established customers free of charge if they recommended a friend as a potential customer[45]—an introductory service (Terra & Kajus, 2017). By referring to "a subjective value" in the case of *Naturally Yours Cosmetics*[46], the CJEU held that the taxable amount was the price paid by *Empire Stores* as the supplier of that article.[47] This meant that the CJEU repeated, in principle, its (incorrect) approach in the case of *Naturally Yours Cosmetics*, determining the value of the delivered goods (the purchase price of the article) to be the taxable amount of the supply of the article (Lippross, 2017). The CJEU explained its decision as follows:

> 18…the consideration taken as the taxable amount in respect of a supply of goods is a subjective value, since the taxable amount is the consideration actually received and not a value estimated according to objective criteria.
>
> 19 Where that value is not a sum of money agreed between the parties, it must, in order to be subjective, be the value which the recipient of the services[48] **(Empire Stores)**[49] ... attributes to[50] the services which he is seeking to obtain and must correspond to the amount which he **(Empire Stores)**[51] is prepared to spend for that purpose. Where, as here, the supply of goods is involved, that value can only be the price which the supplier **(Empire Stores)**[52] has paid for the article which he is supplying without extra charge in consideration of the services in question.[53]

This is incorrect since, according to paragraph18 of the judgment and Article 11(A)(1) of the Sixth Council Directive, the taxable amount is the consideration actually received by *Empire Stores*, not the price that *Empire Stores* paid for the article. Paragraph 19 of the judgment therefore contradicts paragraph 18 of the same judgment.

This decision of the CJEU can be seen as confusing in this regard (van Doesum et al., 2016), but the legal result is clear. The CJEU has, in the case of *Empire Stores*, determined one of the values of the delivered goods to be the taxable amount for practical reasons (the purchase price of the goods from the supplier). This was effectively a violation of Article 11(A)(1) of the Sixth Council Directive, according to which the taxable amount is the value of the service received.

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[42] Supra, fn.22.
[43] Ibid.
[44] UK: CJEU, 2. Ju. 1994, Case C-33/93, Empire Stores, ECLI:EU:C:1994:225. https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:61993CJ0033
[45] Ibid., para. 4.
[46] Ibid., para. 8.
[47] Ibid., the last sentence.
[48] Underlined by me.
[49] Wording in bold added by me. See van Doesum et al. (2017), : "[eds.: in this case the recipient of the services is actually the same person as the person making the supply of the goods]" (p. 219).
[50] Underlined by me.
[51] Wording in bold added by me.
[52] Ibid.
[53] Supra, fn. 44, paras. 18-19.

This was also an infringement of Article 1(2) of the VAT Directive and of the nature of VAT in general (Stadie, 2009). Article 1(2) of the VAT Directive provides that "the principle of the common system of VAT entails the application to goods and services of a general tax on consumption".[54]

It is clear that VAT is a tax on general consumption, according to Article 1 of the VAT Directive. The established customer in the case of *Empire Stores*[55] is a consumer who has paid for the article with his service (recommending a new customer). Consequently, the taxable amount of the delivery of the article should be the value of the service provided by the established customer as a consumer.[56] The price paid by *Empire Stores* to buy the article was not what the established customer as the consumer had paid (consumed).[57] Therefore, the price paid by *Empire Stores* cannot be the taxable amount for the supply of the article.[58]

The CJEU did not actually adhere to its decision in the earlier case of *Naturally Yours Cosmetics*, since it held in this new case that part of the wholesale price of the delivered goods was the taxable amount. In the case of *Empire Stores*, the CJEU concluded that the purchase price of the delivered goods was the taxable amount.[59] The CJEU had developed the definition of the subjective value in the case of *Empire Stores*: it is the amount which the supplier is prepared to spend now, which means that it is the purchase price regarding the supply of a goods (or the cost of the goods regarding the supply of a service[60])—and so it is. This is the bespoke[61] definition of the subjective value in current EU law.

The CJEU decision in the case of *Bertelsmann* (Case C-380/99)[62] concerned the supply of non-cash bonuses by the Bertelsmann book club to its existing members in return for the introduction of a new customer. The CJEU further maintained (Lippross, 2017) its incompatibility with Article 11(A)(1) of the Sixth Council Directive[63], determining that the taxable amount for the supply of a bonus was the purchase price of the bonus plus the cost of delivery[64], i.e. the value of the goods delivered. The taxable amount should, in my view, be assessed according to the time and effort invested by the existing members when introducing new customers (acting as a recruiting service). In this case, the CJEU has refined the definition of subjective value and held that it is the cost of goods/services which the supplier has paid, including all the additional costs.

The value of delivered goods/services can be divided into two categories: the purchase price and the sales price of the delivered goods/services. The CJEU first ruled in the case of *Naturally Yours Cosmetics* that the taxable amount was the sales price[65] but then, in the case of *Empire*

[54] Supra, fn. 2.
[55] Supra, fn. 44.
[56] Ibid.
[57] Ibid.
[58] Ibid.
[59] Ibid.
[59] Ibid. para. 19, derived from "…the amount which he is prepared to spend for that purpose. Where, as here, the supply of goods is…", if there the supply of goods is, there should be the supply of services.
[61] See Pfister (2015): "insbesondere" (p.31, fn.4).
[62] DE: CJEU, 3. Jul. 2001, Case C-380/99, *Bertelsmann*, ECLI:EU:C:2001:372. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61999CJ0380
[63] Supra, fn. 41.
[64] Supra, fn. 62, para 25.
[65] Supra, fn. 3.

Stores, that it was the purchase price[66] and lastly, in the case of *Bertelsmann*, the total purchase price of the delivered goods.[67] Both the sales price and the purchase price were the value of the supply, not the value of the consideration. Thus, all these decisions of the CJEU infringed Article 11(A)(1) of the Sixth Council Directive.[68] According to the Correlation Table in Annex XII of the VAT Directive, Article 73 of the VAT Directive[69] replaces Article 11(A)(1)(a) of the Sixth Council Directive.[70] The contents of both articles are identical. These CJEU decisions therefore violated Article 73 of the VAT Directive.[71]

B. The Problem of "Subjective Value"

1) By determining the taxable amount in barter transactions in cases in which the consideration has no market price to be the value of delivered goods/services rather than that of received goods/services, the CJEU has essentially assumed an equivalence between the values of the supply and the consideration.[72] It makes a generalisation that if, in barter transactions, the consideration has no market price, or the value of the consideration cannot be determined exactly, the value of the supply may be used as the taxable amount (Reiß, 2019; Stadie, 2009). This generalisation must be resolutely rejected, since there is no principle of equivalence in VAT law.[73] The supplier does not have to sell their service at the usual market price in every transaction, nor is it possible for them to do so. It is usual in market economics that a supplier is able to sell their goods or services at a price below or above their cost.[74]

It is common that the entrepreneur must sell, or desire to sell, their goods/services at a discount, e.g. under liquidity pressure, due to the voluntary or compulsory relocation of a factory/office, or because of the strategic conversion of an investment focus. This happens both in sales for money and in barter transactions.[75] Each party in a barter transaction has good reason to ascribe a different value to the consideration (HMRC, 2021). The barter transaction is only a modality of payment. The assertion that the two transactions in barter transactions are equal in value (Korn, 2019) is tantamount to assuming that an entrepreneur will never suffer a loss.

2) Although the CJEU's decision in the case of *Empire Stores* concerned a situation in which the consideration had no market price, the definition of subjective value in that case was not restricted to that particular situation, since the CJEU referred only to situations "where that value is not a sum of money agreed between the parties".[76] When referring to barter transactions, the CJEU did not distinguish between a case in which the consideration has a market price and a case in which it did not have one.[77] Following the wording of the CJEU

[66] Supra, fn. 44.
[67] Supra, fn. 62.
[68] Supra, fn. 41.
[69] Supra, fn. 3.
[70] Supra, fn. 41.
[71] Supra, fn. 2.
[72] Supra, fn. 3, para. 17.
[73] See Korn (2019); BFH 7. 5. 1981, V R 47/76, BStBl. 1981 II at 495, n. 11; BFH Urteil 03.12.1953 - V 119/53 U BStBl 1954 III at. 65; Windsteig (2015); see Ruppe and Achatz (2018, § 1, n. 62).
[74] NL: CJEU, 12. Mai 2016, Case C-520/14, *Gemeente Borsele*, ECLI:EU:C:2016:334, para. 26. https://eur-lex.europa.eu/legal-content/GA/TXT/?uri=CELEX%3A62014CJ0520
[75] For a different opinion, see Stapperfend (2021).
[76] Supra, fn. 44, para.19.
[77] Ibid.

precisely in this respect shows that a subjective value can be used in cases of barter transaction in which the consideration also has a market price.[78]

However, a general rule for using a subjective value in all cases in barter transactions does not exist, since the CJEU has applied the subjective value as the taxable amount only in cases of barter transaction in which the consideration has no market price. In cases where the consideration has a market price, the CJEU has not so far used the subjective value as the taxable amount.

The decision of the CJEU in the case of *Orfey Balgaria* (Case C-549/11)[79] concerned the construction of a building by *Orfey Balgaria* in exchange for the building right as a consideration.[80] *Orfey Balgaria* determined the taxable amount to be 302, 712.36 BGN[81], according to the open market value of the real property.[82] The Bulgarian authorities determined the taxable amount to be 684, 000 BGN, since that was the taxable value of the building right according to a certified document.[83]

The CJEU rejected the company's view that the taxable amount should be the property's open market value, since the conditions of application laid down in Article 80(1) of the VAT Directive were exhausted[84], and these conditions were not met in the case of *Orfey Balgaria*.[85] The CJEU ruled that:

> Articles 73 and 80 of that directive[86] must be interpreted as precluding a national provision, such as that at issue in the main proceedings, under which ... the taxable amount of the transaction is the open market value of the goods or services supplied.[87]

The CJEU did not clearly indicate what the taxable amount of the building should be. However, it excluded the application of Article 80 of the VAT Directive. It can be deduced that the CJEU adhered to Article 73 of the VAT Directive and determined the taxable amount to be 684000 BGN (the consideration received by Orfey according to a certified document), since the CJEU mentioned Article 73 and 80 of the VAT Directive in the same sentence.[88]

Although the CJEU had, in the case of *Orfey Balgaria*, referred[89] to the decision in the *Empire Stores* case[90], it did not pursue that decision in practice[91], and reached a correct judgment compliant with Article 73 of the VAT Directive. If the CJEU had followed the (incorrect) view

[78] Ibid.
[79] BU: CJEU, 19 Dec. 2012, Case C-549/11, *Orfey Balgaria*, ECLI:EU:C:2012:832. https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62011CJ0549
[80] Ibid., para. 15.
[81] Ibid, para. 16.
[82] Ibid, paras 17 & 18.
[83] Ibid, para 17.
[84] Ibid., para. 47.
[85] Ibid., paras. 48 & 49.
[86] Underlined by me.
[87] Supra, fn. 44, para. 49.
[88] Ibid.
[89] See Lippross, (2017); Supra, fn. 44, para. 45.
[90] Supra, fn. 44.
[91] See Pfister (2015, p. 36): "Der EuGH greift allerdings...letztlich nicht auf".

in the *Empire Stores* decision[92], it would have determined the taxable amount to be the cost of the construction of the building (a value of the supply) [93], as that was what *Orfey Balgaria*, as the supplier, had paid.

The most recent CJEU decision relating to the taxable amount of barter transactions is the case of *A Oy* in 2019.[94] *A Oy* provided a demolition service to its customer.[95] The consideration consisted of an amount of money and the supply of recyclable scrap metal.[96] The CJEU held that the taxable amount of the supply of services (demolition) was the money paid by the customer, plus the value of the supply of scrap metal, represented by a reduction in the price charged for the demolition service by *A Oy*.[97] The decrease in price was based on an estimate of the amount of money for which the recyclable scrap metal could be sold.[98] The CJEU stated that: "A tries to estimate in advance the quantity of such goods and the price likely to be obtained on their resale ...so that the price of the demolition services contract proposed to the client is as competitive as possible." [99]

The total demolition service provided by *A Oy* can be divided into two parts:

Part 1: *A Oy* provided its customer with part of a demolition service in exchange for money.
Part 2: *A Oy* provided its customer with part of a demolition service in exchange for the supply of recyclable scrap metal.

***A Oy* provides a demolition service**		**Consideration provided by customer**
Part 1	Part of the demolition service in exchange for money.	Money
Part 2	Part of the demolition service in exchange for the recyclable scrap metal.	The recyclable scrap metal

Part 1 was not a barter transaction, since the consideration was money.
Part 2 was a barter transaction. A barter transaction concerns two taxable transactions, if both of the participants are taxable persons according to Article 9 of the VAT Directive.[100] This

[92] Supra, fn. 44.
[93] See Pfister (2015, p. 36): "...in keinerlei Zusammenhang zu den Kosten der von Ofrey erbrachten Leistungen steht".
[94] BU: CJEU, 10 Jan. 2019, C-410/17, *A Oy*, ECLI:EU:C:2012:832. https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62017CJ0410
[95] Ibid., para. 33.
[96] Ibid., para. 38: "that the service supplier, namely a demolition company, in addition to receiving monetary payment from its client for carrying out demolition works, acquires, pursuant to the demolition contract, recyclable scrap metal that it may then sell on."
[97] Ibid., para. 47: "the taxable base of the supply of services which is the subject matter of a demolition contract, such as that at issue in the main proceedings, is constituted by the price actually paid by the client and by the value attributed by the service provider to the recyclable scrap metal…".
[98] Ibid., para. 47: "as reflected in the amount of the reduction of the price charged for the supply of services".
[99] Ibid., para.17.
[100] Ibid., para. 62 (1), the Court (Ninth Chamber) hereby rules: "however, subject to value added tax only if it is made by a taxable person acting as such."

meant that the demolition service in Part 2 involved two taxable transactions(see van Doesum et al. 2015, p. 217):

- Supply 1—the initial supply (van Doesum et al., 2015): *A Oy* provided its customers with part of the demolition service in exchange for the supply of recyclable scrap metal.
- Supply 2—a return supply (van Doesum et al., 2015): the customers provided *A Oy* with recyclable scrap metal in exchange for part of the demolition service.

Therefore, there are actually three transactions in CJEU Case *A Oy*:

A demolition service in exchange for money

Transaction 1: *A Oy* provided its customers with part of the demolition service in exchange for money.

A barter transaction (involving two transactions)

Transaction 2: The initial supply(van Doesum et al., 2015): *A Oy* provided its customers with part of the demolition service in exchange for the supply of recyclable scrap metal.

Transaction 3: A return supply(van Doesum et al., 2015): the customers provided *A Oy* with recyclable scrap metal in exchange for part of the demolition service.

In transaction 2, where *A Oy* provided its customers with part of the demolition service, the consideration was the supply of the recyclable scrap metal by the customer. The CJEU did not state what the taxable amount was for this part of the demolition service and said only that:

> A tries to estimate in advance the quantity of such goods and the price likely to be obtained on their resale, and that price is **factored**[101] in to the calculation of the price when preparing the quote for the demolition services, so that the price of the demolition services contract proposed to the client is as competitive as possible.[102]

However, the CJEU has not explained how this price was factored into the calculation. *A Oy* has two possible ways of ascertaining the taxable amount: it could be their cost of the part of the demolition service or the sale price of the recyclable scrap metal. The method that *A Oy* would choose can be derived from the CJEU's statement above.[103]

According to the decision in the case of *Empire Stores*, the taxable amount is a subjective value, and a subjective value is what the supplier has paid for the delivered goods.[104] Using the subjective value, *A Oy* should determine the taxable amount to be his cost[105] of the part of the demolition service (the subjective value), since the cost is what *A Oy* had paid as the supplier.

[101] Bolded by me.
[102] Supra, fn. 94, para.17.
[103] Ibid.
[104] Supra, fn. 44.
[105] See Terra & Kajus (2017, p. 757): "(where the supply of services is involved … the value can only be the cost price which the supplier incurred for those services)".

However, the CJEU had clearly stated that "A tries to estimate … the price likely to be obtained on their resale … so that the price of the demolition services … is as competitive as possible".[106] *A Oy*'s aim was to obtain the contract for demolition. Therefore, they would sell the recyclable scrap metal at as high a price as possible so that they could keep their offer price for the demolition services as low as possible. The scrap metal has a market price.[107] Apparently, *A Oy* was likely, therefore, to focus on the sale price, not their cost.[108] The sale price was what *A Oy* could obtain from the sale of the recyclable scrap metal and represented the value of the consideration.[109] Consequently, the taxable amount of the part of the demolition service provided by *A Oy* was the value of the consideration which *A Oy* could receive in the market by selling the recyclable scrap metal.[110] This is compatible with Article 73 of the VAT Directive.

In summary, it can be seen that the CJEU applied the subjective value (costs of the supplier) as the taxable amount only in cases in which the value of the consideration in barter transactions had no market price.[111] The CJEU made these decisions for practical reasons or for the sake of simplicity[112] and only as an exception. In the case of *Orfey Balgaria* in which the received goods/services had a market price, the CJEU adhered to Article 73 of the VAT Directive and decided that the taxable amount was the value of the consideration.[113] In the case of *A Oy*, in which the received good had a market price, the CJEU decided indirectly that the taxable amount was the market price (the value of the consideration).[114] It can be concluded that the CJEU has no intention to dispense with Article 73 of the VAT Directive.

