





# Measures of Tax Compliance Outcomes

A PRACTICAL GUIDE

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## *Foreword*

Recent reports commissioned by the Forum on Tax Administration (FTA) have recommended that revenue bodies strengthen their outcome measures. Revenue bodies face many difficulties in developing and implementing outcome measures. However considerable progress has been made towards the goal of using better outcome measures in practice.

This study is intended to provide practical guidance to revenue bodies wishing to enhance and enrich their existing measures with timely measures of compliance outcomes. The study shares experiences of what has worked for revenue bodies, what challenges have been faced and how they might be overcome.

The study was commissioned by the Forum on Tax Administration and sponsored by the Commissioner of the United Kingdom, Mr. Edward Troup. It has been prepared by a task group from Australia, Canada, Denmark, Japan, the Netherlands, New Zealand, Norway and the United Kingdom with support from the OECD Secretariat. The project has further benefited from input and feedback from the SME Compliance Sub-group, the Large Business Network, the FTA membership via a survey and the Tax Administration Research Centre (University of Exeter/Institute for Fiscal Studies).

### **The Forum on Tax Administration**

The Forum on Tax Administration (FTA) was created by the Committee on Fiscal Affairs in July 2002. Since then the FTA has grown to become a unique forum for co-operation between revenue bodies at Commissioner-level with participation from 46 countries. Our vision is to create a forum through which tax administrators can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world. The work programme of the Forum is decided and overseen by a Bureau comprised of commissioners from 12 revenue bodies. The FTA vision is to create a forum through which tax administrators can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world. This vision is underpinned by the FTA's key aim which is to help revenue bodies increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance.

The FTA is supported by a number of specialist sub-groups and networks to help carry out its mandate: The Taxpayer Services Sub-group, the SME Compliance Sub-group, the Large Business Network, and the High Net Worth Individuals Network, and the Offshore Compliance Network.

More information on the FTA, including details on products and publications, can be found at its dedicated website: [www.oecd.org/tax/fta](http://www.oecd.org/tax/fta)

The study is part of the OECD Tax Administration Information and Guidance Series, which extends across a range of areas of key interest to revenue bodies. National revenue bodies differ in a number of important ways, including in respect of their institutional legacies, the tax systems they administer, and the broader context they are part of. The series is therefore intended to inspire and inform revenue bodies rather than promote a standard approach to tax administration, which may be neither practical nor desirable.

Inquiries concerning this study should be directed to the International Co-operation and Tax Administration Division at the OECD Centre for Tax Policy and Administration.

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## Abbreviations and acronyms

<b>ATO</b>	Australian Taxation Office
<b>CRA</b>	Canada Revenue Agency
<b>EC</b>	European Commission
<b>FTA</b>	Forum on Tax Administration
<b>GST</b>	Goods and Services Tax
<b>HMRC</b>	Her Majesty Revenue and Customs (United Kingdom)
<b>IR</b>	Inland Revenue (New Zealand)
<b>IRS</b>	Internal Revenue Service (United States)
<b>IT</b>	Information technology
<b>NTCA</b>	Netherlands Tax and Customs Administration
<b>NTA</b>	National Tax Agency (Japan)
<b>NTA</b>	Norwegian Tax Administration
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>SKAT</b>	Danish Customs and Tax Administration
<b>SME</b>	Small and medium enterprises
<b>STA</b>	Swedish Tax Agency
<b>TADAT</b>	Tax Administration Diagnostic Assessment Tool
<b>TCF</b>	Tax Control Framework
<b>VAT</b>	Value Added Tax
<b>UK</b>	United Kingdom
<b>US</b>	United States



## Preface

Revenue bodies have always cared about tax compliance outcomes: collecting the right revenues, improving taxpayers’ voluntary compliance, and administering the tax system with integrity and confidence. As the world has changed, revenue bodies have evolved to deliver these outcomes. This evolution will continue as new technology increases the pace of change.

