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Extract from Rigsrevisionen's report on
**the Danish customs and tax authorities' (SKAT) control
of claims for VAT refunds**
submitted to the Public Accounts Committee



1849
147.281
237
1976
114.6
22.480
908

1. Introduction and conclusion

1.1. PURPOSE AND CONCLUSION

1. This report concerns the Danish customs and tax authorities' (SKAT) control of claims for VAT refunds (negative VAT payments) before these are paid to the taxpayers. The Ministry of Taxation has overall responsibility for SKAT's effective and efficient administration of taxes, including VAT refunds. SKAT administers and enforces the tax laws in respect to citizens and businesses, and is legally authorised to check issues relating to VAT and make decisions on refunds.

SKAT paid DKK 235 billion to taxpayers reclaiming negative VAT in 2015, which corresponds to just under 25 per cent of the government's total revenue from taxes and fees. VAT refunds have increased from 139.9 billion in 2009 to DKK 235 billion in 2015, corresponding to a growth of approximately 68 per cent. The considerable financial amounts involved and the fact that VAT is a high-risk area, has prompted Rigsrevisionen to initiate the study.

2. Rigsrevisionen has limited its study to include only the control exercised by SKAT before payment of VAT refunds. The Ministry of Taxation has informed Rigsrevisionen that the ministry is of the opinion that the study cannot be limited to address only SKAT's control of refunds, since issues relating to VAT refunds are checked by other sections in SKAT. However, these checks are mainly made after payment of the refunds. It is Rigsrevisionen's assessment that the study can be limited to the department for control of refunds, since the Danish act on government accounting includes specific requirements relating to the control of payments. Moreover, it is Rigsrevisionen's assessment that the materiality and risk of the area is such that it may be difficult to recover refunds that have already been transferred to the taxpayers.

The Ministry of Taxation has also made it clear that the report conveys the perception that Rigsrevisionen's conclusions and sub-conclusions apply to SKAT's administration of VAT in general, in spite of the fact that the conclusions concern only the control of VAT refunds. Rigsrevisionen would therefore like to emphasise that any references made in the report to SKAT's control of VAT refunds concern only the control that takes place *prior* to the actual payment of the refunds.

NEGATIVE VAT PAYMENTS

The difference between outgoing VAT and incoming VAT (the VAT liability) can be both positive and negative. If it is negative, the taxpayer can request a refund of the balance.

3. On 30 November 2016, the Ministry of Taxation published the outcome of a service check of the VAT area that had been prepared by the ministry's internal group audit function. The report addresses more aspects of the VAT area than Rigsrevisionen's report, which is limited to control of VAT refunds. Rigsrevisionen received a draft version of the report on 28 September 2016. We were informed by the ministry that the report was to be considered a work in progress and would therefore be subject to change. We were also informed that the preliminary report should be treated as confidential and that the results presented in the report were not to be published. Rigsrevisionen received the final version of the report on the day when the outcome of the service check was published, and we have therefore not had opportunity to include the results of the report in our study.

It appears from the report by the ministry's group audit function that the ministry's service check of the VAT area was not intended to uncover incidents of fraud or errors in the accounts. However, it is stated in the report: "On the present basis, the Ministry of Taxation's internal group audit function has not found evidence that has led it to assume that VAT returns are exposed to systematic fraud of the character and extent that affected refunds of dividend withholding tax. With SKAT's risk assessment and reporting procedures as point of departure, we [the Ministry of Taxation's internal group audit function] cannot dismiss the existence of significant gaps in the total VAT revenue".

It is Rigsrevisionen's immediate assessment that the results presented in the report by the ministry's internal group audit function are, in all materiality, consistent with the observations and conclusions presented in this report.

4. The purpose of Rigsrevisionen's study is to assess whether the Ministry of taxation has ensured adequate control of VAT refunds. The report answers the following questions:

- Has SKAT *organised* the control of VAT refunds before payment to the taxpayers in a satisfactory manner?
- Is SKAT exercising a satisfactory *level of control* of VAT refunds before payment to the taxpayers?