3) According to the consistent jurisprudence of the CJEU, the barter transaction and the transition in which the consideration is money are similar situations.[115] The barter transaction is only a subcase of the taxable supply against the consideration (Korn, 2019). Following the principle of neutrality, the two should therefore be treated equally. In the case of *Goldsmith*[116], Advocate La Pergola stated that:

> the principle of nondiscrimination … demands that barter transactions be treated **in the same manner**[117] as money transactions**. Fiscal neutrality**[118] specifically

[106] Supra, fn. 94.
[107] Supra, fn. 94, para. 17: "That waste consists partly of goods that A may resell to companies who purchase recyclable scrap metal".
[108] Supra, fn. 94.
[109] Ibid.
[110] Ibid.
[111] See Spilker (2019, p.731): "denn hier liegt hier ein Ausnahmefall vor".
[112] See HMRC (2016): "It is probable that it will be easier to identify costs incurred by the newspaper in providing the advertising service than the costs incurred by the other trader".
[113] Supra, fn. 94.
[114] Supra, fn. 94.
[115] Supra, fn. 79., para. 33; Supra, fn. 13, para. 39; Supra, fn. 93, para. 36; DE: CJEU, 16. Sept. 2020, Case C-528/19, *Mitteldeutsche Hartstein-Industrie*, ECLI:EU:C:2020:712, para. 45 (https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62019CJ0528).
[116] UK: CJEU, 3. July 1997, Case C-330/95, *Goldsmiths*, ECLI:EU:C:1997:339. https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:61995CJ0330
[117] Bolded by me.
[118] Bolded by me.

> requires equal treatment for those different economic activities in order to avoid distortions of the more general Community VAT system.[119]

If the consideration is in kind, it should be valued. The value of the supply can be serviced as a basis of the estimation, since the supplier would consider whether he enters into a barter transaction on the basis either of the purchase price or of the costs which he has paid. The supplier would consider a possible profit or a possible loss, depending on the market situation. The subjective value, according to the judgment of the CJEU in the case of *Empire Stores*[120], is the purchase price (van Doesum et al., 2016) of the supply. This is incorrect, since neither profit nor loss is considered. The CJEU has assumed, mistakenly, that a supplier can always sell his goods or service in excess of the purchase price of his goods. This contradicts the reality, since the price depends on the market and thus fluctuates. In the case of *Scandic Gåsabäck*, the CJEU stated that: "the fact that the price paid for an economic transaction is higher or lower than the cost price is irrelevant to the question whether a transaction is to be regarded as a 'transaction effected for consideration'".[121]

According to Kolozs (2009), "certain market sectors are sometimes forced to sell their products at a lower price than the purchase price (p. 210). These sectors include "IT stores, software producers, fashion designers" and "clothing and shoe stores" (Kolozs, 2009, p. 210). Therefore, the subjective value introduced by CJEU does not reflect the economic reality.

In the case of transactions in which the consideration is money, the entrepreneur can freely set the price (the taxable amount) depending on the market situation, since Article 80 of the VAT Directive[122] only applies to a delivery or service to recipients where the supplier has family or other close personal ties to the recipients. Should the entrepreneur enter into a barter transaction, his taxable amount according to the subjective value of the CJEU can only be his expense, even if he exchanges his goods or service at a value lower than his expenses, and even if he has no family or other close personal ties to the recipients of the supply. The subjective value minimises the taxable amount, so Article 80 of the VAT Directive[123] would apply automatically to any barter transaction.

This makes the barter transaction unattractive for the supplier when compared to transactions where the consideration is money and denies the supplier the opportunity to freely choose this type of transaction. In the case of *Goldsmiths*, the CJEU ruled that:

> no distinction between consideration in money and consideration in kind is drawn in either Article 11A(1)(a) or Article 11C(1) … Since the two situations are, economically and commercially speaking, identical, the Sixth Directive treats the two kinds of consideration in the same way.[124]

and that:

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[119] OPINION OF ADVOCATE GENERAL LA PERGOLA delivered on 27 February 1997 in case of *Goldsmiths*, para. 28, ECLI:EU:C:1997:94. https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:61995CC0330
[120] Supra, fn. 44.
[121] SWE: CJEU, 20. Jan. 2005, Case C-412/03, *Scandic Gåsabäck*, ECLI:EU:C:2005:47, para. 22. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62003CJ0412
[122] Supra, fn. 2.
[123] Ibid.
[124] Supra, fn. 116, para. 23.

> A distinction…**discourages traders from entering into barter contracts**[125], although such contracts are not, in financial or commercial terms, in any way different from transactions in which the consideration is expressed in money, and consequently restricts traders' freedom to choose the contract which they consider to be most suited to satisfying their economic interests.[126]

The concept of subjective value introduced by the CJEU leads to inequality between the tax treatment of transactions in which the consideration is money and the tax treatment of barter transactions. It is regarded as contrary to the system (Probst, 2019) and violates the principle of neutrality (Ruppe & Achatz, 2017).

3. PROBLEM IN GERMAN TAX LAW

There are special rules for barter transactions in dUStG (the German VAT Act): Section 3 (12) dUStG for the definition and Section 10 (2) (2) dUStG for the taxable amount.

The BFH is in a much better position than the CJEU to ascertain the taxable amount in barter transactions in those cases where the value of the consideration has no market price. This is for two reasons. Firstly, the BFH can estimate the value of the consideration according to Section 162 AO (German General Tax Code): "Where the revenue authority cannot determine or calculate the tax base, the revenue authority shall estimate it. All circumstances which have an impact on the estimation shall be taken into account".[127]

Secondly, the BFH can rely on its settled case law and derive the information from the value of the supply to determine the value of the received goods/services (Treiber, 2021).

Before the CJEU introduced the concept of subjective value, the BFH had made a decision according to Section 162 AO (German General Tax Code) and its settled case law.

A. The Consideration has no Market Value

The BFH is required to apply these rules, following the decisions of the CJEU, according to Article 4(3)(2) TEU (see Englisch, 2021a; EU, 2012a). After the CJEU's introduction of subjective value, in all cases where the consideration has no market prices, the BFH made further decisions according to Section 162 AO (German General Tax Code) and its settled case law, but referred, in addition, to the "subjective value" in the CJEU judgment in the case of *Empire Stores*.[128] Indeed, the concept of subjective value introduced by the CJEU has not changed the judgment of the BFH in this respect since, in all relevant cases, the BFH held that the taxable amount was the purchase price, expenses, and cost. According to the CJEU, the subjective value is what the supplier has paid, while the purchase price, expenses, and cost are

[125] Bolded by me.
[126] Supra, fn. 116, para. 25.
[127] DE: Abgabenordnung in der Fassung der Bekanntmachung vom 1. Oktober 2002 (BGBl. I at 3866; 2003 I, at 61), die zuletzt durch Artikel 1 des Gesetzes vom 21. Dezember 2019 (BGBl. I, at 2875) (German General Tax Code in the version of the announcement of October 1, 2002 (Federal Law Gazette I, at 3866; 2003 I, at 61), was last amended by Article 1 of the Law of December 21, 2019 (Federal Law Gazette I, at 2875)). Translation of Section 162, para. 1, by the Federal Ministry of Finance (https://www.gesetze-im-internet.de/englisch_ao/englisch_ao.html).
[128] Supra, fn. 44.

also what the supplier has paid. Therefore, all decisions made by the BFH have actually been compliant with the subjective value, according to CJEU. For example:

a) The BFH's decision on March 28, 1996[129], concerned a barter transaction of goods in exchange for a service. A housewife invited guests to her home and held a party. At the party, she let a dealer sell his goods. The dealer gave her some of the goods as a reward for holding the party. The holding of the party by the housewife had no market price. The BFH decided that **the purchase price** of the gifts delivered by the dealer was the taxable amount of the supply of the gift.[130]

b) The BFH's decision of July 10, 1997[131], concerned a barter transaction of a service in exchange for a service. A brewery rented out a property to a landlord for a property owner, managed the property, and secured the rent. The consideration was that the property owner had to allow advertising for this brewery (such as its logo and photos of its beer) to be displayed on his property and the landlord was obliged to sell the beer of the brewery. The problem was how to determine what the taxable amount of the service of the brewery should be (finding the landlord for the property owner, placing advertising in the house, managing the house, and securing the rent). The service provided by the property owner (giving permission to display advertising at his property and obliging the landlord to sell the brewery's beer) had no market price. The BFH determined that **the expenses** incurred by the brewery as a provider of the service could be an indication of the taxable amount.

c) The BFH's ruling of June 10, 1999[132], concerned a company that gave its director private use of a company car. The BFH held that there was a barter transaction in which the free use of the car was exchanged for the director's working performance, and that the taxable amount of the service (the use of the car) was, therefore, the director's working performance. The value of the working performance could be estimated by **the cost** of using the car.[133]

d) The BFH's decision of April 16, 2008[134], concerned a barter transaction of a service against goods (a car). The activity of an advertising company was to rent advertising space on cars. A local community allowed the advertising company to use a car free of charge, but the advertising company had to place advertisements from the local community on the car and drive it for five years. After five years, the advertising company would become the owner of the car. In this case, the local community delivered a car to the advertising company and the consideration was a service of the advertising company (driving a car with advertisements for five years). There was no market price for driving a car featuring advertising for five years, so the BFH decided that the taxable amount of the delivered car was **the purchase price** of the car (the value of the delivered goods).

e) The BFH's ruling of July 11, 2012[135], concerned a barter transaction between a publisher and a medical association, involving the production of a journal in exchange for a right. The publisher printed the medical journal for the medical association free of charge and, in return,

[129] BFH 28. 3. 1996, V R 33/95, BFH/NV 1996, 936, at 29.
[130] Ibid., at 29, unter 2.
[131] BFH 10. 7.1997, V R 95/96 BStBl. 1997 II at 668, unter II. 3, n. 27.
[132] BFH 10. 6. 1999, V R 87/98, BStBl. 1999 II at 580.
[133] BFH 10. 6. 1999, V R 87/98 BStBl. 1999 II at 580, unter 2 a).
[134] BFH Urteil v. 16.04.2008 - XI R 56/06 BStBl 2008 II S. 909.
[135] BFH 11. 7. 2012, XI R 11/11 BStBl. 2018 II at 146, unter II. 3 b), n. 36.

received the right to place advertisements in that magazine. The right to place advertisements in a medical magazine had no market price. The BFH held that the FG (German Financial Court) of Saxony had correctly ascertained the production **costs** of the magazines (the value of the delivered goods) to be the taxable amount of the print of the journal.

B. The Consideration has a Market Value

Before 2018, in cases of barter transaction in which the consideration had a market value, the BFH and German tax authority took the market value of the consideration to be the taxable amount, following Section 9 of the Bewertungsgesetz (the German Valuation Act)[136], even after the CJEU had introduced the concept of subjective value. This conformed with Article 73 of the VAT Directive. For example:

a) The BFH's decision of August 1, 2002[137], was based on the following situation: Company R and P allowed a non-profit air-sports club to use, free of charge, a balloon bearing its company logo, as well as a vehicle. The company bore all of the costs, such as the gas required to fly the balloon, and the vehicle. The consideration was that the non-profit air-sports club flew the balloon 30 times a year as an advertising activity and made a media echo (i.e. improved the media presence of the company). The BFH held that the non-profit air-sports club had advertised R and P, and that the consideration was the use of the balloon and vehicle.[138] This was a barter transaction of a service (advertising) in exchange for a service (use of the balloon and vehicle) and the supplier was the non-profit air-sports club. The BFH confirmed the judgment of the FG (German Financial Court) Cologne that the taxable amount of the advertising service provided by the non-profit air-sports club was the value of the services received (the costs of R and P).[139] In this case, the BFH correctly determined the taxable amount to be the value of the consideration (the costs of R and P), in accordance with Section 10 (2) (2) dUStG[140] and Article 73 of the VAT Directive (Englisch, 2021b). Although the BFH had referred to the CJEU's concept of subjective value[141], it did not actually adhere to the CJEU's decision. If the BFH had followed this decision, it would have used the subjective value as the taxable amount. The subjective value, according to the CJEU, is what the supplier had paid, so in this case it should have been the costs of the non-profit air-sports club, since the club was the supplier of the service (advertising).

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[136] Bewertungsgesetz in der Fassung der Bekanntmachung vom 1. Februar 1991 (BGBl. I S. 230), das zuletzt durch Artikel 2 des Gesetzes vom 16. Juli 2021 (BGBl. I S. 2931) geändert worden ist. (The German Valuation Act in the version of the announcement of February 1, 1991 (Federal Law Gazette I p. 230), last amended by Article 2 of the law of July 16, 2021 (Federal Law Gazette I p. 2931) has been changed. https://www.gesetze-im-internet.de/bewg/BewG.pdf.

[137] BFH 1. 8. 2002, V R 21/01, BStBl. 2003 II at 438.

[138] Ibid, II. 1. b): "Der Kläger erbrachte die Werbeleistungen auch gegen Entgelt…in Gestalt tauschähnlicher Umsätze…. Das Entgelt…bestand in der Überlassung fahrbereiter Ballone zur Nutzung".

[139] BFH 1. 8. 2002, V R 21/01 BStBl. 2003 II at 438, unter II. Anfangen.

[140] DE: Umsatzsteuergesetz in der Fassung der Bekanntmachung vom 21. Februar 2005 (BGBl. I at 386), das zuletzt durch Artikel 3 des Gesetzes vom 21. Dezember 2019 (BGBl. I, at 2886) (German Value Added Tax Act in the version of the announcement of February 21, 2005 (Federal Law Gazette I, at 386), the last through Article 3 of the Law of December 21, 2019 (Federal Law Gazette I, at 2886).

[141] Ibid, II. 3. a).

b) The BFH judgment of April 15, 2010[142], held that a barter transaction existed in part between a GmbH & Co. KG and its limited partners (two credit institutions).[143] GmbH & Co. KG provided its limited partners with credit analysis services and received a reimbursement of its costs and the deployment of personnel from the limited partners in return.[144] The BFH decided correctly that the taxable amount of part of the supply of credit analysis services (services provided by GmbH & Co. KG) was the service received (the cost of the deployment of personnel by the credit institutions), according to Section 10 (2) (2) dUStG and Article 73 of the VAT Directive.[145] The BFH only indirectly referred to the CJEU's decision involving subjective value in the case of *Empire Stores*[146], as it ruled that the taxable amount was determined in accordance with the BFH's decision on April 16, 2008.[147] However, the BFH did not actually adhere to this CJEU decision. If it had done so, it would have used the subjective value as the taxable amount. The subjective value, according to the CJEU, is what the supplier had paid so, in this case, it should have been the costs of GmbH & Co. KG since it was the supplier of the service (credit analysis).

The BFH's judgment of April 25, 2018[148], concerned a car dealer who sold a new car, receiving both cash and a used car from the customer in exchange. Even though the consideration (the used car) had a fair market price, the BFH confirmed the judgment of the FG (German Financial Court) Lower Saxony that the taxable amount of the delivery of the new car was the sale price[149] of the new car (the value of the delivered goods) (Reiß, 2018). The BFH totally abandoned the view that it had taken in previous decisions, justifying this radical change by referring to a subjective value[150] in the CJEU case of *Empire Stores*.[151] This decision has been heavily criticised in the literature (Spilker, 2019).

In my opinion, this decision of the BFH included two clear mistakes. Firstly, it completely infringed Article 73 of the VAT Directive, according to which the taxable amount should be the consideration (in this case, cash and the value of the used car).[152] Secondly, the BFH did not actually apply the subjective value, as defined by the CJEU in the case of *Empire Stores*[153], since a subjective value, according to that case, is what the supplier had paid (the purchase price of the goods). Had the BFH used the subjective value as the taxable amount, it should have used the purchase price paid by the car dealer for the new car as the taxable amount, not the sale price of the new car. It is clear that the BFH had used the sale price of the new car as

[142] BFH 15. 4. 2010, V R 10/08 BStBl. 2010 II at 879, unter II. 2, n. 20.
[143] Ibid, Gründe I. 2.: "Unternehmensgegenstand der Klägerin war…die Erbringung von Dienstleistungen ...für die Kommanditisten der Klägerin".
[144] Ibid, Gründe I. 6: "…da der Wert der Personalgestellung durch die Kommanditisten an die Klägerin zum Entgelt gehöre", Gründe, II. 17: „"…liegen entgeltliche Leistungen der Klägerin an ihre Kommanditisten vor, …im Rahmen eines tauschähnlichen Umsatzes…".
[145] BFH 15. 4. 2010, V R 10/08 BStBl. 2010 II at 879, unter II. 4, n. 37.
[146] Supra, fn. 44.
[147] BFH-Urteil in supra note 138, Gründe, II. 37: "…bemisst sich das Entgelt nach … (BFH-Urteil in BFHE 221, 475, BStBl II 2008, 909, unter II.3.b)".
[148] Supra, fn. 22.
[149] Niedersächsisches Finanzgericht 11. Senat, Urteil vom 26.05.2016, 11 K 10290/15, ECLI:DE: FGNI:2016:0526.11K10290.15.0A: "3. …berichtigte Umsätze in Höhe von…" , "4…. des ursprünglichen Neuwagenverkaufs nicht mindere…", "20. …nach dem Wert der Neufahrzeuge…".
[150] BFH 25. 4. 2018, XI R 21/16 BStBl. 2018 II at 505, unter II. 2. d).
[151] Supra, fn. 44.
[152] Supra, fn. 2.
[153] Supra, fn. 44.

the taxable amount, since the original judgment of the FG (German Financial Court) Lower Saxony was about the correction of the taxable value of new cars when sold.

4. PROBLEM IN AUSTRIAN LAW

As with the German VAT Act, there are special rules for barter transactions in öUStG (the Austrian VAT Act[154]): see Section 3(10) and Section 3a(2) öUStG 1994 for the definition; and Section 4(6) öUStG 1994 for the taxable amount. The taxable amount is the market price of the consideration, according to Section 4.6.1 öUStR 2000 (the Austrian VAT regulation[155]); while the market price of the consideration is determined according to Section 10(2) öBeWG[156] 1955 (the Austrian tax valuation law).