In the United Kingdom we have developed a “promote, prevent, respond” compliance approach in response to these changes. We will promote voluntary compliance by making it easier for taxpayers to get it right; prevent non-compliance by intervening at the point of transaction; and respond robustly to non-compliance by those who deliberately evade or avoid.

As our approach evolves we need to develop measures to demonstrate our successes and improve our performance. In recent years, measuring the effectiveness of innovative compliance interventions has been a challenge across the FTA.

This report does not prescribe a set solution because the development of measures is an ongoing process rather than a one-off effort. Instead, it builds on revenue bodies’ experiences, facilitated by the unique international forum the FTA provides, to offer practical guidance on principles, approaches and implementation for compliance measures. By sharing best practice across revenue bodies, we make faster and surer progress on this and other challenges.

I would like to thank everyone that has contributed to this report: the task group, the twenty FTA Member Countries who provided input, the Compliance Sub-group, the Large Business Network, and the Secretariat at the OECD who provided the task group with invaluable support.

Edward Troup  
Sponsoring Commissioner



## Executive summary

Revenue bodies want to measure tax compliance outcomes because outcomes are what they ultimately care about: that taxpayers are paying the right tax, that the right revenues are coming in and that the tax administration system has integrity so people have confidence in it. Everything that the revenue bodies do is about achieving these and other outcomes.

Traditionally revenue bodies have measured their success through a narrow range of output measures, such as audit yield, in the belief that these output measures would closely track the impact on outcomes, such as getting the right revenues in. However, while this was a reasonable belief when revenue bodies relied solely on audit approaches to achieve compliance outcomes it is not suitable for the breadth of work that revenue bodies currently undertake. When revenue bodies design their processes, write their guidance, educate and engage with taxpayers they are seeking to achieve compliance outcomes.

However measuring outcomes is not easy, and understanding what caused those outcomes is even more difficult. Using outcome measures in practice, with timely reporting of outcomes that can be used to appropriately inform decision making presents further challenges. And the changes that are required to embed outcome measurement are not just technical but also cultural.

Therefore revenue bodies need help to measure and report outcomes. This support should be based on the challenges revenue bodies have actually faced and what actually worked to overcome them. Therefore, through the Forum on Tax Administration common challenges have been identified and best practice in outcome measurement has been shared. This has developed into practical guidance that speaks about the challenges and solutions in the same language used everyday within revenue bodies. This report does not prescribe text book academic solutions as revenue bodies need to choose measures most relevant for them. Instead, this report provides guiding principles that directly address the common pitfalls; it shares examples of outcome measurement approaches that revenue bodies have found useful and how these approaches have been adapted to the circumstances of taxpayer segments. These measurement approaches build on revenue bodies' current measures in an evolutionary manner, and demonstrate the considerable progress that revenue bodies have already made with these difficult issues.

This report begins by explaining the key terms and context in an introductory chapter. The second chapter presents the guiding principles developed by this report from the experience of revenue bodies. The third, fourth and fifth chapters respectively present a stock take of practical approaches for measuring whether the right revenues are coming in, that taxpayers are complying voluntarily and that the community has confidence that tax is administered fairly. The sixth chapter discusses choosing the “right” set of outcome measures for a revenue body. The seventh chapter shares lessons learnt on implementing outcome measures. The report concludes with recommendations for measuring tax compliance outcomes.



## *Chapter 1*

### **Introduction**

*This chapter explains the purpose, context and scope of this report along with the key definitions and terms used throughout this report. It also sets out the business case and benefits of strengthening outcome measures.*

## Purpose of this report

The rationale for measuring outcomes is simple: outcomes are what revenue bodies' ultimately care about (such as improved compliance and sustained revenues). Therefore, successful performance is measured as improving outcomes. Measuring outputs (revenue bodies' deliverables) is a conventional way of assessing whether revenue bodies are on track to improve outcomes. However, output measures alone do not allow revenue bodies to tell whether their compliance strategies are effective at achieving their desired outcomes.