CONCLUSION

The Ministry of Taxation has not ensured that SKAT exercises satisfactory control of VAT refunds before payment to the taxpayers. In 2015, VAT refunds amounted to DKK 235 billion distributed on 317,643 VAT returns, of which just under 2 per cent were checked. Rigsrevisionen finds that the Ministry of Taxation should take steps to strengthen the control as soon as possible to minimise the risk of unlawful refunds.

The Ministry of Taxation does not have any analyses that adequately explain the increase in VAT refunds from DKK 139.9 million in 2009 to DKK 235 million in 2015, corresponding to a growth of 68 per cent. The ministry has informed Rigsrevisionen that changes in the VAT export scheme are a significant driver behind the increase in VAT refunds, and that the development in negative VAT largely follows the development in positive VAT. Rigsrevisionen finds that the Ministry of Taxation should be able to account for the causes of the development in negative VAT, since even small percentage variations – if caused by errors – can lead to great losses for the government.

SKAT has not organised its control in a satisfactory manner. SKAT does not have to the necessary analysis results and knowledge that would allow it to organise its control based on materiality and risk. In 2015, the average value of a VAT return was DKK 740,000. No formalised procedures for pre-assessments are available, and it is left to the individual members of staff working with pre-assessments to determine if a VAT return can be approved for payment. Moreover, each member of staff had in 2015 on average approximately three minutes to assess whether a VAT return should be approved for payment or transferred to further control. Rigsrevisionen finds that the organisation of the pre-assessments entails a risk that VAT returns are not selected for control based on an assessment of materiality and risk. To this should be added that only few of the VAT returns that are initially selected for control, are being checked. The examination also showed that SKAT operates with a threshold of DKK 10,000. This means that SKAT pays refunds of approximately DKK 0.5 billion annually without prior control. Rigsrevisionen finds that the probability of being selected for control should comprise all VAT returns received.

It is Rigsrevisionen's assessment that SKAT's control of VAT refunds before payment to the taxpayers is inadequate; SKAT's selection of VAT returns for control has not to the extent required been based on an assessment of materiality and risk. Rigsrevisionen's analyses show that SKAT has focused its control on small refund claims. Rigsrevisionen's examination also shows that despite the fact that SKAT knows that VAT returns submitted by newly registered businesses represent a greater risk, they are not checked more frequently than returns submitted by all businesses collectively. The examination also shows that VAT returns submitted by businesses that have previously been unable to provide documents for negative VAT, or whose accounts have been in disorder, are only to a limited extent exposed to a higher frequency of checking. To this should be added that SKAT has not adjusted the scope of its control activities to take into consideration peak periods. Consequently, the probability that a VAT return will be checked varies from one day to the next and is largely determined by the number of VAT returns received that particular day and not by the materiality and risk associated with the individual VAT return. It is also Rigsrevisionen's assessment that inadequate control of data entered online by the businesses entails a risk that material errors are not subsequently detected by SKAT's department for control of refunds.

NEWLY REGISTERED BUSINESSES

Newly registered businesses are in this report defined as businesses that have been VAT registered within the past two years.

SKAT has executed payments to businesses 4,000 times since August 2013, without the legal powers to do so. Payments have been executed following the businesses' adjustment of positive VAT liability balances on returns previously submitted. In the period August 2013 to October 2016, SKAT processed 3,988 positive VAT adjustments incorrectly. As a result, SKAT has, wrongfully, refunded approximately DKK 722 million to the taxpayers. It should be noted that this amount might also have been set off against the taxpayers' tax liabilities, if any. The consequence of this error is that businesses that should rightly pay VAT instead receive a VAT refund that is later collected by SKAT. All of these VAT return adjustments have been through SKAT's control of refunds, which, however, led to the suspension of only a few payments. The Ministry of Taxation has informed Rigsrevisionen that SKAT and the department of the Ministry of Taxation were not aware of this practice before Rigsrevisionen addressed the issue. The fact that a system error that leads to the execution of unauthorised payments and increases the risk of losses, can remain uncorrected for so long, indicates shortcomings in SKAT's administration. The Ministry of Taxation has informed Rigsrevisionen that it has implemented manual initiatives to prevent unlawful payment of VAT adjustments. The Ministry of Taxation has also stated that there are no immediate indications that the payments made in error are associated with fraud or arrears problems.