For example, the decision of VwGH (the Austrian Supreme Administrative Court) of March 28, 1958 (Auer et al., 2019; Muehlehner, 1994) concerned a barter transaction in which a right to use water was waived in return for the free delivery of electrical energy. The taxable amount of waiving this right was the value of the consideration and the consideration was the free delivery of electrical energy. The VwGH decided that the taxable amount was the local normal market price of electrical energy, which was an objective value (Muehlehner, 1994). The Austrian specialist literature is aware that this view was incompatible with the CJEU ruling on *Empire Stores* (Auer et al., 2019; Muehlehner, 1994) after 1994. However, the VwGH ruled that if the consideration did not have a market price, the value of the consideration was derived from the value of the service provided (Muehlehner, 1994).

The Austrian financial administration still holds the view, presented in Section 4.6.1 öUStR 2000, that the taxable amount of barter transactions is the market price of the consideration, and it avoids using the phrase "subjective value". At the same time, the Austrian financial administration has applied the CJEU judgments in the case of *A Oy*[157] and the case of *Empire Stores*[158] as individual cases in Section 4.6.3 öUStR 2000, according to which the taxable amount is a subjective value (the cost of the supplier).

The BFG (Austrian Federal Finance Court) decision of February 11, 2019[159], concerned a barter transaction. A car dealer allowed a journalist to drive a car free of charge for 15 days as a test vehicle and bore the entire cost. The consideration was that the journalist wrote a newspaper report on the test drives. Since the value of the consideration had no market price, the BFG decided that the taxable amount was a subjective value—the costs of the car dealer (Spilker, 2019).

To summarise, the Austrian financial administration, the BFG (Austrian Federal Finance Court) and the VwGH (Austrian Supreme Administrative Court) all decided that the taxable amount of a barter transaction was, in principle, the value of the consideration, which was the

[154] Bundesgesetz über die Besteuerung der Umsätze 1994 (amended on 25.3.2021), RIS - Umsatzsteuergesetz 1994 - Bundesrecht konsolidiert, Fassung vom 21.05.2021 (bka.gv.at).
[155] Umsatzsteuerrichtlinien 2000 (amended on 10.12.2020), Umsatzsteuerrichtlinien 2000 (bmf.gv.at).
[156] Bewertungsgesetz 1955 (amended on 29.10. 2019), RIS - Bewertungsgesetz 1955 - Bundesrecht konsolidiert, Fassung vom 21.05.2021 (bka.gv.at).
[157] Supra, fn. 94.
[158] Supra, fn. 44.
[159] BFG RV/7101000/2016. https://360.lexisnexis.at/d/entscheidungen-findok/bfg_rv71010002016/u_finanz_BFG_2019_lnat_cases_vt_123116__e91c0f3760, (accessed on 6.10.2021).

market price according to objective criteria. If, however, the value of the consideration had no market price, the taxable amount of the barter transaction was applied as a subjective value, following the CJEU's decision in the case of *Empire Stores*[160], i.e. the cost of the supplier (Spilker, 2019). Indeed, the Austrian decisions matched those of Germany before the latter's radical change in 2018.

5. PROBLEM IN THE UNITED KINGDOM

HMRC's view of barter transactions where the consideration is not money is as follows:

> Non-monetary consideration has to be valued by reference to a subjective value that the parties must be regarded as having assigned to the consideration.
>
> A difficulty arises when each party has good reason for ascribing a different value to the consideration. The question of discrepant or equivalent values applying to supplies within a barter transaction has not been considered by the VAT Tribunals or Courts and any cases of this kind should be submitted to the VAT Supply team. (HMRC, 2021)

It is clear that HMRC presupposes an equivalence of the values between the supply and the consideration in barter transactions, and decides that the taxable amount is the subjective value that both parties in a barter transaction have assigned to the consideration. However, according to HMRC's wording, this is different from the CJEU's concept of subjective value, as presented in its *Empire Stores* judgment[161], according to which the supplier (one party) has assigned a value to the consideration. Since both HMRC and the CJEU presuppose an equivalence of value between the supply and the consideration, they therefore achieve an identical result and determine the taxable amount to be the purchase price.

However, HMRC is conscious that asymmetry between the value of the supply and the consideration is possible, and is awaiting a decision on this matter from the VAT Tribunals or Courts.[162]

6. LOOKING FOR A NEW SOLUTION – DE LEGE FERENDA

A. Comparison of the CJEU and BFH Decisions

Before the radical change in 2018, the BHF estimated (Stapperfend, 2021) the taxable amount, according to Section 162 AO (German General Tax Code), in cases where the consideration has no market price, referring additionally to subjective value, as defined in the CJEU's judgment of *Empire Stores*.[163] In this estimate, a value of one's (the company's) own performance served as an indication of the value of the consideration, according to settled BFH case law.

This complied with German law, but not with Article 73 of the VAT Directive, since the BFH used the value of the supply, instead of the value of the consideration as the taxable amount.

[160] Supra, fn. 44.
[161] Supra, fn. 44.
[162] HMRC, supra note 2.
[163] Supra, fn. 44.

In theory, the BFH's decision was also not completely compliant with the CJEUs decision in the case of *Empire Stores*.[164] This is because the CJEU held that the taxable amount is the subjective value, and the subjective value was what the supplier had paid for the (i.e. its own) supply (purchase price). The distinction between the BFH and the CJEU is that, while the BFH estimates the taxable amount, the CJEU determines it. It should be borne in mind that the taxable amount estimated on the basis of the value of the supply could be higher as well as lower than the amount paid by the supplier. Therefore, the decision of the BFH was closer to the economic reality than that of the CJEU.

Since the BFH held, in all relevant settled cases, that the taxable amount was the purchase price, expenses and cost (see 3.A), and that all of these amounts were what the supplier had paid, all the decisions of the BFH were actually compliant with the subjective value according to the CJEU. As a result, the relevant cases of BFH conform both to German law and to the decision of the CJEU.

Indeed, before the radical change in the BFH judgment of April 25, 2018, the BFH and the CJEU acted in a similar way. They determined one of the values of the supply to be the taxable amount, when the value of the consideration had no market price.

From a legal point of view, there is a significant distinction between the different approaches taken by the BFH and CJEU. The BFH's approach has a legal basis, since the BFH can estimate the taxable amount according to Section 162 AO (German General Tax Code). This enables it to take the value of the supply as the basis of the estimation of the taxable amount, in which case the consideration has no market price, even though Section 10 dUStG (Article 73 of the VAT Directive) states that the taxable amount is the value of the consideration.

Since there is no rule in the VAT Directive that is comparable to Section 162 AO (German General Tax Code), which enables an estimation of the taxable amount, the CJEU is unable to use the value of the supply as the basis of the estimation of the taxable amount in cases where the consideration has no market price. It seems that the absence of a comparable regulation to Section 162 AO (the German General Tax Code) caused the CJEU to create the concept of subjective value in order to determine the taxable amount to be the value of the supply when the value of the consideration has no market price, just because the value of the supply is easily available.

In fact, using the subjective value as a means, the CJEU has only achieved a result which the BFH had reached much earlier, using Section 162 AO (German General Tax Code) and its settled case law. This reveals a systemic deficit in European tax law; there is no general rule that allows an estimation of the taxable amount.

The BFH's judgment on April 25, 2018[165], represented a radical change (See 3. B. 2). According to this decision, the taxable amount of the supply should always be the value of the supply, regardless of whether or not the consideration has a market price. This decision completely infringed Article 73 of the VAT Directive. The BFH justified this judgment by citing the use of subjective value in the CJEU's decision in the case of *Empire Stores*.[166] The BFH mistakenly over-interpreted the concept of subjective value and went in a completely

[164] Ibid.
[165] Supra, fn. 145.
[166] Supra, fn. 44.

wrong direction. The reason for this could be that the BFH did not appear to discover the true reason for the CJEU's introduction of subjective value, which was that no rule comparable to Section 162 AO (German General Tax Code) in the VAT Directive, which allowed for the use of the value of the supply as the taxable amount, existed.

Indeed, in its case law, the CJEU had estimated the taxable amount. In the case of *Skarpa* (Case C-422/17)[167], the CJEU agreed to estimate[168] the profit margin based on the actual total costs of the services provided. This produced the taxable amount, using Article 308 of the VAT Directive. However, this article is only a special rule for travel agents. A general rule for estimating the taxable amount, whose scope of application is comparable to the scope of application in Section 162 AO (German General Tax Code), cannot be derived from this CJEU decision. The CJEU justified the special rule for travel agents as follows: "[T]he essential aim of the rules of that special scheme is to avoid the difficulties to which economic operators would be exposed by application of the normal principles of the VAT Directive…".[169]

If the taxable amount for travel agents can be estimated for the sake of simplicity, other values could also be estimated. This implies that the German view, i.e. Section 162 AO (German General Tax Code), could be introduced into the VAT Directive.

This would not be a new development. The CJEU Case of *RPO* (C-390/15)[170] concerned the question of a violation of the general principle of equality, implied by the different treatment of books that were physical objects and books transmitted by electronic means. The CJEU applied an examination scheme which it had first used in 2008 in a decision about greenhouse gas emission certificates.[171] The EU Grand Chamber previously described this decision as permanent case law.[172] This examination scheme first considered the objective comparability of two subjects based on their regulatory context and then, if necessary, devoted a possible justification to it. In establishing this examination scheme, von Danwitz, the German judge at the CJEU, who was the reporter at the time, contributed his German understanding derived from the case law of the German Federal Constitutional Court.[173] With the ruling in the case of *RPO*[174], a fundamental decision now exists for EU tax law and, in particular, for VAT law.[175] German law had therefore enriched EU law.

The VAT Directive needs a new article comparable to Section 162 AO (German General Tax Code) de lege ferenda, according to which the taxable amount can be estimated. This new rule should also provide the basis of the estimation. In the circumstances under discussion the

[167] PL: CJEU, 19 Dez. 2018, Case C-422/17, *Skarpa*, ECLI:EU:C:2018:1029. https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62017CJ0422
[168] Ibid., the last paragraph.
[169] Ibid., para. 28.
[170] PL: CJEU, 7 Mar. 2017, Case C-390/15, *RPO*, ECLI:EU:C:2017:174. https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62015CJ0390
[171] FR: CJEU, 16. Dec.2008, Case C-127/07, *Arcelor Atlantique et Lorraine*, ECLI:EU:C:2008:728. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62007CJ0127
[172] Supra, fn. 167, para. 42.
[173] See Lars Dobratz, Die Beschränkung des ermäßigten Steuersatzes für Bücher auf Lieferungen auf physischem Träger ist mit dem Grundsatz der Gleichbehandlung des Unionsrechts vereinbar – Keine Notwendigkeit einer erneuten Parlamentsanhörung wenn die finale Richtlinienfassung in ihrem Wesen nicht vom Wortlaut des Richtlinienvorschlags abweicht, UR 10/2017, at 393 (400).
[174] Supra, fn. 170.
[175] Supra, fn. 173.

consideration has no market price, so the basis of the estimation can only derive from the value of the supply.

B. Replacement for the Term "Subjective Value"

Indeed, the idea of determining the taxable amount to be the value of the supply as an exception is not an invention of the CJEU. This approach already exists in the VAT Directive. According to Article 80 of the VAT Directive, the taxable amount is the open market value. Article 72 of the VAT Directive provides that: "'open market value' shall mean the full amount that … a customer … would have to pay, under conditions of fair competition, to a supplier at arm's length".[176]

According to Article 72(1) of the VAT Directive, the open market value represents the value of the supply[177] and may be applied to determine the taxable amount in barter transactions where the consideration has no market price.

In fact, the BFH has suggested that a value of the consideration could be determined according to the open market value, in accordance with Article 80 and Article 72 of the VAT Directive.[178] It finally had to abandon this idea, however, since the scope of application of Article 80 of the VAT Directive was exhaustive, according to the CJEU judgement in the case of *Orfey Balgaria*.[179] However, in the case of *Balkans and Sea*[180], the CJEU provided that the taxable amount cannot be the open market value in cases other than those listed in Article 80 of the VAT Directive, "in particular where the taxable person has a full right of deduction of VAT".[181] This means that it was still possible that the taxable amount could be the open market value when the taxable person did not have the full right of deduction of VAT. This showed that the CJEU obviously did not regard the extension of the scope of Article 80 of the VAT Directive as absolutely taboo.

The idea of open market value already existed in the original version of the Sixth Council Directive (1977)[182], in Article 11 Part A (1) d, with regard to Article 6 (3) and Article 11 Part B (1) b. Article 80 of the VAT Directive was introduced in 2006 in the Sixth Council Directive as Article 11 Part (7) and then in the VAT Directive from 2007 (Treiber, 2021). The purpose of open market value, according to Article 11 Part A(1)(d) of the Sixth Directive was the prevention of distortions of competition. This also followed Article 3 of the Sixth Directive. The purpose of the open market value in Article 80 of the VAT Directive is to prevent tax evasion or avoidance. The wording shows that Article 11 Part A(1)(d) of the Sixth Directive pursues a different aim from Article 80 of the VAT Directive. It is explicitly demonstrated that Article 80 of the VAT Directive only applies if the purchaser or the provider is not entitled to a full VAT deduction. The distortion of competition in Article 11 Part A(1)(d) of the Sixth Directive does not, in my opinion, depend on an entitlement to the deduction of VAT.

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[176] Supra, fn.2.
[177] See Berger et al. (2018, p.392): "…üblichen Preis des Gutes oder der erbrachten Dienstleistung…".
[178] BFH, Urt. v. 25.4.2018 XI R 21/16 BStBl. 2018 II at 505, unter II 2 f).
[179] Supra, fn. 79,, para. 47.
[180] BU: CJEU, 26 Apr. 2012, Case C-621/10 and C-129/11, *Balkan and Sea*, ECLI:EU:C:2012:248. https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62010CJ0621
[181] Ibid., para. 52.
[182] Supra, fn. 41.

The open market value in Article 11 Part B(1)b of the Sixth Council Directive served as a substitute taxable amount for the importation of goods (repealed by Directive 91/680/EEC) (Gunacker-Slawitsch, 2015). Open market value did not apply in only a single article. In the VAT Directive, Article 72 has a special and preceding position.[183] Article 72 of the VAT Directive is a single regulation in Title VII. 1. Chapter 1. This indicates that the open market value, according to Article 72 of the VAT Directive, is defined independently in the VAT Directive, the application of which was not, and is not, restricted to one single article and can be applied in other cases.

According to Article 72(1) of the VAT Directive, the open market value is the total amount that the customer has to pay in order to receive the goods or services under arm's length conditions of fair competition. It follows that the open market value is an objective value of the supply, since the amount at arm's length is a value assessed according to objective criteria. Consequently, the open market value cannot be the taxable amount in a barter transaction in cases where the consideration has no market price. This is because the taxable amount should be a value related to the individual barter transaction. It is thus a subjective value according to the CJEU judgment in the case of *Empire Stores*, "not a value estimated according to objective criteria".[184]

However, the open market value according to Article 72 (1) of the VAT Directive can be the taxable amount in a barter transaction where the consideration has no market price in normal market circumstances, when no special circumstances arise. The open market value itself can be higher or lower than the purchase price (or cost), depending on the market situation.

In the CJEU case of *Skripalle*, Mr Skripalle owned some housing and let these properties to a limited company, the shareholders of which were his adult son and his wife.[185] The rent was lower than his cost, but corresponded to normal market rents for comparable properties in the area.[186] The judgment of the CJEU held that if there is no risk of tax evasion, Article 80 of the VAT Directive does not apply, despite the closely related connection, within the meaning of Article 80(1) of the VAT Directive, between the supplier and the recipient.[187] This means that the consideration may be less than the purchase price if the agreed consideration represents the market value, despite the close relationship between the supplier and the recipient. This should also apply to the barter transaction.

If special circumstances arise in an individual barter transaction, the taxable amount should be estimated, so that the open market value can act as the basis of the estimate. This means that an estimate should be made in two stages. First, the open market value should be determined and then any possible special circumstances in the individual barter transaction should be considered.

Regarding the decision of CJEU in the case of *Empire Stores*[188], the open market value of the article that *Empire Stores* offered to its established customers without charge should first have

[183] See Englisch (2021, Kap. 5, n. 5.63): "systematische Methode".
[184] Supra, fn. 44, para. 18.
[185] DE: CJEU, 29 May 1997, Case C-63/96, *Skripalle*, ECLI:EU:C:1997:263, para.3. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61996CJ0063
[186] Ibid., para. 5.
[187] Ibid., para. 31.
[188] Supra, fn. 44.

been determined. The open market value is the taxable amount. It can be the purchase price of the article if the open market price is the same as the purchase price, or can exceed or be lower than the purchase price of the article, depending on the market situation. In the case of *Empire Stores*, there are no special circumstances, so the taxable amount is the open market price. A special circumstance is conceivable, for example, if the term of usage of the article that *Empire Stores* offered were to expire in one week's time. In this case, the taxable amount of the supply of the article should be lower than the open market price. It is also possible that the taxable amount exceeds the open market value—for instance, if *Empire Stores* unexpectedly receives an order for large quantities of this article and temporarily has insufficient reserves. *Empire Stores* then suggests to an established customer that it supplies them with another article, but the customer insists on having this particular article because they prefer it. As a result, *Empire Stores* reluctantly sends the customer the original article. In this specific circumstance, the taxable amount could surpass the open market value.

Extending the scope of Article 80 of the VAT Directive to include barter transactions in which the consideration has no market price de sententia ferenda could only demonstrate that the taxable amount is the open market value. However, the open market value does not take the special circumstances of specific cases into account. Consequently, an extension of the scope of Article 80 of the VAT Directive does not make much sense, and a new rule about the taxable amount in a barter transaction in cases in which the consideration has no market price should be introduced de lege ferenda.

If the lawmaker of the VAT Directive wishes to regulate every detail, this would create an illegible volume, as the regulation would already be out of date when it is proclaimed (Kirchhof, 1987). Therefore, the new rule about the taxable amount in a barter transaction in cases where the consideration has no market price should contain a general clause stating that all circumstances that are important for the estimation must be considered.