Revenue bodies have been working to strengthen their outcome measures for some time but have encountered practical difficulties in designing measures that provide timely indications of how successful they have been in terms of outcomes rather than outputs. Therefore this report sets out practical guidance to help revenue bodies measure the effect of their compliance strategies on outcomes, starting with guiding principles for outcome measures and then moving on to examples of current and emerging best practice in outcome measurement approaches. While the focus of this report is on outcome measures, performance measurement frameworks need to be balanced, including both outputs and outcomes, to show that the revenue body has used resources efficiently as well as effectively. As revenue bodies generally have well established output measures, achieving this balance requires enriching the performance measurement framework with more outcome measures to achieve a comprehensive overall framework of both efficiency and effectiveness.

The purpose of this report is to help revenue bodies enrich and enhance their performance measures to measure the success of current and emerging compliance strategies in terms of improved compliance outcomes (defined and discussed in the next section). The context for this work is the evolutionary change in compliance approaches (discussed later in the introduction). Many of the developments in performance measures follow a similar evolution building on previous measurement approaches. Revenue bodies have common goals, such as collecting the right tax at the right time in the most efficient way, and therefore common interests in developing outcome measures. While there are common outcomes the best way of measuring these outcomes will depend on the data available to the revenue body. Additionally, differences in approaches and priorities mean that there is no single "right" set of measures and revenue bodies will need to decide what measures they need to manage their organisation.

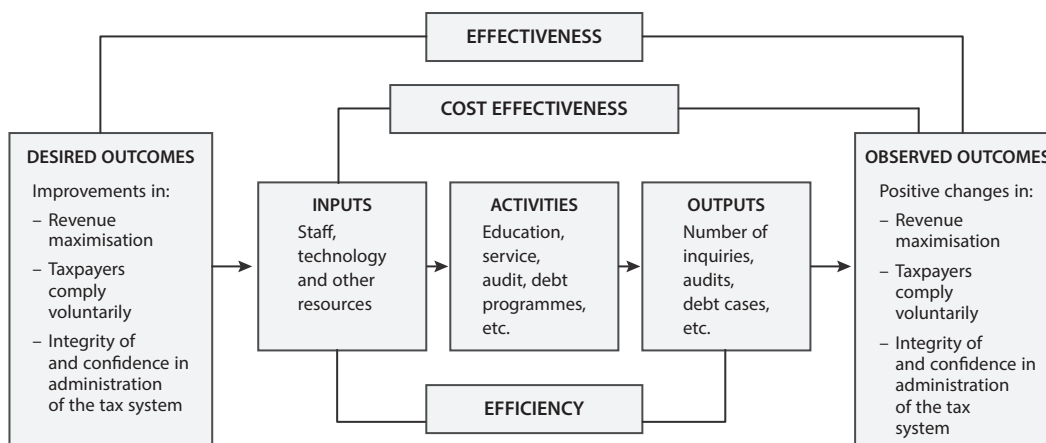
## Definitions of key terms

The tax compliance programme logic model is frequently used to relate how revenue bodies' actions deliver outputs which in turn improve outcomes (Figure 1.1). This model includes measures of outputs and efficiency as well as measures of outcomes and effectiveness. These terms are defined briefly below:

- **Outputs** are the deliverables (products or services) of the revenue body's completed internal activities.
- **Outcomes** are the ultimate desired objectives, what the revenue body's strategy sets out to achieve; these are often external to the revenue body.
- **Efficiency** is the ratio of the revenue body's outputs to inputs; increased efficiency means delivering more for less.
- **Effectiveness** is the extent to which the revenue body's activities and outputs achieve desired outcomes.



