



Extract from the report to the
Public Accounts Committee on
SKAT's work to increase small
and medium-sized companies'
compliance with the tax system

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1. Introduction and conclusion

1.1. Purpose and conclusion

1. This report concerns SKAT's (the Danish Central Tax Administration) work to increase small and medium-sized companies' compliance with the tax system. SKAT has estimated the tax gap for small and medium-sized companies to be DKK 8.8 billion in 2014, which is 78 per cent of the total tax gap of DKK 11 billion, as defined in the Danish Finance Act. For a number of years now, small and medium-sized companies have increasingly submitted incorrect tax returns.

The purpose of SKAT's compliance work is to ensure that small and medium-sized companies that do not comply with the regulations pay the correct taxes and dues. SKAT is aiming to organize its compliance work in a manner that will have the largest possible impact on the tax gap. In addition to specific compliance activities, SKAT is also providing guidance and employing other measures to reduce the tax gap and increase compliance. These measures may include law amendments and adjustments of systems in order to reduce tax evasion and the level of errors.

2. The purpose of the study is to assess whether SKAT is tackling the compliance of small and medium-sized companies in a satisfactory manner. The report answers the following questions:

- Is SKAT's work to increase the tax compliance of small and medium-sized companies organised in a satisfactory manner?
- Has SKAT's compliance work had a satisfactory impact on the tax compliance of small and medium-sized companies?

*The **tax gap** is the difference between the amount appearing from the tax return and the amount that should have been reported (the tax potential). The tax gap includes both taxpayer errors and deliberate tax evasion. The target defined for the tax gap in the Finance Act is composed of the estimated tax gap and arrears.*

CONCLUSION

It is Rigsrevisionen's overall assessment that the effort made by SKAT to increase the tax compliance of small and medium-sized companies is not satisfactory.

SKAT has estimated the tax gap for small and medium-sized companies to be DKK 8.8 billion in 2014. According to SKAT's most recent measurement, the tax compliance of small and medium-sized companies has declined and there are errors in more than half of the tax returns submitted by these companies. To this should be added that the companies perceive the risk of detection as being significantly lower than it was in 2012. These facts may have a negative impact on the tax gap in the longer term and it is therefore important that SKAT's compliance work is organised in a way that addresses this development.

The organisation of SKAT's compliance activities in 2014 and 2015 is not considered satisfactory by Rigsrevisionen.

The Danish Finance Act includes a performance target for the tax gap of 2 per cent of the tax potential, and SKAT's compliance work is to contribute to achieving this target. SKAT met the 2 per cent target in 2012, 2013 and 2014. However, the target set in the Finance Act applies to SKAT's activities to generate additional tax revenue, in general, and SKAT has not defined specific internal operational sub-targets for its compliance work. In the opinion of Rigsrevisionen, the tax gap target should be supplemented with sub-targets relevant for managing SKAT's compliance work.

SKAT's compliance activities are implemented in so-called compliance projects, which – in accordance with SKAT's procedures – are selected systematically based on, for instance, SKAT's compliance studies and an overriding principle of cost efficiency. It is, however, not possible to document that the final prioritization of the projects is based on the criteria defined by SKAT. SKAT has a general perception of the extent to which the compliance projects address the tax and VAT gap, but is unable to determine the extent to which the control also covers more specific taxes and dues that small and medium-sized companies are required to settle with SKAT.

Rigsrevisionen agrees with SKAT that cost efficiency is a good starting point for selecting compliance projects, but it cannot stand alone. There are approximately 670,000 small and medium-sized companies in Denmark and SKAT is planning to check well over 3 per cent of them in the course of 2015. Companies are selected for compliance checks based on an assessment of the risk associated with each individual segment, but all companies in the respective segments should be at risk of being selected for a compliance check. It is Rigsrevisionen's assessment that the risk of being selected for control is one among several factors that may increase the risk of detection, motivate the companies to submit correct tax returns and reduce the risk of tax evasion. The risk of detection should play a larger role in SKAT's planning of the control and SKAT should actively consider the extent to which, and how, the risk of detection can be increased.

Rigsrevisionen's review of the six compliance projects completed in 2014 and 2015 shows that SKAT for three of the projects has estimated the additional tax revenue generated for the state. Rigsrevisionen finds that SKAT – in accordance with its internal procedures – should estimate the tax revenue generated for all completed projects to facilitate cost benefit analyses. The review also shows that the projects have led to large adjustments of the taxable income of the companies that have been checked. After having completed the projects, SKAT has estimated that none of the six projects has had a lasting impact on the tax gap, nor have they led to a general improvement in the level of compliance among the companies. Against this backdrop, Rigsrevisionen has concluded that the effect of SKAT's compliance work has not been satisfactory.

A **segment** represents a proportion of the tax gap and the individual elements in the segment shares certain characteristics. A segment can be made up of a group of taxpayers or a specific tax-related theme. SKAT has defined 22 segments as targets for its compliance work.