7. CONCLUSION

1) According to Article 73 of the VAT Directive, the taxable amount shall be the consideration received by the supplier. When the consideration is in kind, it must be given a value. The CJEU and the BFH have determined the value of the consideration to be the market price of the consideration in cases where the consideration has a market price.

2) A problem arises when the consideration has no market price. In Germany, this problem is easy to solve since Section 162 AO (German General Tax Code) allows the taxable amount to be estimated. This enables the BFH to use the value of the supply as the basis of the estimation. However, there is no rule in the VAT Directive comparable with Section 162 AO (German General Tax Code). The CJEU is therefore unable to use the value of the supply as the taxable amount in the same circumstances.

3) In these circumstances, the CJEU created the concept of subjective value to determine the taxable amount of barter transactions where the consideration has no market price. According to the CJEU's decision in the case of *Empire Stores*[189], the subjective value is the amount which the supplier has paid for the goods (their purchase price). The subjective value represents the

[189] Supra, fn. 44.

value of the supply. This is an infringement of Article 73 of the VAT Directive, according to which the taxable amount is the value of the consideration received.

This is a violation of Article 1(2) of the VAT Directive and also of the nature of VAT as a general tax on consumption by the customer (Stadie, 2009). The value of goods purchased by the supplier is not what the customer has paid, but what the supplier has paid.

The subjective value does not reflect the economic reality, since neither a profit nor a loss is considered. The CJEU has mistakenly assumed that a supplier can always sell his goods or service for a higher value than the purchase price of his goods. However, the price depends on the market and can fluctuate.

4) According to the consistent jurisprudence of the CJEU, a barter transaction and a transaction in which the consideration is money amount to the same situation. The barter transaction is only a subcase of the taxable supply against the consideration. Due to the principle of neutrality, the two should be treated equally.

In the case of transactions where the consideration is money, the entrepreneur can freely set the price (the taxable amount) depending on the market situation, since Article 80 of the VAT Directive only applies to supply to recipients with whom the supplier has family or other close personal ties. If the entrepreneur enters into a barter transaction, their taxable amount can only be their expense, according to the CJEU's definition of the subjective value, even if they exchange their goods or service at a value below their expenses, or if they have no family or other close personal ties to the recipients of their supply. The subjective value minimises the taxable amount. Article 80 of the VAT Directive should automatically apply to any barter transaction.

The subjective value leads to unequal treatment between transactions where the consideration is in money and barter transactions, and it therefore violates the principle of neutrality.

The subjective value is not a satisfactory method of ascertaining the taxable amount in barter transactions where the consideration has no market price.

5) Indeed, even after its introduction, the CJEU ascertained the subjective value (the purchase price of the supply) to only be the taxable amount in cases where the consideration has no market price. In cases where the consideration has a market price, the CJEU held that the taxable amount is the value of the consideration, according to Article 73 of the VAT Directive. Obviously, the CJEU has no intention of abandoning Article 73 of the VAT Directive, and has applied the subjective value only in exceptional cases.

6) Before 2018, in cases where the consideration has a market value, the BFH held that the taxable amount was the value of the consideration, according to Article 73 of the VAT Directive.

In the case of April 25, 2018[190], the BFH took a radical turn by over-interpreting the subjective value. Despite the fact that the consideration (the used car) had a market price, the BFH determined the sale price of the new car (the value of the supply) to be the taxable amount.

[190] Supra, fn. 148.

This means that the BFH no longer distinguishes between those cases where the consideration has a market price and those where it does not. The taxable amount should be the value of the supply in all barter transactions. This entirely violated § 10 (1) (2) of the dUStG and Article 73 of the VAT Directive.

The reason for this could be that the BFH seemed not to understand why the CJEU had introduced the subjective value. The CJEU had only done this because there is no rule comparable to Section 162 AO (German General Tax Code) in the VAT Directive which enables it to use the value of the supply as the taxable amount.

This decision of the BFH caused a controversy in Germany about the issue of ascertaining the taxable amount in barter transactions where the consideration does not have a market price. This controversy prompted a search for a new solution, as well as the writing of this article.

7) The VAT Directive should include a new article comparable to Section 162 AO (German General Tax Code) de lege ferenda, according to which the taxable amount can be estimated. The new rule also should make it clear what the basis of the estimation is. Since, in the relevant circumstances, the consideration has no market price, the basis of the estimation can only be derived from the value of the supply.

8) The idea of determining the taxable amount as the value of the supply in exceptional circumstances is not the invention of the CJEU, but already exists in the VAT Directive. According to Article 80 of the VAT Directive, the taxable amount is the open market value, following Article 72 of the VAT Directive. The open market value, according to Article 72(1) of the VAT Directive, represents the value of the supply.

Application of the open market value, according to Article 72 of the VAT Directive, was not and is not restricted to a single article. This creates the opportunity for further application of the open market value.

The open market value cannot be directly used as the taxable amount in a barter transaction in cases where the consideration has no market price, since it is assessed according to objective criteria.

However, it can be the taxable amount in normal market situations. If special circumstances arise in individual barter transactions, the taxable amount should be estimated, so that the open market value can become the basis of the estimation. The open market value itself can be higher or lower than the purchase price (or cost), depending on the market situation.

9) Article 80 of the VAT Directive already has unlimited scope. Extending its scope further to include barter transactions in which the consideration has no market price de sententia ferenda could only result in the finding that the taxable amount in such cases is the open market value. However, the open market value does not take the special circumstances of each case into account. Extending the scope of Article 80 of the VAT Directive in this respect does not, therefore, make sense. Consequently, a new rule should be introduced de lege ferenda concerning the taxable amount in case of barter transaction where the consideration has no market price.

10) With regard to the agreement of the 27 member states of the EU, which may present difficulties, this paper proposes that a new Article 42a should be introduced into Council Implementing Regulation (EU) No 282/2011.[191] This would allow the taxable amount to be determined in barter transactions where the consideration has no market price, and is therefore proposed de lege ferenda:

Proposed Article 42a of Council Implementing Regulation (EU) 282/2011:

In barter transactions, if the consideration, which the supplier has received or will receive from the customer or a third party in return for the delivery, cannot be determined, the taxable amount can be the open market value according to Article 72 Sentence 1. This applies only if no special circumstances are found, following due diligence from a prudent business person. If the individual case involves special circumstances, the taxable amount must be estimated, with the open market value, according to Article 72 Sentence 1, serving as the basis of the estimate. All the circumstances that are important for the estimate must be considered.

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EXPLORING RISK MANAGEMENT IN DEVELOPING COUNTRIES' TAX ADMINISTRATIONS

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Abstract

One of the major challenges currently facing developing countries is how to raise adequate tax revenues for development financing. The United Nations (UN), the World Bank, the International Monetary Fund (IMF), and other multilateral organisations are all making efforts to tackle this issue. This paper contributes by advocating risk management in developing countries' tax administrations. This topic has received some practitioner attention, but is yet to receive adequate academic attention, especially as it relates to developing countries. There has been more focus on tax compliance/noncompliance research. However, this paper argues that tax noncompliance is just one of numerous problems facing tax administrations in developing countries. There is a need to identify other risks, and to build models for the assessment and management of such risks. This paper responds to such needs by using a synthesis of practitioner literature, previous research findings, and the authors' field experiences from developing countries in Asia and Africa. The paper provides useful and practical insights by categorising the risks faced by developing countries' tax administrations into three groups: internal, external, and collusive risks. The paper groups risks into those that are within the control of the tax administration and those that are outside of its control. The analysis suggests directions for further research and provides tax practitioners in developing countries with useful tips on risk management.

Keywords: Risk Management in Tax Administrations, Developing Countries, Internal Risks, External Risks, Collusive Risks.

1. INTRODUCTION

Developing countries face many problems when generating tax revenue to fund their development. This challenge has been acknowledged for a long time. For example, Nicholas Kaldor, who was one of the first researchers to identify this challenge, published his seminal findings in 1963. Kaldor (1963) stated that a dichotomy exists between developing and developed countries in terms of tax revenue generation. He also noted that developed countries generate about 25 to 35 per cent of their Gross Domestic Product (GDP) from tax revenue while developing countries only raise about 8 to 15 per cent of their GDP in this way (Kaldor, 1963). He warned that if developing countries are unable to raise at least 15 per cent of their GDP from tax, they may not be able to exit underdevelopment (Kaldor, 1963). The percentage suggested by Kaldor (1963) was adopted as the official tax revenue adequacy benchmark by the International Monetary Fund (IMF, 2011). In the same vein, the United Nations (UN) supports the minimum level of tax to GDP ratio for developing countries to attain the 2020 Sustainable Development Goals (SDGs) (United Nations Secretariat, 2019). It is now nearly 60 years since Kaldor made his groundbreaking contribution to the subject of the tax revenue

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generation challenges faced by developing countries. While a considerable amount of research has been conducted into the matter and practitioners have made concerted effort to find solutions since then, the tax to GDP ratios of developing countries remain low and the problem of tax revenue adequacy remains largely unresolved. The UN has repeatedly advised developing countries to de-emphasise their reliance on foreign aid and to improve their domestic revenue generation (United Nations, 2018). The organisation has convened three global conferences (the Monterrey Conference, 2002; the Doha Conference, 2008; and the Addis Ababa Conference, 2015) on the theme of domestic revenue mobilisation in order to generate ideas and to emphasise the importance that it attaches to this issue.

The burden of raising adequate tax revenue to finance development lies with tax administrations. However, they face significant risks when performing their statutory functions. As noted by James (2012), "tax administration is a risky business" (p. 345). The risk inherent in tax administration exists partly because the process involves the collection of a share of citizens' incomes and the remittance of these monies to the government. Hence, one of the widely researched risks faced by tax administrations is tax noncompliance: taxpayers failing to comply with tax laws. A huge volume of research has been conducted into tax compliance, with perspectives ranging from the economic to the sociopsychological. However, tax administrations face a variety of risks in addition to tax noncompliance. Unfortunately, there has been little detailed academic analysis of the other risks. Reference materials currently available in respect of this topic include technical publications on risk management in tax administrations written by international organisations. These works may not be adequate for the purpose of academic analysis. Moreover, technical papers by international organisations, such as the Organisation for Economic Co-operation and Development (OECD), are written with particular objectives and styles that may not align with academic research. Furthermore, the limited number of academic papers on risk management in tax administrations in existence were written many years ago (for example, James, 2012). There is a need for an update that recognises contemporary risks facing tax administrations. For example, there are growing risks arising from digitalisation and technology that were not envisaged a few years back. Additionally, there is a need for academic research into the specific risks facing tax administrations in developing countries as distinct from those in advanced countries which are the focus of the existing academic papers. It should be emphasised that the issues faced by tax administrations in developing countries are significantly different from those faced by administrations in advanced countries (Besley & Persson, 2014).

This paper makes several contributions to the literature on tax administration. First, in a similar way to the European Commission (2006), the authors present a model of risk identification for tax administrations, especially those in developing countries, which captures external risks, such as tax noncompliance and the growing risks arising from technology and digitalisation. The paper also identifies internal risks that may arise within tax administrations. Second, the paper alludes to a possible risk of collusion between internal and external forces (collusive risk). Third, the paper contributes to the literature by further classifying risks faced by tax administrations into two categories—those that can be controlled by tax administrations and those that cannot but the effects of which can be mitigated by them. The paper makes a useful contribution to the theory and practice of tax administration due to the fresh analytical insights that it presents. Additionally, at a time when the world economy faces an unprecedented economic shutdown arising from COVID-19, there is a further threat to tax administrations' revenue because business incomes are on a downward spiral. This is an ongoing problem at the

current time and shows that a large-scale national or global disruption is potentially an external risk factor for tax administration, a factor that is captured in our model.

The paper's sources consist of secondary research findings and the practitioner literature on risk management for tax administrations. These sources are complemented by some of the authors' wide field experiences in tax administration in Asian and African countries. Different risk management models are available in the academic and practitioner literature (Chartered Institute of Management Accountants [CIMA], 2008; Lundquist, 2014). To avoid complexity, this study follows a simple three-step framework: risk identification, risk assessment, and risk management. The remainder of the paper proceeds as follows. Section two presents a model of risk identification comprising internal, external, and collusive risks, and discusses individual risks in the external category with insights from the literature and practice. Section three discusses individual risks in the internal category. Section four presents some frameworks for managing the risks identified in the paper. Section five concludes the paper with discussion of implications for further research and the practice of tax administration.

2. CATEGORIES OF RISKS FACING TAX ADMINISTRATIONS IN DEVELOPING COUNTRIES

Although developing countries generally have similar socioeconomic, political, and legal environments, there are significant country variations. Their levels of development also vary widely. Due to these differences across jurisdictions, a standardised approach to tax administration is neither practicable nor desirable. This section identifies a broad range of risks that affect tax administrations in developing countries. While the creation of a standard list of risks is neither possible nor practicable, the risk identification model provided in this section incorporates as many risks as possible. A tax administration may not face all of the risks identified, but would definitely be exposed to some of them. Furthermore, the level of risk may vary among tax administrations in different countries. Despite these differences, the authors believe that the risk management model in Figure 1, and the categories of risks identified in Figure 2, will be adequate for tax administrations in developing countries. Additionally, the classification into internal, external, and collusive risks will go a long way to improve the understanding and management of these risks.

Figure 1: Risk Management Model

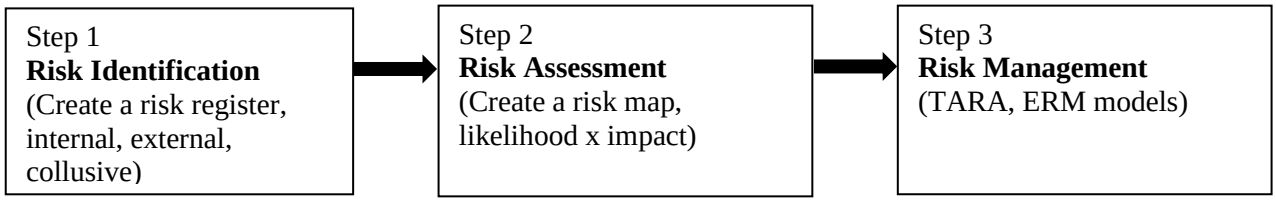
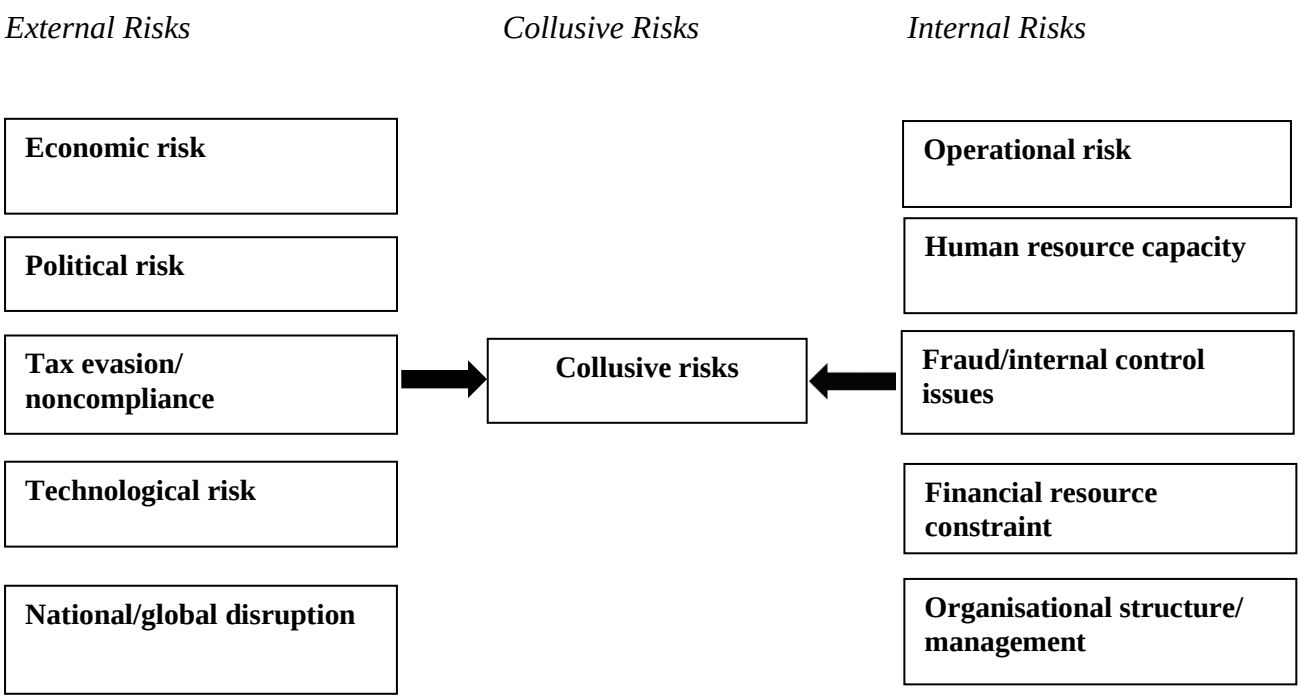


Figure 2: Risk Identification Model



2.1 External Risks

External risks are those emanating from activities or elements operating outside of the control of the tax administration. They include economic risks, political risks, tax evasion and avoidance, technological risks, and national/global disruptions.

Economic risks

The European Commission (2006) identified economic conditions as one of the risks facing tax administrations. Favourable economic conditions increase tax administrations' revenues while adverse conditions decrease them. This position has some support from the literature, especially in developing countries that are prone to experiencing adverse economic circumstances. For instance, Fishlow and Friedman (1994) found that the public in developing countries resort to tax evasion as an adjustment mechanism when there is inflation and during economic downturns, and this has a significant negative effect on government revenues. Economic conditions may be broadly interpreted to include economic indices, such as GDP per capita, the Human Development Index, economic status of taxpayers, etc. The OECD (2006) notes that taxpayers' economic status and economic problems—e.g., whether a "household can save and/or get by, or whether it needs to spend savings or borrow" (p. 3)—affect their willingness to pay taxes and thus affect tax administrations' revenues.