Figure 1.1. Tax compliance programme logic



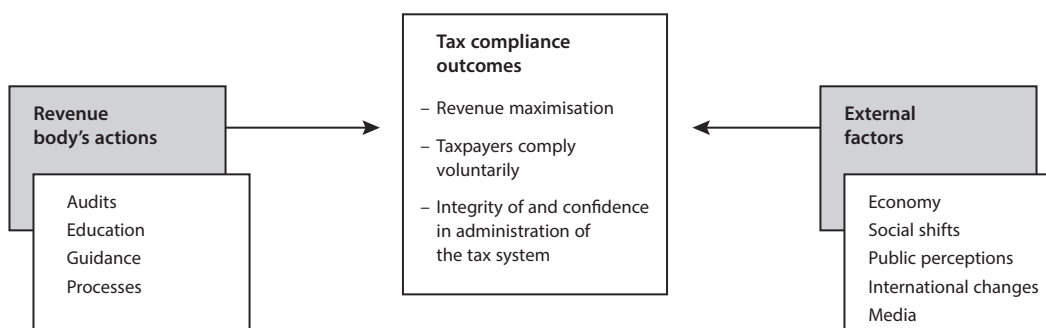
Source: Based on “Evaluating the Effectiveness of Compliance Risk Treatment Strategies” (OECD, 2010a).

There are three main interconnected categories of tax compliance outcomes:

- **Revenue outcomes:** These relate to collecting the right tax at the right time. The focus is less on taxpayers’ behaviour and more on getting the right tax result. This is often expressed as maximising tax revenues or closing the tax gap.
- **Voluntary compliance outcomes:** These relate to taxpayers’ behaviour in complying voluntarily with tax obligations: registration, filing, reporting, payment and any additional obligations. In essence, it is about taxpayers being “in control” of their tax obligations, which covers both what tax results and how the taxpayer got to that result.
- **Integrity outcomes:** These cover both that the revenue body administers the tax system fairly and that the community has confidence in the revenue body’s administration of the tax system.

Given this report’s focus on outcomes and effectiveness it is important to note the distinction between outcomes and effectiveness (which are sometimes used interchangeably). Tax compliance outcomes are defined as the levels of voluntary compliance, the levels of uncollected tax and the levels of confidence in the tax administration. Effectiveness is defined as the extent to which the revenue body’s actions achieve these outcomes. Outcomes are affected by both the effectiveness of the revenue body’s actions and external factors outside the revenue body’s control.

Figure 1.2. Influences on tax compliance outcomes



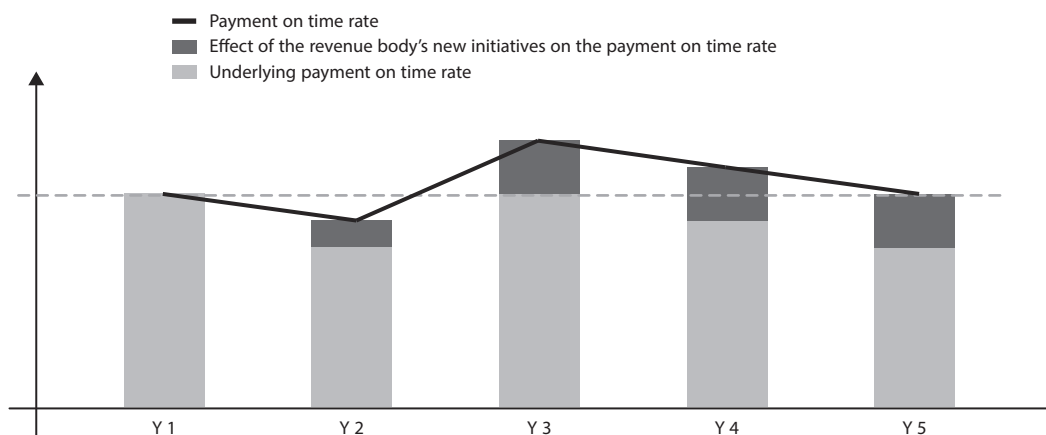
At the strategic level (organisational level or across the wider tax administration system), outcomes are revenue bodies' ultimate goals so it is important to measure outcomes even if changes may be due to external factors and the effect of specific interventions cannot be disentangled. These outcome measures need to be interpreted in context, such as considering changes to external factors and the trend in the outcomes.

However at the operational level (programme, project or team view), measures are required that allow the revenue body to identify what approaches are working (whether the intervention is effective). Revenue body use numerous interventions simultaneously and if only the outcomes are measured it will not be able to tell which interventions are successful and should be increased, and which interventions are unsuccessful (or even damaging) and should be ceased.

Therefore what makes an outcome measure fit for purpose depends on the purpose that the measure will be used for. For use at strategic level measuring outcomes and interpreting in context may be enough, but for use at operational level revenue bodies need measures that help identify which interventions are effective.

Figure 1.3 illustrates the difference between outcomes and effectiveness. In this example, a revenue body's desired outcomes are high rates of payment on time. It therefore introduces new initiatives to influence taxpayers to pay on time. At the operational level, it measures the effect of these interventions (shown by the blue bar). These interventions are effective and increase the payment on time rate higher than it would otherwise have been (the grey bar shows what the payment on time rate would have been without the new interventions). At the strategic level, the overall outcome (shown by the black line) fluctuates due to the revenue body's actions and changes in external factors, such as economic conditions.

Figure 1.3. Differences between outcomes and effectiveness



Strategic measures of the overall outcome and operational measures of effectiveness are complementary. Together they allow the revenue body to present a nuanced performance narrative: the overall outcome has remained stable as the effectiveness of the new interventions has been balanced out by more challenging external factors.

## Context

Revenue bodies' approaches to achieving tax compliance outcomes have evolved significantly in recent decades, in part due to a changing operating context and an improved understanding of why taxpayers comply. Each new step has built on experience and knowledge from the previous steps. However performance measures have not kept pace with this evolution of approaches.

Revenue bodies' traditional basic instrument for ensuring tax compliance is auditing submitted tax returns. This remains one of the most important compliance treatments for all revenue bodies. Traditional deterrence approaches focused predominately on audit coverage, motivated by a view that taxpayers' compliance behaviour is decided primarily by an economic cost-benefit risk calculation. This assumes taxpayers comply because the likelihood and costs of being caught evading outweigh the likelihood and benefits of getting away with evading. From this viewpoint, revenue bodies' sole administrative tool to increase tax compliance is to increase the frequency of audits, with audit coverage (the ratio of taxpayers to audits) an obvious performance measure.

However, auditors are one of revenue bodies' most precious and expensive resources. Therefore revenue bodies sought to utilise audit resources more efficiently by selecting the highest risk cases for their auditors. The OECD Forum on Tax Administration (FTA) report *"Compliance Risk Management: Managing and Improving Tax Compliance"* from 2004 articulated this risk based approach. The focus on risk selection of audit cases has been enabled by data and technology as explained by the supporting report *"Compliance Risk Management: Audit Case Selection Systems"*. This risk based approach is designed to be more cost efficient, delivering more tax revenues for lower operating costs. The success of this approach is measured primarily by the additional tax revenues from audit activities (audit yield).

*"Compliance Risk Management"* also set out a more sophisticated view of taxpayer behaviour which saw deterrence as just one factor amongst many in determining whether taxpayers comply voluntarily. This was in recognition that non-compliance covers a continuum from unintentional error to deliberate evasion, which cannot be explained by a purely economic model of deterrence. In response revenue bodies began to segment taxpayers according to the "compliance pyramid" (OECD, 2004a). While enforcement responses will always be required for the deliberately non-compliant, a supporting, educating or enabling approach is likely to be more efficient and effective for taxpayers that want to comply.

The OECD FTA report from 2010 *"Understanding and Influencing Taxpayers' Compliance Behaviour"* built on this with a model of five drivers of taxpayer behaviour: economy, norms, deterrence, opportunity and fairness. Through a better understanding of taxpayer behaviour, revenue bodies can make more effective use of their resources to develop strategies which will have a sustainable impact on taxpayer compliance (OECD, 2010a). While a risk based audit approach remains at the core of compliance approaches it has ceased to be the sole treatment available and revenue bodies have developed risk differentiated frameworks that apply different treatments to different types of taxpayer.

These approaches increasingly look to prevent errors from occurring at the early stages of processes ("upstream"), often before the tax return has been submitted, rather than responding and correcting them after the event ("downstream"). Upstream and downstream approaches are applicable to all taxpayer segments as revenue bodies want all taxpayers to pay the right tax at the right time, and take actions against those who don't. However the

implementation of these approaches needs to be adapted to the taxpayer segment because segments' environments and compliance risks are not identical.