Although all countries face economic problems occasionally, developing countries are more prone to the risk of economic fluctuations (inflation, recession, instability, unemployment, etc.). This is due to a variety of factors but, importantly, it depends on the quality of governance. Unfortunately, many developing countries lack the good governance to be able to efficiently manage their economies. In countries with economic instability, tax administrations face significant risks from tax revenue fluctuation due to large-scale noncompliance during downturns (Fishlow & Friedman, 1994). In addition to being impacted by noncompliance, tax revenues may decrease as economies shrink because taxes are paid from business profits. When economies go into recession, businesses make losses or earn lower profits, and their statutory tax obligations and ability to pay are reduced. Another economic issue prevalent in developing countries that poses a significant risk to tax administrations is the existence of a large informal economy. Large volumes of business activities are conducted outside of the formal records that can be utilised for tax assessment. That means that these business activities escape the tax net.

Political risks

Public opinion about the government, whether favourable or not, can significantly influence taxpaying behaviour. This is a widely researched topic in the tax compliance literature (Doerrenberg, 2015). In this paper, this phenomenon is considered a political risk—the risk of citizens' failure to support the government and thereby engage in tax noncompliance. Research on this subject has approached it from different but interrelated perspectives. Moreover, some studies have investigated the influence of public spending and/or availability of public goods on tax revenue (Doerrenberg, 2015). A common thread that runs through the literature is that government actions or inactions affect citizens. Citizens trust and support the government when policies affect them positively, and withdraw their trust and support if they perceive the government to be incompetent or corrupt.

Political risk is a factor that manifests outside of tax administrations. Tax administrations are not involved in political decisions; rather, they are answerable to political leaders. However, they face significant political risks arising from political decisions (Umar et al., 2017). Developing countries are often viewed as being deficient in the quality of governance. There is substantial empirical evidence to support this position, including the World Governance Index (WGI), which is published annually by the World Bank. The WGI has consistently given many developing countries rankings. As such, the governments in many of these countries are unpopular with their citizens. As predicted by numerous studies on tax and governance (Doerrenberg, 2015), developing countries' tax administrations find it extremely difficult to raise tax revenue. Therefore, political risk is a significant external risk for tax administrations in developing countries and cannot be easily controlled.

Tax evasion and avoidance

Tax evasion and avoidance are probably the most recognised risks facing tax administrations, and have been widely researched since Allingham and Sandmo (1972)'s seminal work was published. Tax evasion significantly reduces the amount of tax revenue that any tax administration can raise. The amount of tax generated by a tax authority is a function of the tax base multiplied by the tax rate and the level of compliance. This means that a high evasion level will effectively neutralise the revenue accruable from a large tax base and a high tax rate. In this paper, tax evasion/avoidance is included among the external risks that tax administrations face because it is perpetrated by taxpayers who operate from outside of the

immediate purview of the tax administration. While the tax administration may have some control in terms of being able to introduce laws and policies in order to deter noncompliance, taxpayers make their own decisions about whether to comply with tax laws or to evade tax. Moreover, taxpayers are independent, external parties.

Technological risks

Technology has no doubt contributed to increased efficiency in tax administrations. It has resulted in the automation of taxpayer registration, making it easier for tax administrations to identify taxpayers and their relevant information. Technology, in the form of e-filing, has also made it easy for taxpayers to complete and submit their tax returns from the comfort of their homes and business premises. However, the use of modern technology is also associated with risks that are growing in several dimensions. For instance, e-commerce has generated a complex web of online transactions that tax administrations are struggling to track. Business is now being conducted across jurisdictions without the need for any physical presence. This continues to pose a significant challenge for tax administrations, especially in developing countries where technical capacity is limited. One of the emerging risks to tax administrations posed by technological advancement is the use of cryptocurrencies. These currencies are not domiciled in a particular country and cannot be tracked to particular individuals and transactions. This makes their taxation a potential challenge for tax administrations.

National/global disruption

Large-scale disruption to economic activities might occur on a national or global scale and can have a profound effect on a tax administration's ability to generate tax revenues. Such disruptions might affect business operations, thereby significantly reducing profits and even causing widespread unemployment. For instance, the COVID-19 pandemic, which is ongoing at the time of writing, has disrupted businesses worldwide. The impact of this on tax administrations is not immediately apparent but will become clearer with time. Tax administrations need to be aware of risks arising from sudden natural disasters, pandemics, and wars, etc. that might cause large-scale disruption to business activities and, consequently, affect their own ability to raise tax revenue.

3. INTERNAL RISKS

Internal risks are those that occur within the workings of tax administrations. They include risks arising from day-to-day operations, constraints in terms of human and financial resources, structural risks, and management risks.

Operational risks

Tax administrations perform a wide range of routine functions. They identify and register taxpayers, facilitate tax filing, collect taxes due, audit taxpayers when necessary, and provide taxpayer services in order to facilitate compliance. In performing these functions, tax administrations face the risk of failures that could significantly affect their capacity to raise tax revenue. This is more likely in developing countries that are still trying to build capacity for the complex task of tax administration. Some tax administration functions and their associated risks are described below.

Taxpayer registration: Jimenez et al. (2013) describe taxpayer registration as "the process, by which the tax administration collects basic taxpayer identifying information such as names, addresses and legal entity types" (p.14). Taxpayer information allows tax administrations to identify eligible taxpayers by various parameters, such as geographical spread, active or inactive status, and business nature/scale (Jimenez et al., 2013). Most tax authorities now have a central database of eligible taxpayers within their jurisdictions. Each taxpayer is assigned a unique identification number. This enables tax authorities to preserve and retrieve information about a taxpayer whenever necessary. It also facilitates the planning of tax administration operations, as tax authorities have access to a wide range of information about taxpayers (Jimenez et al., 2013). There is a risk that tax administrations in developing countries will fail to capture a large number of eligible taxpayers in their databases. This is due to the particular demography of these countries and the low capacity of the tax administrations. It is widely acknowledged that a significant portion of businesses in many developing countries operate informally and are not captured in the tax net. This means that the tax authorities cannot collect taxes from these businesses.

Taxpayer audit: Tax authorities undertake audits of selected taxpayers at the end of each tax period. This is to ensure that taxpayers' returns are accurate and devoid of fraudulent misrepresentations. Auditing is a crucial function of tax administration. However, even in advanced countries, not all taxpayers are audited. This implies that tax administrations face the risk of a large number of taxpayers escaping undetected if they evade taxes. Developing countries' tax administrations face more challenges when performing tax audits, especially in terms of their capacity to detect evasion. According to Umar et al. (2017), detection is a problem in developing countries and, even when tax evasion is detected, it is not easy to prosecute offenders due to complex systemic problems.

Taxpayer services: Taxpayer services are currently the preferred means of facilitating voluntary compliance. Tax authorities are increasingly being advised to treat taxpayers as clients/customers, as the private sector does. Mutual antagonism between tax authorities and taxpayers leads to tax noncompliance. One important taxpayer service is to pass information on all aspects of the tax system to taxpayers. The provision of taxpayer services also involves assisting and guiding taxpayers through the tax payment process in order to facilitate tax compliance. Additionally, these services include listening to taxpayers' complaints and resolving issues promptly. Moreover, high tax compliance costs have been found to reduce compliance. Tax administrations can reduce high tax compliance costs by providing taxpayer assistance, and by reducing the amount of time and effort that it takes taxpayers to perform their statutory duties. There is a very high risk that taxpayer services could fail, thereby causing dissatisfaction among taxpayers and leading to tax noncompliance. This risk is particularly high in developing countries, where public services are not very effective.

Tax law complexity: One crucial tax administration tool is tax law. However, tax laws have been found to be too complex for taxpayers to understand, thereby leading to noncompliance (Tanzi, 2017). Developing countries copied complex tax laws from advanced countries without taking their own peculiarities into consideration. Such tax laws become difficult to implement, thereby causing noncompliance. Complex tax laws are also a problem for the tax administration. In some developing countries, the tax laws are outdated and are not regularly reviewed in line with contemporary realities.

Human resource capacity

Tax administration is a highly demanding public function and, as such, requires a high level of professionalism. Unfortunately, developing countries' public sectors often lack the expertise to administer such organisations effectively. Even where limited expertise is available, tax administrations compete with the private sector to attract a skilled workforce. The private sector often gains the upper hand in this competition because it offers better remuneration. Although this situation is gradually improving, the human resource constraint constitutes a significant risk to tax administrations and should not be ignored or taken for granted. This is more so with the increasing complexities of the 21st century, which create unprecedented challenges for both private and public sector organisations. In order to keep pace with the changing environment and to manage the evolving disruptions, tax administrations need a skilled and up-to-date workforce; otherwise, they risk losing a significant portion of their revenues. Some of the emerging threats that require skilled responses are globalisation, base erosion and profit shifting (known as BEPS), and digitalisation.

Financial resource constraint

Ironically, while tax administrations collect revenues for governments, they are often faced with financial constraints when performing their duties. Tax administration is expensive, as significant funds are required in order to employ adequate and skilled staff, procure modern software and equipment, conduct tax audits, and so on. Developing countries, with their chronic funds shortages, find it difficult to adequately finance modern tax administrations. One way in which this problem is being addressed is through the provision of technical assistance by international development organisations such as the IMF and the World Bank. In some developing countries, tax administrations are being allowed to keep a percentage of tax collected in order to finance their operations as a means of tackling fund shortages.

Internal fraud/leakages

While tax administrations fight tax evaders, they face significant risk from their own staff, who may choose to compromise the system for selfish gain. Like other public sector organisations in developing countries, tax administrations are not immune to fraudulent activity that diverts public funds into private hands.

Structural and management risk

Tax administrations, like other public and private sector organisations, require the appropriate structure and management skills in order to attain their objectives. In developing countries, tax administrations were previously structured in the traditional bureaucratic style and served as departments under the supervision of their country's finance ministry (Sarr, 2016). Such a structure made them nonresponsive to contemporary challenges. In recent times, most tax authorities in developing countries have gained some measure of autonomy. However, the semi-autonomy currently enjoyed by tax administrations in developing countries is yet to yield significant results. This may be due to problems other than their structure and there is a need for tax administrations to embrace 21st century management techniques. Public sector organisations in more advanced countries are embracing contemporary management techniques, such as lean management, total quality management, and new public management. As such, developing countries' tax administrations risk failing to attain their objectives if they

retain old fashioned, public sector, bureaucratic management techniques amidst the complexities of the 21st century.

4. RISK ASSESSMENT AND MANAGEMENT

The next step after identifying risks is to assess and manage them. According to CIMA (2008), risk assessment involves weighing the likelihood of a risk occurring against the severity of its impact if it is not mitigated. Risk management is a crucial element in contemporary management. There is a need to identify risks that may threaten the objectives of the organisation and to put strategies in place to deal with them. Risk management is, therefore, the process of reducing the possibility of adverse consequences occurring: by reducing the likelihood of an event taking place; by minimising its impact; or by taking advantage of the upside risk (CIMA, 2008). An organisation's management team is responsible for establishing a risk management system. Risk management is a process that was developed in order to assist with the management of business enterprises, and knowledge of its principles and practice has evolved over time.

One widely accepted risk management model is the enterprise risk management (ERM) framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2004). Proponents of the ERM framework argue that it is an improvement on the traditional practice of risk management in organisations, which places responsibility for risk management on functional managers, who are required to manage the respective risks arising from the departments that they supervise. For instance, the Chief Finance Officer is, traditionally, responsible for managing risks in the area of finance operations. Similarly, the production manager is responsible for risks arising from the production process. While this approach technically makes sense, proponents of the ERM framework find it to be severely limited when managing enterprise-wide risks (CIMA, 2008). Some of the arguments against the traditional risk management approach, according to Beasley (2016), are as follows. First, there are many risks that may not fall directly within the purview of a single functional department of an enterprise (Beasley, 2016). Such risks "fall between the siloes", which means none of the silo leaders can see them or claim responsibility for them (p. 2). Beasley (2016) notes that a risk can affect an organisation without recourse to the organogram. Consequently, this risk may escape the attention of functional departmental heads and have disastrous consequences for the entire organisation (Beasley, 2016). Second, some risks may affect more than one department at the same time or at different times (Beasley, 2016). The implication is that one manager may be managing such risks as they affect their own department without taking their effect on other units into consideration, and multiple silos may manage the same risk in different ways (Beasley, 2016). Third, when risks are managed in the traditional way, a departmental response to a risk might negatively affect the performance of other units (Beasley, 2016).

Due to the weaknesses of the traditional risk management method, the ERM framework has gained acceptance over the past decade (Beasley, 2016). Beasley (2016) notes that, "the objective of enterprise risk management is to develop a holistic portfolio view of the most significant risks to the achievement of the entity's most important objectives" (p.3). He adds that "the 'e' in ERM signals that ERM seeks to create a top-down, enterprise-wide view of all the significant risks that might impact the business" (Beasley, 2016, p. 3). He notes this means that the responsibility for managing risk that might affect attainment of the organisation's objectives lies with senior management and the board of directors (Beasley, 2016). According

to Beasley (2016), the ERM framework should not be seen as a one-off project; rather, it is an ongoing project, because "risks constantly emerge and evolve" (p. 4). While the ERM framework has been widely accepted as a contemporary risk management model, the TARA framework is also viewed as a model that can be used to deal with present and future risks. TARA is an acronym for "transfer", "avoid", "reduce" and "accept", and these terms are briefly explained below.

Transfer: This means to transfer or, at least, to share the risk with a third party. For instance, a company might insure an asset that faces a significant risk of being stolen or accidentally damaged. This will effectively transfer the risk to the insurance company and, if an incident occurs, the impact on the organisation will be minimal. Additionally, an organisation may transfer the risk of embarking on a large project by engaging other organisations as partners. This means that two or more organisations will bear the entire risk in proportion to their participation.

Avoid: Organisations can prevent the occurrence of certain risks by avoiding activities that could trigger them. This strategy is preferable if the risk has a very large impact on the organisation and also has a high likelihood of occurring. If such activities must be undertaken, it is necessary to have a thorough risk management plan in place.

Reduce: This means to reduce the risk exposure, usually by carrying out the activity in a different way. This strategy is suitable when the risk will not have a significant impact but is likely to occur. However, if it is not possible to reduce risk exposure, a company might have to accept the risk (if it will not have a significant impact) or avoid it altogether.

Accept: Risk acceptance means knowing that a risk will occur and going ahead anyway (perhaps even doing nothing about it). Managers might decide to have contingency plans to deal with the fallout from such risks. More often, accepted risks have a low probability of occurring and, even when they occur, they do not have a substantial impact.

For tax administrations, there is a need to assess both external and internal risks, as outlined in our framework. Risk assessment for tax administration requires objective quantification and/or subjective judgment. It is possible to obtain data on some risks. For instance, an examination of tax compliance/evasion records from previous years might help a tax administration to predict current risks. External economic risks can also be predicted using readily available economic forecasts by agencies such as the World Bank and Standard and Poor's. Political risks may be difficult to assess using quantitative data, but utilising past experience and subjective measures can assist. Tax administrations can assess internal risks through self-appraisal or by engaging experts. Such appraisals may utilise SWOT (i.e. strengths, weaknesses, opportunities, and threats) analysis to determine internal capabilities and weigh them against threats.

Once the risk assessment has been completed, actions should be taken to manage the risks. Naturally, of the risks identified, those most likely to occur and to have the most damaging impacts should receive priority. When considering the TARA model, it is important to note that it may not be feasible for tax administrations to transfer their risks by insuring them. However, they may be able to reduce many risks and accept those that they cannot do anything about. Risks that can be significantly reduced by tax administrations include the external risks of noncompliance by taxpayers and most of their internal risks. Tax administrations are not in

a position to be able to prevent external factors, such as economic conditions and political risks. However, engaging in proactive risk management practices could enable them to foresee such risks and take actions to mitigate their impact. For instance, when facing economic problems, like inflation and recession etc, tax administrations can assess potential impacts and consider possible mitigating actions at the onset. Similar measures can be taken in respect of political risks. The risks identified in this paper, their characteristics, and recommendations for their mitigation are summarised in Table 1.

Table 1: Categories of Risks, Their Characteristics and Mitigation Measures

Risk type	**Risk location**	**Control span**	**Recommended mitigation measures to be taken by the tax administration**
Economic risk	External	Not within the tax administration's control	Assess the implications of economic issues and take proactive measures
Political risk	External	Not within the tax administration's control	Assess the implications, which may include noncompliance. Take proactive measures (e.g. improve taxpayer engagement)
Tax evasion/ noncompliance	External	Partly within the tax administration's control	Conduct risk-based audits, improve tax service quality, train staff, etc.
Technological risk	External	Not directly within the tax administration's control	Keep abreast of technological trends and respond appropriately
National/global disruptions	External	Not within the tax administration's control	Take proactive measures when disruptions occur
Operational risk	Internal	Within the tax administration's control	Improve tax service quality, simplify tax laws, and ensure lower compliance costs
Human resource capacity	Internal	Within the tax administration's control	Employ skilled staff, and train and retrain all staff.
Fraud/internal control issues	Internal	Within the tax administration's control	Tighten internal controls
Financial resource constraint	Internal	Partly within the tax administration's control	Negotiate with political leaders to secure adequate funding for tax administration operations
Organisational structure/management	Internal	Within the tax administration's control	Embrace modern management techniques, such as lean management and new public management
Collusive risk	Internal/external	Partly within the tax administration's control	Tighten internal control and ensure that there is less interface between staff in sensitive positions and taxpayers

5. CONCLUSIONS

Developing countries face a tax revenue generation crisis. This problem has been a subject of academic interest for several decades. The problem has also attracted attention from the UN, the World Bank, the IMF, and many other multilateral development agencies. Unfortunately, the problem has persisted. As noted by the IMF (2015), the largest contributing issue is tax noncompliance, and academic researchers have focused on tax noncompliance in line with the position taken by international practitioners. While this paper concurs with the mainstream position that tax noncompliance is a major problem, it explores risk management more broadly, arguing that tax noncompliance is just one of the problems that tax administrations in developing countries face. Risk management is a possible and less costly way for tax administrations in developing countries to increase tax revenues. These tax administrations need to take stock of the wide range of risks that they face and analyse them. This will allow them to gain a better understanding of the dynamics of such risks and manage these risks more effectively.

We have identified a wide range of risks and classified them as internal or external risks based on whether they exist within the tax administration structure or whether they operate from outside of it. While the classification of tax administration risks as internal or external provides useful insights, this paper added collusive risk as another dimension. This is a situation whereby internal elements (within the tax administration) collude with external parties (taxpayers) to defraud the government of tax revenues. Collusive risk is significant in some developing countries and should receive further attention from academic researchers and practitioners.

Overall, the key message of this paper is that tax administrations in developing countries should engage in risk mapping, which involves the identification of all possible risks to which they are exposed, and ranking such risks in terms of likelihood that they will occur and the scale of their impact. The current practice, which places more emphasis on tax compliance, audit, and sanction, should be modified. There is a need to focus on a wider range of risks. Interestingly, if other risks are properly managed by tax administrations, tax compliance should improve and tax evasion be reduced.

The framework provided in the paper is a generalised one. It is common knowledge that each country's tax administration faces unique challenges. While this paper's framework serves as a guide, there is need for country-specific case studies to be undertaken. We hope that academic researchers in various developing countries can take up this challenge. Furthermore, this paper has proposed a framework for risk management by a tax administration. Future research could apply quantitative or qualitative data to the suggested framework to investigate one or more categories of risk. Finally, as developing countries intensify the quest for sustainable revenue, professional risk management in tax administration is an under-explored area and may constitute an important part of the solution.

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UTILISING TECHNOLOGY TO IMPROVE COMPLIANCE: THE JAMAICA EXPERIENCE

Hank Williams[1]

Abstract

Tax Administration Jamaica (TAJ) successfully completed the implementation of the three phases of its Revenue Administration Information System (RAiS) project in December 2016. The implementation of the RAiS resulted in the modernisation and re-engineering of processes and operations in order to positively influence taxpayers' behaviour and voluntary compliance levels. Central to this was the attention focussed on the creation of an effective tax system built upon the principles of simplicity, transparency, maintenance of revenue adequacy, and the broadening of the tax base.

Such guiding principles enabled the tax authority to take advantage of changes to key pieces of legislation, policies, business rules, and standard operating practices. Particular emphasis was also placed on strengthening human resource capacities in order to make optimal use of the RAiS's features. TAJ also engaged with key stakeholders throughout the implementation process.

The RAiS has not only impacted customer service delivery, but has also greatly improved compliance in respect of registration, filing, payment, and accurate reporting. The analytical models used in the RAiS have underpinned the development and design of targeted strategies to achieve increased compliance in those areas. Hence, the tax authority is now in a better position to aggressively pursue tax avoiders and evaders through intelligence and enforcement actions.

It is obvious that the tax authority has made significant strides when it comes to providing cutting-edge systems to improve voluntary compliance and public confidence in tax administration. Finally, the author trusts that the lessons emerging from TAJ's practical experience will prove to be valuable for other countries' tax administration systems in the future.

Keywords: Revenue Administration Information System, Voluntary Compliance, Tax Administration.

1. BACKGROUND

Globally, the evolution of technology has significantly changed the future for tax administrations. Tax administrations have been forced to pay significant attention to the rapid and continuous state of evolution in digital technology (Organisation for Economic Co-operation and Development [OECD], 2014). Interestingly, countries have been forced to amend their tax agendas to include technological advancements and rapid evolutions in order to address international tax matters (The Association of Chartered Accountants, 2018, & OECD, 2018). This has significantly disrupted and transformed the traditional mode of

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operation so as to maximise taxpayer risk compliance activities. There is presently a greater demand for the usage of modern technologies in order to bolster tax administrations' capacities to take a risk-based approach to compliance management.

The OECD states that the revenue bodies could improve their performance in future, both in terms of compliance risk management and meeting service expectations, through the successful use of technology (OECD, 2009; United Nations, 2019). This would allow tax authorities to focus their attention on improving the allocation of their scarce resources so as to achieve optimal tax compliance. Therefore, it would result in the introduction of an array of interventions that would help revenue authorities to meet what the OECD (2004) defines as its "primary goal": to "collect the taxes and duties payable in accordance with the law and to do this in such manner that will sustain confidence in the tax system and its overall administration" (p. 7).

Jamaica has also adopted a risk-based approach to compliance-related activities that involves the use of a modern information technology system. This has resulted in TAJ changing the way that it does business and, most importantly, taking a new approach to risk management in respect of taxpayer compliance. The aims of this paper are to outline the role that technology plays in taxpayer compliance risk management and to address the major tax issues that arise within the Jamaican taxpayer population.

2. INVESTMENT IN TECHNOLOGY TO IMPROVE TAX COMPLIANCE

TAJ successfully implemented the third and final phase of its new RAiS in September 2016. It made a substantial investment in this customised Internet-based solution, which was built using sophisticated risk models in keeping with international best practices. In order to do this, TAJ reengineered its workflow management procedures and changed its core business processes.

It was crucial that the new system had a comprehensive range of predictive modelling and risk assessment capabilities. This was very timely, as the organisation was grappling with a large volume of data obtained from various sources. The new system can collate and use that data in order to better understand compliance risks, something that was previously virtually impossible to do. The implementation of the RAiS has provided TAJ with a foundation for a structured and direct path to gaining the insights needed to improve its decisions.

Tax administrations also urgently need to find creative ways by which to address the rapid developments in the digital economy (United Nations, 2019). This comes at a time when many countries across the Caribbean are faced with the need to improve their tax administrations (Collosa, 2020; Reyes-Tagle & Ospina, 2021). Tax administrations throughout the Caribbean continue to struggle with numerous difficulties and obstacles beyond their information technology (IT) infrastructures. As a result, many countries have invested in automation through upgraded IT systems and have taken other crucial steps to improve their service offerings. For example, the Barbados Revenue Authority (BRA) implemented an integrated tax system that was more flexible and accurate in order to keep pace with complex compliance demands and the expectations of taxpayers (BRA, 2018). Interestingly, TAJ has benefited from implementing its RAiS in the same way and this allowed it to turn its attention to implementing solutions in response to the global COVID-19 pandemic.

Henry (2020) estimated that government revenue would decline by 18% as a result of the slowing down of economic activities due to the pandemic. This, the most significant economic challenge in Jamaica's history, has not only impacted the tax administration but has significantly affected its ability to respond as the major revenue collection agency. COVID-19 has brought unique challenges to tax administrations due to the high levels of uncertainty that they face while trying to ensure the continuity of all essential services with due consideration to the health and safety of all (The Inter-American Center of Tax Administration, the Intra-European Organisation of Tax Administrations, & the OECD, 2020). The need for the modalities of operations undertaken to maximise tax compliance activities to be significantly transformed is inescapable. There is presently a higher demand for the use of modern technologies in order to prevent tax administration from coming to a standstill.

Jamaica's RAiS is also designed to build partnerships and foster voluntary compliance, and enables taxpayers to connect with the tax authority in a more personal and interactive manner. Therefore, it is prudent to ensure that no unauthorised party can access sensitive taxpayer information. Strict measures are in place to ensure the security of taxpayers and to counteract threats that may undermine the integrity of the database system.

TAJ is now in a position to utilise a structured and systematic process in order to identify high priority risks that require urgent attention and allocate its finite resources accordingly. This process contains a series of iterative steps to systematically identify, assess, rank, and treat tax compliance risks, and to monitor and evaluate taxpayer activities in order to support evidence-based decision making. It is important that TAJ's taxpayer compliance risk management process is consistent with international best practices (OECD, 2004).

To that end, the process resulted in significant improvements being made to the administration of taxes and taxpayers were provided with access to a wider range of online services. These improvements were all geared towards improving the taxpayer experience as well as the efficiency and effectiveness of customer service delivery.

3. DATA SOURCES

TAJ's taxpayer compliance risk management process utilises the following:

- ✓ Economic and financial data;
- ✓ Data supplied by taxpayers on their tax returns;
- ✓ Data supplied by third parties;
- ✓ Information available on the Internet and from other relevant sources.

Of particular interest is the fact that TAJ currently receives data from 245 third-party entities annually. These third-party entities are required to submit information about all payments made to independent contractors providing goods and services, purchases registered by corresponding entities, payments to private medical practitioners for medical services, and payments made by non-resident customers for various services.

TAJ has organised the treatment of risks into the following broad categories:

- Bauxite and mining
- Customs
- Betting and gaming
- Public bodies
- Tourism
- Medical and pharmaceutical
- Petroleum
- Utilities.

4. TAX COMPLIANCE RISK MANAGEMENT ENVIRONMENT

Overview

TAJ's RAiS was designed to optimise the leverage of knowledge and experience of users in the areas of data analytics and predictive modelling. The system entails an iterative sequence of steps: data cleaning, data integration, data selection, data transformation, data mining, pattern evaluation, and knowledge presentation. Most importantly, the RAiS facilitates the effective and efficient transformation of raw data from various sources into information that can guide the development of various programmes to improve voluntary compliance.

Data Cleaning and Integration

Data cleaning involves the process of addressing any anomalies contained in the data received, such as errors or missing values, and the removal of all outdated or incorrect information. TAJ adopts a process in which data from all sources is either updated or removed. This includes information that is deemed to be incomplete, incorrect, improperly formatted, duplicated, or irrelevant, thus improving the quality of information and enabling TAJ to make more accurate decisions. Focus is placed on ensuring that data gathered contains the important attribute of a unique identifier commonly referred to as a taxpayer registration number (TRN).

Interestingly the RAiS, through its data warehouse, integrates data from all data sources to build an entity profile that contains a comprehensive representation of all known information about each taxpayer. This forms a repository of multiple heterogeneous data sources organised under a unified schema in a single location in order to facilitate further analysis and risk mitigation efforts.

For example, a taxpayer's basic attributes include information such as the location, segmentation, and age of their business, and details of the sectors with which their business is associated. They also include information about the taxpayer's estimated or real income, filing and payment history, and other factors that could suggest or predict how the taxpayer will behave in the future. It should also be noted that entities are able to upload and submit third-party data at their convenience and according to the requirements of TAJ.

Data Mining

Han, Kamber and Pei (2012) define data mining as "the process of discovering interesting patterns from massive amounts of data" (p. 33). TAJ's RAiS enables the use of analytical techniques through various functionalities such as summarisation, consolidation, and

aggregation, as well as the ability to view information from different angles. It can turn a large collection of data into knowledge that meets the organisation's needs.

This enables TAJ to identify major tax risks within the overall taxpayer population based on tax obligations. This has facilitated a review of the risks contained in the tax system. More specifically, tax compliance risk factors have emerged from legislative context, government policies, public opinion/surveys, international agreements, and economic conditions. The process used by TAJ takes taxpayer segmentation into consideration according to the most recent Jamaica Industrial Classification (Statistical Institute of Jamaica, 2016). The behaviour of taxpayers within each segment is examined using customised rules and calculations to find, filter, augment, or matching data from the system's main database and/or the data warehouse. The RAiS identifies anomalies and creates leads that suggest corrective measures that could be taken in response to the compliance risks. It is extremely important to note that the RAiS can identify possible treatment options according to the tenets of compliance: registration, filing, payment, and correct reporting.

Data Analytics

The RAiS has been developed utilising analytical models that enable TAJ to evaluate risk at taxpayer level. These analytical models are able to rank and prioritise risk factors using appropriate macroeconomic and statistical analyses according to the tenets of compliance. They are used to assign overall scores to taxpayers based on their profiles, tax histories, tax revenues at risk, and other relevant information.

In the context of revenue administration, data analytics is the process of compiling, organising, and using data so as to learn from past and current experiences in order to: better use resources; understand and predict patterns of non-compliance; reduce costs; and increase revenue collections (Ernst & Young Global Ltd., 2019). Analytics models have also been used within TAJ to improve the compliance rate and the efficiency of the way in which TAJ operates as a semi-autonomous revenue authority. Moreover, the system utilises risk scoring in order to produce a probability distribution for non-compliance, with a view to maximising revenue collection, minimising revenue shortfalls, and predicting changes in taxpayers' behaviour.

For example, in an effort to better exploit data from various sources, boost efficiency and increase revenue collection, TAJ has used the RAiS's analytics score model in order to robustly determine the collection cases to be worked on based on the likelihood of generating J$6,000 per day. Scores are automatically calculated by the system and range from a percentile of 0 to 100, with 100 being the greatest likelihood of collection.

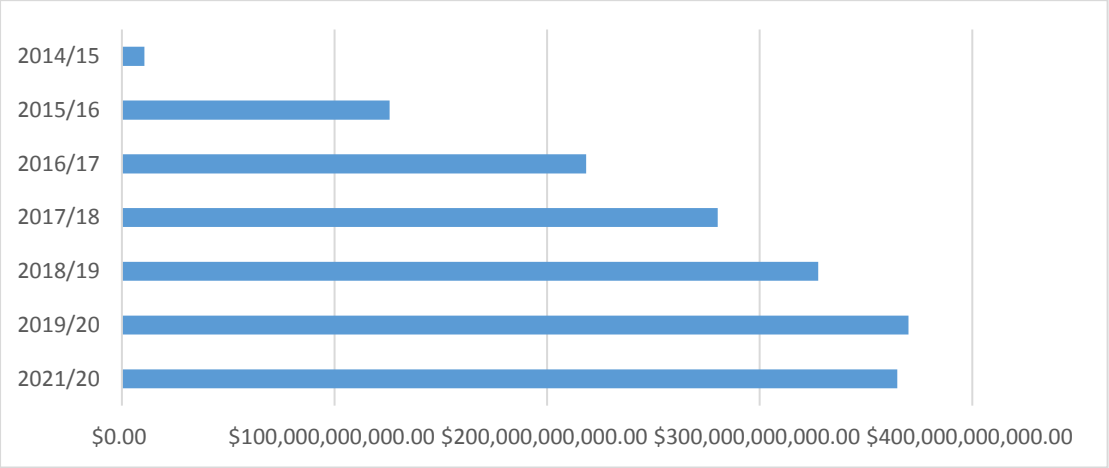
5. IMPACT OF TAJ'S RAIS ON COMPLIANCE

The implementation of the RAiS has had a major impact on TAJ's strategy. Not only has it had a positive impact on customer service standards, it has greatly improved compliance rates in respect of registrations, filing, payments, and accurate reporting. The analytical models incorporated within the RAiS have underpinned the development and design of targeted strategies to promote voluntary compliance. Furthermore, such models have placed TAJ in a position to aggressively pursue tax avoiders and evaders through intelligence and enforcement actions.

Since the RAiS was implemented, the amount of time that taxpayers take to comply with their tax obligations has been significantly reduced. The use of the system makes it easier to do business and to pay taxes, as evidenced by growing numbers of positive taxpayer testimonials and increased use of the electronic services platform.

Figure 2 illustrates that 1,007,286 payments were processed electronically in FY2020/21, with a total value of J$364.74M. This represents a 3.353% increase in electronic payments and an 819% increase in transaction amounts when compared to FY2014/15 (prior to the implementation of the RAiS).

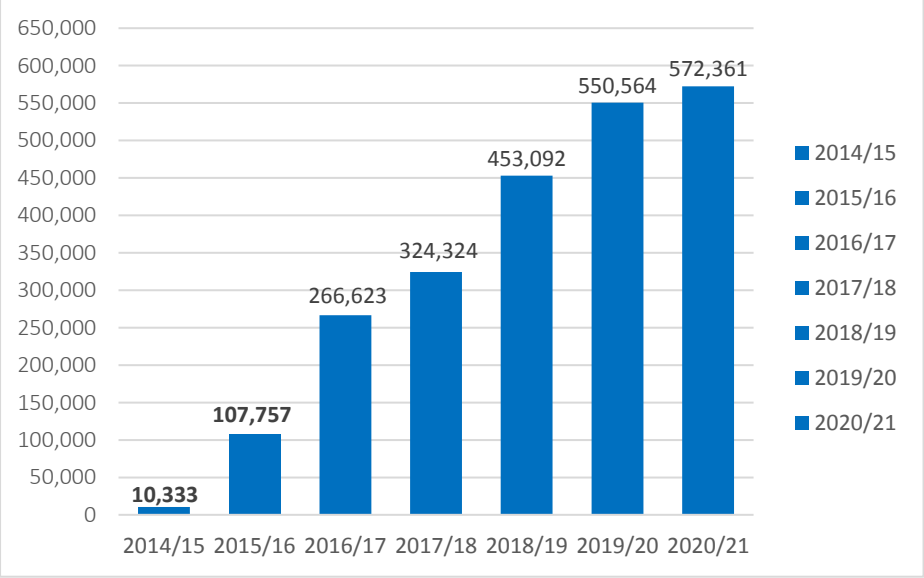
Figure 2: Number of ePayment Transactions



Data Source: TAJ

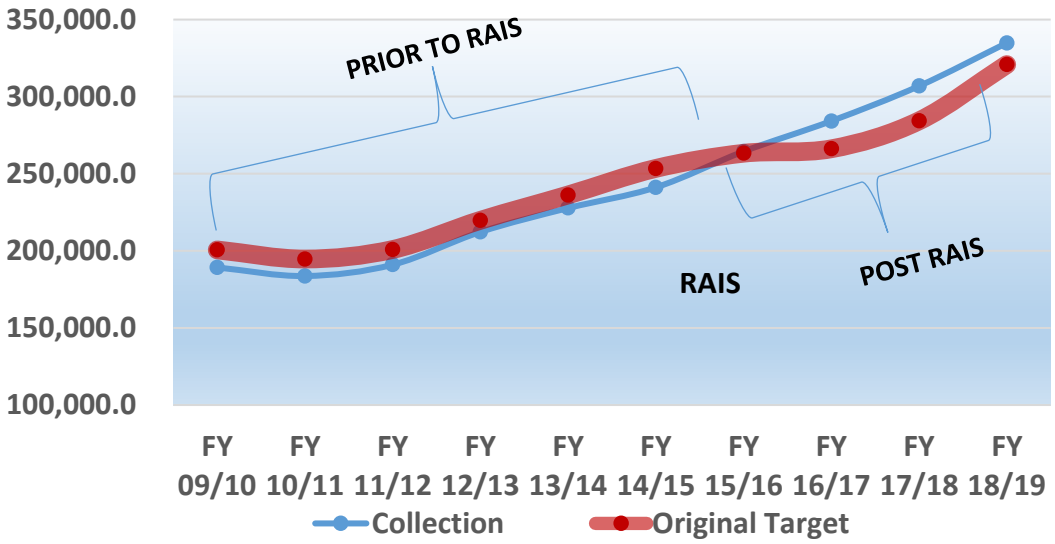
Additionally, as illustrated in Figure 3, electronic filing transactions in FY2020/21 stood at 573,361, an increase of 5.439% when compared to those received in FY 2014/15 (10,333).