The OECD FTA report from 2012 *“Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises”* set out that some risks are most effectively addressed through upstream approaches and some by downstream approaches. Therefore “prevention and cure are, in this way, complementary aspects of any balanced regulatory strategy” (OECD, 2012). However the OECD FTA report *“Together for Better Outcomes”* from 2013 noted that work is needed on performance measures for these approaches:

Narrow output measures are relatively easy to work with, but may channel attention and resources away from innovative approaches. Documenting outcomes and attributing them to revenue body activities (and their individual components) on the other hand represents a number of challenges. Therefore more pragmatic approaches are often required (OECD, 2013).

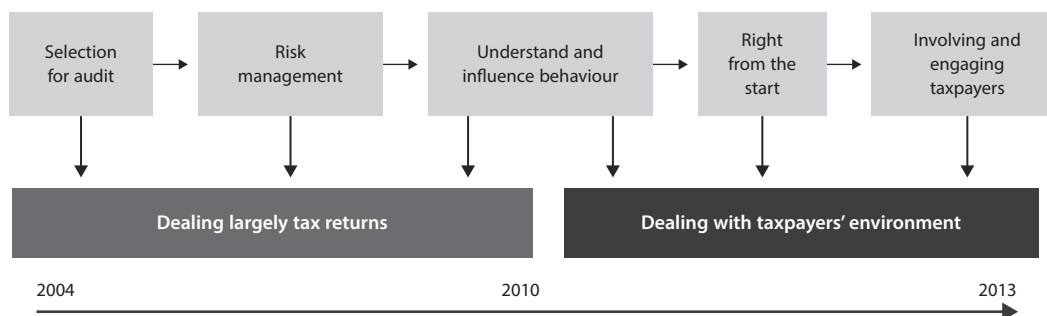
The OECD FTA report from 2013 *“Co-operative Compliance: A Framework”* sets out seven pillars for a co-operative approach to achieving large businesses' tax compliance outcomes. This approach aims for the right tax to be paid at the right time so that the revenue body has justified trust in the tax return rather than needing to audit by default. As with the approaches outlined in *“Right from the Start”*, the tax return ceases to be the starting point in the compliance process and should often be the end of the compliance process, as contentious issues are identified and resolved prior to filing. This approach is not suitable for all businesses as it is dependent on taxpayers providing disclosure and transparency upfront. However it brings benefits of early certainty for these business and reduced costs from tax disputes. The report identified limitations of current measures for demonstrating the success of co-operative compliance and made three relevant recommendations on developing performance measures:

- Measures of the effectiveness of co-operative compliance strategies need to be refined and integrated into the assessment of the overall compliance strategy. Measures which rely on audit interventions alone will not suffice. Revenue bodies need to place greater emphasis on a basket of measures with an outcome rather than an output focus. At the tactical/operational/activity level measures are needed that help guide activities towards actions that are most effective in terms of outcomes.
- Measures of co-operative compliance will need to focus on the portion of the tax base that is assured as accurate as a result of there being a co-operative relationship. There is also scope for revenue bodies to make much better use of data about disputes to inform strategic thinking and policy making.
- Revenue bodies should use improved measures to validate the business case for co-operative compliance and to make the contribution it makes to overall compliance outcomes more transparent to their key stakeholders (OECD, 2013).

The most recent work of the OECD FTA from 2014 *Tax Compliance by design: Achieving improved SME tax compliance by adopting a system perspective* focuses on designing compliance into systems. This encompasses not just the revenue body's processes, but recognising that revenue bodies can influence the compliance environment, and the processes of taxpayers and stakeholders. Insights from behavioural economics and psychology show that “small changes in the taxpayer's environment can have a big impact on behaviour” (OECD, 2013). Revenue bodies utilising these approaches have found that small changes in processes or the taxpayers' environment can have significant effects on compliance.