Figure 3: Distribution of Electronic Services in Jamaica



Data Source: TAJ

Figure 4: Distribution of Domestic Revenue Collection vs. Original Target



Data Source: TAJ

Since the RAiS was implemented, TAJ has begun to exceed its original collections targets. This is reflected in Figure 4, which reveals a positive trend. These positive annual outcomes have resulted in the continuation of focused compliance strategies that are guided by the application of this new technology.

Interestingly, use of the RAiS has definitely enhanced TAJ's ability to anticipate customer expectations through the modification of business processes. This has, ultimately, resulted in the organisation becoming more efficient. Benefits for taxpayers and TAJ have been identified, as set out below:

Benefits of the RAiS for Taxpayers

- Reduced processing time for individual and business transactions.
- Access to online services for the major tax types.
- Real-time access to their accounts.
- Reduction in operating expenses.
- Greater level of transparency.
- More convenient transactions.

Benefits of the RAiS for TAJ

- Work can be assigned to team members efficiently.
- Work assigned to team members can be monitored in real time.
- Information can be accessed quickly.
- Timely reporting.
- Reduced processing time.
- Reduced operational costs.
- Increased revenue collection and meeting of revenue targets.
- Improvement in enforcement and other compliance actions.

6. CONCLUSION

The implementation of the RAiS has signalled not only a change in the way that TAJ does business but, most importantly, a transformation of the organisation so that it can sustain confidence in the system and its overall administration. TAJ has placed much attention on ensuring that its limited resources are strategically aligned in order to maximise its compliance activities in an efficient and timely manner.

This technological evolution has sought to broaden the holistic profile of taxpayer risk in order to improve taxpayer service and enforcement approaches. This, coupled with a renewed thrust to register new taxpayers, encourage "online and on time" filing, improve payments, and ensure correct reporting, has significantly contributed to TAJ's achievements.

It is important to note that, along with making technological advances, TAJ underwent a change management programme that resulted in a shift in its service delivery model. The shift in TAJ's service delivery methodologies brought about a corresponding shift in taxpayers' perceptions of, and attitudes towards, the payment of taxes and compliance.

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BIG DATA, AUTOMATIC EXCHANGE OF INFORMATION AND THE RIGHTS OF TAXPAYERS

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Abstract

In the last decade, a new form of exchange has been adopted—the automatic exchange of information (AEOI)—which is viewed as the new global standard. Never before has there been so much enthusiasm for tax administrations around the world to cooperate in the fight against tax evasion. In a very short amount of time, there has been a drastic move from the exchange of information (EOI) on request to spontaneous AEOI. The development of the Internet of Things (or IoT) has also brought about astounding changes to the way in which tax authorities around the world operate, and the use of big data by the tax administrations has come as no surprise.

While the previous focus may have been on determining taxpayers' fair shares of tax, the current strategy focusses on tax transparency, where taxpayers' information is shared with governments around the world. The sudden occurrence of scandals that resulted in the denouncement of major tax evasion schemes that started in 2008 with the fall of the Swiss bank UBS made a major contribution to the development of the new framework of EOI, which was endorsed by the Organisation for Economic Co-operation and Development (OECD) in its fight against harmful tax practices. With estimated losses in annual tax revenues due to tax evasion schemes totalling more than USD 100 billion (OECD, 2021a), it is unsurprising that governments around the globe have been motivated to adopt the new global standard.

The aim of this paper is to explore how the rights of taxpayers have been disregarded in the quest to find a potential solution to curb tax evasion. While AEOI and big data have proved to be effective tools for tax authorities, some concerns about the protection of the rights of taxpayers and taxpayers' information arise as a result of their use. Accordingly, this paper has been divided into four main sections. After the introductory section, the different rights of taxpayers in the context of AEOI and big data are analysed. Section three delves into the current risks for taxpayers when their information is exchanged or processed on a large scale. Finally, section four includes recommendations about what can be done to ensure that the rights of taxpayers are respected in the context of AEOI and big data.

1. INTRODUCTION

Cross-border trade has promoted the growth of economies through, amongst other things, foreign exchange. However, the opacity of these transactions has resulted in the loss of government revenue through base erosion and profit-shifting (BEPS) schemes, such as the concealment of assets offshore to avoid taxes (Cockfield, 2016). It has also promoted

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international crimes, like terrorism, which is often funded by illegal cross-border income, as was the case with the Ericsson List (Shiel, 2022). Consequently, in order to halt these activities, countries have elected to exchange relevant tax information with each other (OECD, 2012a).

The exchange of information (EOI) provides tax authorities with insight into taxpayer's activities and enables them to efficiently enforce domestic tax laws (OECD, 2021b). It can be done in various ways, including the exchange of information upon request (EOIR), country-by-country reporting, the spontaneous exchange of information (SEOI), the use of tax examination boards, and AEOI. Of these methods, AEOI is preferred due to its efficiency (Jaiswal & Biyani, 2017).

EOI, particularly AEOI, requires big data to be exchanged at regular intervals (OECD, 2012a). Big data is obtained from financial institutions and the revenue authorities of the source country. It comprises taxpayers' data, such as their bank account numbers, tax identification numbers, account balances, and places of residence (OECD, 2012a). The sharing of such private data raises concerns about taxpayers' rights, such as their right to privacy. Therefore, countries have devised mechanisms for protecting these rights, including the enactment of data protection laws (OECD, 2012b).

This article examines the use of big data in the EOI and its impact on taxpayer rights. It discusses the benefits and pitfalls of exchanging tax information. It also provides viable recommendations to ensure that governments are able to engage in EOI while protecting the rights of taxpayers.

2. RESEARCH METHODOLOGY

We used the desk research method in order to conduct this study, and reviewed published literature, as well as laws governing EOI and taxpayer rights. We also reviewed the OECD's *Model tax convention on income and capital* (OECD, 2017), the 2011 European Union (EU) directive on administrative cooperation[4], and the *United Nations model double taxation convention between developed and developing countries* (UN, 2021), which guided the drafting of EOI provisions. We elected to use this methodology because, in our opinion, it is a cost-effective and efficient way in which to investigate this topic.

3. FORMS OF EOI

Tax information may be shared unilaterally, bilaterally, or multilaterally.

a) Unilateral Agreements for EOI

EOI may rely on unilateral agreements, such as the intergovernmental agreements (IGAs) signed under the U.S. Foreign Tax Account Compliance Act (FATCA). This Act was enacted on the presumption that revenue losses were occurring as a result of secret offshore investments by U.S. taxpayers (Christians, 2013). It mandates foreign financial institutions (FFIs) to report information about accounts held by U.S. taxable persons (Internal Revenue Service [IRS], n.d.). The reportable information includes the name, income, account number, and taxpayer identification number of the account holder (IRS, n. d.).

[4] http://data.europa.eu/eli/dir/2011/16/2020-07-01

These IGAs have been signed with countries such as Cabo Verde and Brazil (U.S. Department of the Treasury, n.d.). To enforce compliance, the U.S. imposed a withholding tax of 30 per cent on 100 per cent of all income sourced to a U.S asset on non-compliant FFIs (IRS, n.d.). According to Michel and Rosen (2011), "the most significant reaction" to this overseas "is the sense that FATCA is another example of strong-armed American law enforcement imposing its will on other countries without their consent", particularly as the IGAs do not require U.S.-based financial institutions to share information with other states in turn (p. 711). Nonetheless, FATCA established a basis for AEOI across the globe (Sadiq & Sawyer, 2016).

In light of the above, unilateral agreements are not preferred because they promote the one-sided sharing of information.

b) Bilateral Agreements for the EOI

Unlike unilateral agreements, bilateral agreements allow for the sharing of information between two states (OECD, 1998). This reciprocal sharing of data promotes EOI and tax transparency (Cockfield, 2017).

In order to promote EOI across the globe, the OECD (2002) developed the *Model agreement on the exchange of information in tax matters (Model TIEA)*, later supplemented with the model protocol (OECD, 2015). This provides guidance on how to draft EOI agreements between two states. A number of countries have signed TIEAs: Australia has signed a TIEA with the Netherlands Antilles, for example, and the United Kingdom has signed a TIEA with the British Virgin Islands. The progress made in the monitoring and implementation of the exchange of information agreements is summarised in the tenth anniversary report (OECD, 2019a) of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes.

c) Multilateral Agreements for EOI

Multilateral agreements have promoted EOI by providing states with guidance on how to draft and implement EOI provisions between multiple jurisdictions (OECD, 2014). The obligation on banks to share information across multiple jurisdictions was first introduced in EU Council Directive 2003/48/EC on the taxation of savings income (Beer et al., 2019). Later, this directive was replaced with Council Directive 2014/107/EU which allows AEOI to be implemented in accordance with the OECD's Common Reporting Standard (CRS) (Beer et al. 2019).[5]

The CRS provide guidance about the standard of AEOI in order to achieve consistency across states, including detailing what they may consider as reporting institutions, reportable accounts, and reportable information (OECD, 2014). Financial institutions that are required to report information include custodial and depository institutions, while reportable accounts comprise accounts held by reportable individuals and entities, whether passive or active. Reportable financial information includes, but is not limited to, all types of investment income.

[5] https://www.oecd.org/tax/automatic-exchange/common-reporting-standard/

4. TYPES OF EOI

The predominant types of EOI are:

a) EOIR

EOIR occurs when two or more countries agree to exchange information upon request. Where a signatory to the agreement needs information that is available in the other contracting state, the former may ask the latter to share the information (OECD, 2017). The information requested must relate to a specific case: the request must not be a fishing expedition (OECD, 2017).

This method is viable for developing countries with low technical expertise and technology. However, it is inefficient due to the bureaucracy involved (Jaiswal & Biyani, 2017). In addition, the need for the information to be "foreseeably relevant" (OECD, 2002, p. 4) limits the potential benefits of this method. This is because "tax evasion schemes are, by their very design, intended to ensure that information is concealed from domestic tax authorities" (Beer et al., 2019, p. 7). Therefore, in most cases, it is challenging to determine the relevance of the information beforehand.

b) SEOI

States may agree to share tax information whenever they find it and deem it to be relevant (OECD, 2017). For instance, in 2018, Switzerland shared tax ruling reports relating to BEPS activities with partner states, such as France and Russia, through SEOI (Swissinfo.ch, 2018). This method enables states to obtain information that they were previously unaware of. However, it is undesirable due to its "irregular nature" (Jaiswal & Biyani, 2017, p. 9).

c) AEOI

According to the OECD (2012a), "the AEOI is the systematic and periodic transmission of bulk taxpayer information from the source country to the residence country concerning various categories of income (e.g. dividends, royalties, salaries, pensions, etc.) (p. 7). AEOI is preferred to EOIR and SEOI due to its consistency and efficiency (Jaiswal & Biyani, 2017). It has been implemented worldwide in both developed and developing countries, such as Switzerland, the United Kingdom, South Africa, and Ghana.

5. BIG DATA AND AEOI

The OECD (2012a) summarised the AEOI process. Taxpayers provide information about their identity to a financial institution. The financial institution reports the non-resident taxpayer's identity and payments to the authorities. The authorities then merge the big data according to the country of residence. Collosa (2021) describes big data as large amounts of reliable information from varied sources. In the context of AEOI, big data includes taxpayers' names and the tax identification numbers assigned to them by their state of residence, as well as their temporary and permanent addresses. Furthermore, it includes the amount of income earned, tax refunds, and details of the payer in the source state (OECD, 2012a).

Having collected the data, the source country transmits it to the residence country. However, it must first encrypt it in order to avoid data leakage (OECD, 2012a). The residence country decrypts the data and feeds it into "an automatic or manual matching process" (OECD, 2012a, p.10). This allows the residence country to identify individual taxpayers and match any information received about them to their existing records (OECD, 2012a). Machine learning technology can be utilised to reveal patterns that would otherwise be obscured (Cockfield, 2019). The analytical reports compiled from the matching processes enable the residence country to determine the tax liability of its residents arising from their worldwide income or assets, as well as the accuracy of their income declarations (OECD, 2012a). Based on these reports, the residence country "may commence compliance action against a taxpayer that may not have complied with reporting obligations, or make a specific request" to the source country for "additional information" (OECD, 2012a, p. 10).

The use of big data and machine learning in tax administration has contributed to the efficiency of revenue authorities across the globe. In the United States, utilisation of machine learning technology has improved the IRS's efficiency and increased revenue collection (Federico & Thompson, 2019). For instance, between 2012 and 2014, the IRS retrieved $25 million in fraudulent refunds in Georgia through big data computer analysis (Bourquard & Kirsch, 2014).

While the use of machine learning has increased revenue collection, the process of establishing the algorithms often reinforces the biases of the actors involved (Löfgren & Webster, 2020). For example, biases related to race raise concerns with regard to algorithmic fairness (Löfgren & Webster, 2020; Politou et al., 2019). Unfortunately, according to the Information Commissioner's Office (2017) "the autonomous and opaque nature of machine learning algorithms can mean that decisions based on their output may only be identified as having been discriminatory afterwards – when the effects have already been felt by the people discriminated against" (p. 52). However, incorporating accepted principles such as equality within the writing software may minimise the inclusion of biases (Binns, 2018).

6. THE BENEFITS OF EOI

Countries, especially developing ones, have lost revenue to the BEPS schemes utilised by some multinational enterprises which rely on sophisticated technology, opacity, and lack of cooperation among countries to conceal information that would result in those enterprises paying taxes in the source countries. However, with EOI, some countries have obtained substantial information that has facilitated investigative audits into the dealings of these multinational enterprises and enabled them to collect the revenue that had been lost to BEPS schemes.

According to the OECD (2021b), between 2009 and 2020, EOI "enabled African countries to identify over EUR 1.2 billion of additional revenues (tax, interest and penalties) through offshore tax investigations" (p. 48). For example, Burkina Faso, Cameroon, Kenya, Senegal, South Africa, Uganda, Togo, and Tunisia identified more than EUR 196 million of additional revenue as a result of EOIR (OECD, 2021b). In 2021, Kenya identified more than EUR 8.1 million, Tunisia more than EUR 28.1 million, and Uganda about EUR 1 million in revenue as a result of requests shared through EOIR (OECD, 2022b).

Developed countries have also benefited from the EOI, which has compelled taxpayers to participate in voluntary disclosure schemes that have increased revenue collections. Between

2016 and 2019, 260, 592 taxpayers in Australia utilised the country's voluntary disclosure scheme to report overseas income, resulting in the identification of EUR 620 million in additional liabilities (OECD, 2019a).

Although EOI has promoted transparency and resulted in an increase in revenue collection, the existence of BEPS schemes has persisted across the globe. For developing countries, this is partly due to the high administration costs involved in establishing systems that can facilitate AEOI and ensure the secure transmission of information to and from these countries (Sadiq & Sawyer, 2016). However, with assistance and funding from developed countries, developing states such as Ghana and South Africa have now commenced AEOI. In Kenya, the Multilateral Competent Authority Agreement for the exchange of country-by-country reports (CbC MCAA) was signed in September 2022 (OECD, 2022c). Consequently, the Kenya Revenue Authority can now request country-by-country reports from cooperative jurisdictions under the CbC MCAA (Ernest & Young Global, 2022). In time, most developing countries will be able to participate in, and benefit from, AEOI.

The benefits of cross-border secrecy have also contributed the continued existence of BEPS schemes. Tax haven secrecy is not detested: countries only hate it when they lose revenue. Cockfield (2016) noted that capital importing countries "benefit from the inward portfolio and direct investments by non-residents that are encouraged by tax haven secrecy; the trillions of dollars of investment monies may, for instance, be used to fund new business ventures that promote economic activities and lead to higher employment" within those countries (p. 515). Consequently, this disincentive, and other political incentives, have deterred the total eradication of tax haven secrecy in the world (Cockfield, 2016). Therefore, the end of BEPS is far away, even with the implementation of EOI policies and legislation.

7. EOI AND THE RIGHTS OF TAXPAYERS

There have been considerable changes in the international tax landscape over the last few years. However, the speed at which the EOI standard has changed has been surprising. At the outset, it was illegitimate for governments to use the powers vested in them by the people to assist other governments in the collection of taxes. Therefore, tax authorities had to seek special authorisation and EOI was still often restricted for fear of breaching the duty of confidentiality, especially in cases where no double taxation avoidance agreement (DTAA) was in place. When, in 2002, the TIEA was introduced, this new form of bilateral tax convention provided the legal basis for sharing of tax information. Hence, until 2013, the most common form of EOI was the on-request model (Baker, 2013).