Figure 1.4 summarises the evolution of tax compliance approaches: each new approach has built on those preceding it. However, performance measures have not kept up with innovations in the range of revenue bodies’ compliance interventions (defined as any action initiated by the revenue body to correct taxpayer non-compliance or encourage taxpayer compliance) hence the need for this report.

Figure 1.4. The evolution of tax compliance strategies



Source: OECD (2014), *Tax Compliance by design: Achieving improved SME tax compliance by adopting a system perspective*.

The introduction of innovative approaches has been highly influenced by changes in the operating context, as new technologies have both facilitated new approaches and created new risks that need to be addressed. For some revenue bodies the need to reduce costs has also led to changes in compliance approaches. Throughout the evolution of revenue bodies’ compliance strategies, each new approach has built on previous approaches, and audits remain a key source of insight into compliance behaviour. These approaches have not replaced each other but as set out in *“Right from the Start: Influencing the Compliance Environment for SMEs”* are complementary as each approach works best in different circumstances. Therefore the best compliance strategies choose the most appropriate intervention for the risk or opportunity, rather than utilising one approach for all. This will be a balance of upstream and downstream approaches.

These new approaches have not diminished the importance of core audit activities. In fact, they have increased the effectiveness of downstream audits (and investigations) as these are increasingly targeted at the minority of taxpayers who are the worst and most prolific deliberately non-compliant. This complements upstream approaches for taxpayers willing to engage and co-operate with the revenue body. It sends a strong deterrent message and reassures taxpayers who voluntarily comply, that deliberate non-compliance is being tackled and penalised. Many revenue bodies embarking on upstream compliance approaches have at the same time focused resources on the most serious forms of non-compliance, such as prosecutions for tax evasion.

## The business case for an improved set of performance measures

As the previous section shows most revenue bodies have well established performance measures for their traditional activities. Measures such as audit yield generally work well and their limitations are known and can be mitigated. Similarly some output measures, such as measuring the quality of the revenue body’s work, will be required for upstream and co-operative compliance approaches. Output measures will remain an important component in the basket of compliance measures for most revenue bodies as output and outcome

measures together deliver a balanced performance narrative. However, these performance measures do not do justice to many of the newer approaches. Performance measures therefore need to be refreshed as revenue bodies' compliance strategy and approaches evolve.

These limitations have been noted in two OECD FTA reports from 2013 *“Together for Better Outcomes: Engaging and Involving SME Taxpayers and Stakeholders”* and *“Co-operative Compliance: A Framework”*. Revenue bodies have become increasingly concerned that their existing performance measures can suggest failure when the true story is one of success. For example, adopting a right from the start or co-operative compliance approach might see audit yield from compliance activities decrease which appears as failure on current measures, when in fact voluntary compliance has improved and additional revenues have come in voluntarily.

A survey of the FTA membership for this report identified three main concerns with current performance measures, which tend to be focused on the revenue body's outputs rather than the impact on the desired outcomes:

- **Strategic decision making:** Current performance measures are often output focused. As the deliverables vary by activity these metrics can only measure the outputs of a limited range of compliance activities. These deliverables are not comparable across activities (particularly upstream and downstream) and this lack of common currency makes it difficult to compare the value of potential investments on a like-for-like basis, which limits the usefulness of the measures for strategic resource allocation decisions.
- **Execution of the strategy:** Current performance measures are not fully aligned with revenue bodies' desired strategic objectives and the strategic approaches used. This limits their operational usefulness as it is difficult to see the line of sight from the activities set out in the strategic compliance approach and demonstrate how they contribute to the desired outcomes.
- **Explaining the performance narrative:** Current performance measures do not enable revenue bodies to fully explain their performance narrative to external stakeholders. Revenue bodies want to be able to demonstrate how their actions influence outcomes, and explain why the approach taken was the most effective approach available.

While revenue bodies might address some of these issues through evaluation or tax gap estimation, these methods are inevitably backward looking and of limited usefulness for operational management. Therefore this report does not consider how to estimate tax gaps, which some revenue bodies use as a strategic tool, health indicator or performance indicator; or evaluation techniques, which remain important for understanding and improving interventions. Instead, this report suggests guiding principles and approaches for practical outcome-orientated performance measures to help revenue bodies run their organisations and to help address the above issues.