In 2013, there was a complete shift in the standard of EOI, as states agreed to exchange information automatically—a project encouraged by the OECD. In the early 1990s, the OECD started to work to reduce detrimental tax competition as part of its objective to eliminate harmful tax practices. However, after 2001, the focus shifted to transparency and EOI, which lead to the introduction of AEOI (Baker, 2013).

EOI has taken place for many years but AEOI was new. There had been considerable pressure on states from international organisations like the OECD to establish rules that made AEOI possible. AEOI was also made possible by enhancements in technology and political ambitions to counter tax evasion. However, AEOI appears to have been implemented in a rush, with little consideration having been given to how the new policies and framework could impact

taxpayers' rights. Pistone (2013) rightly highlighted that the rights of the taxpayers would be the "most ignored aspect of global tax law" (p. 217).

Indeed, in order to satisfy the compliance standards imposed by the OECD, many countries were forced to amend their local legislation and, in doing so, disregarded valuable protection of rights that were afforded to taxpayers. For example, in 2013, the Netherlands introduced a bill to amend its local legislation relating to international assistance in tax matters and abolished the notification requirement to taxpayers prior to any EOI, which subsequently also meant that the taxpayer could no longer legally challenge the tax authority's decision to grant information access to another state (Neve, 2017). Hence, not only did the changes made in the international tax landscape not include appropriate protection for taxpayers, they also indirectly contributed to the worsening of the taxpayer's position by restricting their rights.

Baker and Pistone (2015) have pointed out that it was highly scandalous that, due to international pressures on states, existing effective protection of taxpayers' rights was removed and no alternative was provided. In the context of big data and AEOI, we are concerned with four fundamental rights: the right to confidentiality, the right to privacy, the right to data protection, and the right to have an identity. Each of these is considered below:

a) The Right to Confidentiality

The right to confidentiality requires that a person's information is not disclosed to an unrelated third party, whether intentionally or by accident. In respect of EOI, taxpayers should have confidence that any information exchanged is only disclosed or used in accordance with the agreement/s which form the basis of the exchange. The tax treaties that relate to AEOI contain provisions that concern tax confidentiality and the obligation for the parties involved to keep any information exchanged confidential. If there is a data breach or necessary safeguards are not implemented by one party, the other could suspend the EOI. The expectation is that the requesting state should adopt the same level of confidentiality exercised by the other state.

For example, in 2019, the Bulgarian tax agency's security systems were breached and the data leak exposed information about the financial accounts of five million Bulgarian and foreign taxpayers (Krasimirov & Tsolova, 2019). This caused countries like Switzerland to stop exchanging information with Bulgaria (OECD, 2019c).

It is the responsibility of the tax administrations to ensure that EOI occurs with sufficient safeguards in place to ensure that the information processed and exchanged is kept confidential. If sufficient protection is not equally in place in both states involved, EOI should be restricted. However, restrictions should not occur simply as a consequence of proven failures, but should be considered by states before any information exchanges take place. If a particular country cannot afford the same level of protection to taxpayers' information as the home state, the home country should not participate in any EOI, as it should risk a breach of the confidentiality of its taxpayers' information.

b) The Right to Privacy

The right to privacy means the right to have one's affairs kept private. It is one of our fundamental rights, i.e. a right afforded by the constitution in certain countries or by the United

Nations Declaration of Human Rights[6], which implies that it is an essential component of the functioning of a democratic society. According to Kalyon (2022), "the right to privacy is an indispensable right for all taxpayers because a tax authority frequently has information which is pertaining to one's private life" (p. 108). Therefore, it is of extreme importance that, when such powers are exercised, the process is conducted with care and within the limits of what is permitted by law. For example, taxpayers should be notified about any tax inspections to be undertaken and these inspections should be carried out by tax officials, rather than third parties.

The right to privacy encompasses the right to be secure in one's house and the right to be protected against unreasonable search and seizures. "Unreasonable search" means that a person is protected against any search without probable cause to believe that evidence of a crime is present. However, what is happening with EOI and, more specifically, with AEOI is that information is being transferred without there being a need for an investigation and without any probable cause to believe that a crime or tax evasion has taken place. Taxpayers are not even notified that their details are being shared across borders.

c) The Right to Data Protection

When it comes to the right to data protection, the TIEA effectively makes provision for two conditions for the EOI to happen. It requires any request to be specific and justified. A request should be specific in that it must relate to a particular taxpayer and a specified time period, the nature and form in which the information is requested should be mentioned, and the reason for the request must be provided. A request should be justified in that the information requested must be necessary for or "foreseeably relevant" (OECD, 2002, p.4) to the requesting party. Therefore, TIEAs (and DTAAs) provide for the EOI, but under very precise conditions.

AEOI, on the other hand, comes with no rules or limitations. The information is exchanged on a recurring basis and includes data relating to all relevant taxpayers. For example, FATCA is applicable to all U.S. citizens. AEOI does not solely occur as part of an investigation by the IRS or in relation to a suspected case of tax crime. Instead, all financial institutions are required to disclose information about U.S. citizens on a yearly basis. With AEOI, there is also no clarity regarding data retention requirements. No details are provided about how long the information shared can be stored for or the circumstances in which it will be destroyed.

d) The Right to an Identity

Big data is all about predictions and forecasts, and there is a risk that a digital identity will be created for each data subject, i.e. taxpayer. There may be an over-reliance on big data analytics such that taxpayers themselves are no longer considered. This means that there is a risk that they could be discriminated against without being given the chance to react. With big data, we are often unaware of the information that is collected about us and how, or by whom, it is collected. As technology allows for data collection in a more invasive ways, it is therefore important for the law to be updated in order to ensure that taxpayers know what types of personal information are being collected and how this data is being used or processed.

[6] Article 8 of the Universal Declaration of Human Rights, which was proclaimed at the UN's General Assembly on 10 December, 1948 (United Nations, n.d.).

8. THE RISKS FOR TAXPAYERS

Different states have different views about how taxpayers' information should be treated. Some countries, such as Norway and Sweden, publish taxpayers' returns on their online portals, which are available to the public (Stiglitz & Pieth, 2016). Their view is that if a person has made an honest declaration about their earnings, there should be nothing to hide (Stiglitz & Pieth, 2016). Other countries, on the other hand, might feel outraged by this because, for them, taxpayers' information should remain confidential (Stiglitz & Pieth, 2016). Of course, when compared to public disclosure, EOI does not erode taxpayers' privacy, as information shared with other countries should normally be kept confidential.

Indeed, EOI does not lead to the public disclosure of information. However, it results in an increase in the volume and intensity of the information being exchanged, especially via AEOI, where large volumes of data are shared and stored in various countries, which automatically increases the risk of this information being used in an unlawful manner (Brauner, 2013). The more people that have access to the information, the greater the risk that this information will be leaked, and when there is a lack of safeguards in place, it accentuates this problem.

a) The Risk of Taxpayers' Information Being Hacked

When information collected and stored by tax administrations is not effectively protected, hackers could gain access to it. This is not only an issue for countries with poor technological infrastructures or tax administrations. Tax administrations in countries such as the United States, the United Kingdom, and Japan have faced massive taxpayer data losses to carelessness or because there is inadequate protection against hackers in place.

When information is exchanged, it is almost impossible to ascertain whether it is being processed on a secure network or not. Tax administrations have no control over the networks used by their counterparts in other countries and are unable to monitor their cybersecurity efforts. Every year, the interception of tax information results in hundreds of thousands of identity theft cases being reported. In the United States, several cases of tax fraud have been reported and astounding amounts of money were claimed in fraudulent tax refunds as a result of a cyberattack on the IRS (Smith, 2015).

b) The Risk that Confidential Information will be Leaked to the Public

When taxpayers' information is leaked into the public domain, it can cause multiple problems. The information disclosed by taxpayers to tax administrators in their specific jurisdictions is often highly sensitive and may concern their income, net assets, and net worth. They may also need to disclose their expenditure patterns, which can reveal significant details about their lifestyles, religions, or even political affiliations. There is no doubt that taxpayers' information is "among the most sensitive forms of personal information" (Cockfield, 2016, p. 503).

If unauthorised people get access to this information, it may be dangerous for a taxpayer—for example, wealthy people may become targets for criminals, particularly in countries with high crime rates. In addition, the information may be used for the benefit of others and to the detriment of taxpayers. One example of this is the Satakunnan Markkinapörssi Oy and Satamedia Oy case, in which the personal information of more than 1.2 million Finnish taxpayers was published in the *Veropörssi* newspaper and a company was created that enabled

anyone who wished to obtain information about a person to send that person's name to the company in a text message and receive their tax information in return. This practice was challenged in court because it was considered to infringe people's right to a private life.

When confidential information is leaked, its authenticity and validity is often not questioned or verified. However, as Sangar and Blanco (n.d.) note, "the consequences of such leaks can be extremely severe, ranging from reputational loss to plummeting stock price or revenue, to lawsuits and significant regulatory fines being imposed". If we examine the Panama Papers leak, for example, around 11.5 million confidential records said to relate to thousands of offshore accounts used to evade taxes or launder money were revealed (Australian Taxation Office [ATO], 2021). This caused havoc in the international media and large enterprises, political figures, and high-net-worth individuals were accused of hiding their wealth in tax havens. However, investigations by tax administrators later found that most of the accused were compliant and had already declared their tax affairs in their home countries (ATO, 2021).

Following the publication of the Panama Papers by the International Consortium of Investigative Journalists (ICIJ), the ATO (2021) published a declaration stating that using offshore structures was not illegal and that, of the 1,400 Australians identified in the Panama Papers, the majority had already approached the ATO in order to make declarations about their tax positions. Unfortunately, however, when the international media alleges that someone has been involved in criminal activities, it can have a damaging and long-lasting impact on that person's reputation, even if the allegations are ill-founded. It is of extreme importance, therefore, that confidential information is kept secure.

c) The Risk that False Information will be Disclosed for the Sake of Being Compliant

AEOI is subject to certain compliance requirements with reporting deadlines, and failure to adhere to these can either result in states incurring penalties or being labelled as non-compliant which can, in turn, result in other countries refusing to exchange information with them. For example, failure to comply with FATCA reporting could result in a 30 per cent penalty which would be withheld from any U.S.-sourced income. Countries not adhering to the CRS are placed on the "EU list of non-cooperative jurisdictions for tax purposes" (see Council of the EU and the European Council, 2022) and states are encouraged to apply defensive measures, which may include the non-deductibility of expenses incurred in the listed jurisdictions or withholding tax being imposed in relation to exemptions and refunds.

Pressure to comply with and meet filing obligations may lead to a state exchanging erroneous or unverified information with another country's tax authorities. A study conducted by the Aberdeen Group and Sovos Compliance (2016) into FATCA reporting indicated that more than 55% of reports were incomplete and inaccurate. Therefore, it appears that financial institutions reported information that had not been verified, simply in order to be regarded as compliant for FATCA filing purposes.

Another striking example is that of Aloe Vera of America, Inc. v. United States, 699 F.3d 1153 (2012) (*Aloe Vera Case*), in which the IRS disclosed tax information to the Japanese National Tax Administration (JNTA) during a joint investigation. The EOI was provided under the U.S.-Japan DTAA but, when submitting information, the IRS wrongly declared unreported income that was not supported by any investigation and had only been estimated by IRS employees. On receipt of the information, the JNTA claimed the undeclared taxes from the taxpayer, who

had no idea of the basis on which the JNTA had raised the assessment. The JNTA even leaked the information to the local news media, which caused prejudice against the taxpayer and had a negative impact on the reputation of the firm in the Japanese market, as well as causing an estimated corporate loss of more than $47 million (Wöhrer, 2018). All of this occurred simply because the IRS employees felt compelled to complete the EOI within the requested timeframe even though their own investigation was incomplete.

9. RECOMMENDATIONS

While AEOI has been welcomed by tax administrators around the world as an effective tool with which to curb tax evasion, concerns have been raised in respect of the protection of taxpayers' data. It is therefore important that AEOI processes are carried out in a harmonised way and take the rights of the taxpayers into consideration. Therefore, we make the following recommendations to enhance the existing AEOI provisions:

a) Consultation with Taxpayers Should Become a Standard Part of the AEOI Process

The priority of tax administrators should not be to amass taxpayers' information in bulk but, rather, to ensure that the information collected and exchanged is accurate, complete, and of sufficient quality. In order to eliminate the risk of erroneous disclosures being made and ensure that private information, such as trade secrets, is not exchanged, it is imperative that the taxpayers are given the chance to review their information prior to it being transferred to other tax authorities. Taxpayers should be allowed to verify and/or correct their information prior to processing or before it is transferred to another country. Accordingly, we recommend the modification of the AEOI process, such that consultation with the taxpayers becomes part of the normal procedure. The only exception to this rule should be where there are reasonable grounds to believe that notifying the taxpayer could prejudice an investigation.

b) Common IT Infrastructures Should be Utilised

In March 2022, the OECD released details of the report formats required for AEOI, together with rules regarding what needs to be included and a user guide that explains how the reporting should be carried out (OECD, 2022a). Expectations have therefore been set, but nothing has been done to assess the readiness of states to operate reliable digital platforms.

In reality, countries differ in terms of their available resources, information processing and storing capacities, and priorities. For instance, some countries are still struggling to establish reliable online portals for their local tax administrations and some still rely on manual filing processes, as they do not have the expertise or the resources to implement changes to their IT infrastructures. However, due to international pressure, these countries may have given their consent to participate in the AEOI, which requires them to process and submit large amounts of information electronically on a recurring basis. It is questionable whether they will be able to securely and accurately process and store taxpayers' information with their current resources and expertise.

As countries are on an unequal footing, it also implies that they will not all benefit from EOI in the same manner. For example, despite having signed up for EOI, very few African countries are actually collecting tax information, even though it is estimated that Africa loses more than

USD 84 billion annually due to international tax evasion ("Africa loses more than $84bn in illicit financial flows annually", 2022). The problem not only lies with the challenging technological architecture within these countries, but also with their limited administrative capacities, which arise as a result of a lack of trained personnel and a lack of willingness on behalf of their political leaders.

A possible solution to this problem could, therefore, lie in the form of assistance from other developed nations or the OECD's member states, with a common IT platform, developed by experts from high-tech countries, being used by all countries participating in AEOI. This would provide a level playing field for all participating members, which would not only improve the effectiveness of the information exchange but also help to reassure taxpayers that their information is being securely processed and stored whenever it is exchanged.

c) Rules Should be Established with Taxpayers' Representatives

The reality is that taxpayers' welfare has never been considered. The focus was only on how tax authorities could improve their work in order to reach their objective of eliminating tax evasion. This is because the decisions were always taken by representatives of the states, whose aim was to collect the maximum amount of tax revenue. There was no person or institution that would see to it that the rights of taxpayers were not infringed and that taxpayers would not be made worse off by the changes occurring within the international tax landscape. Accordingly, we propose that taxpayers' representatives should be given places at the table and participate in all decision-making matters that directly and indirectly concern taxpayers.

10. CONCLUSION

The focus of international organisations during the last decade has been on making the automatic exchange of taxpayers' information a reality, but the position of the taxpayers whose information is being exchanged has not been considered. Countries have been under pressure to amend their laws to allow for AEOI, but have not really considered its impact on taxpayers or how it would infringe taxpayers' rights. An increase in the scope of AEOI and the use of big data should be accompanied by an improvement in the protection of taxpayers' rights to ensure balance in EOI procedures. The proposals made within this report focus on the achievement of a unified tax system, where the need to combat tax evasion is carried out with the involvement of taxpayers and without depriving them of their fundamental rights.

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IMPLICATIONS OF UMBRELLA COMPANIES FOR TAX ADMINISTRATION

Chartered Institute of Taxation[1]

1. INTRODUCTION

Umbrella companies play an increasingly important role in the U.K. labour market. They permit employment businesses (temporary work agencies) to outsource their pay, employment rights, and tax functions to them (albeit at a cost to the agency and, often, the worker). It appears that the recent rapid expansion in the number of umbrella companies has created a concerning number of non-compliant operators. Two forms of tax non-compliance are observed:

- tax evasion, through the use of mini-umbrella companies (MUCs)[2]; and
- tax avoidance, through the use of disguised remuneration (DR) schemes.

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In response, the government needs to take action to protect the rights of workers and protect exchequer revenues. This note focuses on these behaviours but also comments briefly on the role of umbrella companies and the information that should be conveyed to workers.

2. THE ROLE OF UMBRELLA COMPANIES IN THE LABOUR MARKET

While umbrella companies are not currently defined in U.K. legislation, their place in the temporary work supply chain is well defined—an umbrella company is a labour market intermediary within a supply chain that sits below the end client (the ultimate recipient of the worker's services) and the temporary work agency (or agencies) supplying the worker to the end client, and just above the worker that is performing the services for the end client. Similarly, the role of umbrella companies is also well defined—they take on the obligations relating to employment rights and employment taxes that either the end client (as an employer) or the temporary work agency (as an employment business) would be responsible for had the worker been engaged by either of those parties directly.

The U.K. government has already committed to expanding "state enforcement to umbrella companies by bringing these companies within scope of the new enforcement body [the Employment Agency Standards Inspectorate]".[3] This is to be expected given the increasing role that umbrella companies play in the temporary labour market. It is important that this body not only regulates employment rights for workers engaged by umbrella companies, but also assists His Majesty's Revenue and Customs (HMRC) in tackling tax non-compliance by such businesses.

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[1] This comment is adapted by Gareth D. Myles from the full text of "Umbrella Company Market", the Chartered Institute of Taxation (CIOT)'s response (https://ciotmktgprodeun.azureedge.net/ref885) to His Majesty's Treasury's call for evidence on the umbrella company market (https://www.gov.uk/government/consultations/call-for-evidence-umbrella-company-market).

[2] Mini umbrella company fraud. https://www.gov.uk/guidance/mini-umbrella-company-fraud

[3] Ibid.