## Scope of this report

These outcome measures are relevant for all taxpayer segments but the application and measurement approach needs to be adapted to the segment as the available data and relative compliance risks vary for each segment. Therefore this report includes standalone sections considering how each approach can be applied to SME taxpayers (which are relevant to other high-volume segments) and large business taxpayers (which are relevant

to other high-value segments). While there is less coverage of private taxpayers much of the application to SMEs is relevant, and similarly many of the insights for large business can be applied to measuring the outcomes of compliance initiatives for high net worth individuals. This report does not specifically consider outcome measures for tackling organised fiscal crime; while many of the principles and approach have some application to this context there are additional challenges that need to be addressed. Some of the relevant differences between SME and large business for outcome measurement are summarised below:

Relevant differences between taxpayer segments for outcome measures	
SME	Large Business
<ul style="list-style-type: none"> <li>• SMEs are numerous and diverse, with a range of compliance risks, attitudes and behaviours</li> <li>• One-to-one engagement and audits are not possible on an ongoing basis due to the numbers of SMEs.</li> <li>• Wide range of compliance approaches used</li> <li>• Revenue bodies are taking advantage of better relevant data for compliance</li> </ul> <p>At the strategic level, overall compliance outcomes and trends can be estimated by sampling some SMEs in depth. At the operational level, the impact of projects can be attributed by using statistics to create counterfactuals of similar cases. Increasingly data insights will provide understanding across the whole SME population.</p>	<ul style="list-style-type: none"> <li>• Large businesses are large, complex and unique making generalisations difficult</li> <li>• Tax issues often take years to resolve due to complexity and litigation (often on points of law)</li> <li>• One-to-one engagement and audits provide the revenue with a firm understanding of taxpayers</li> </ul> <p>Outcomes may be visible on an individual basis, but isolating a counterfactual is challenging. For example, under co-operative compliance programmes the revenue body may be able to see that the right outcome has been achieved but it is more challenging to prove that this was due to the revenue body's actions.</p>

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## *Chapter 2*

### **Guiding principles for measuring tax compliance outcomes**

*This chapter recommends six guiding principles to help revenue bodies to measure tax compliance outcomes and the effectiveness of their compliance activities.*

This report has developed six guiding principles to help revenue bodies develop outcome measures for performance management. These principles apply to outcome measures as a whole, rather than to a specific outcome measure. Outcome measures should be:

- Totally aligned with the compliance strategy
- Comprehensive in their view of performance
- Attributable to the revenue body’s actions
- Pragmatically measurable
- Meaningful for external stakeholders
- Integrated into existing and future processes

These principles are based on the experience of revenue bodies that have developed, or are developing, measures of tax compliance outcomes. They are intended as practical guidance for revenue bodies developing and using outcome measures for performance management. The principles are not intended as a manual for outcome measurement, standards for revenue bodies to prescribe or technical measurement guidance. There is already well developed guidance on technical aspects of measurement and this remains relevant to outcome measures. Revenue bodies wanted guidance that addressed practical considerations: sharing good practice, explaining what is feasible, and identifying significant issues and strategies to tackle them. As such, these principles are intended as practical support for revenue bodies developing and using outcome measures. They should be applied sensibly, taking into account the strategic objectives, approach and operating context of the revenue body.

### Totally aligned with the compliance strategy

This report recommends that measures of tax compliance outcomes and effectiveness should be **totally aligned** with the revenue body’s compliance strategy. This starts with the strategic objectives (*what* outcomes are desired) but also considers the main approaches used (*how* the revenue body will achieve the outcomes).

Totally aligning outcome measures to the compliance strategy means that successful performance is defined as the effect of the revenue body’s strategic compliance approach on the desired strategic compliance objectives. This requires both successfully implementing the planned activities of the revenue body’s strategic approach (outputs on Figure 1.1) and demonstrating that these activities generate the desired outcomes (effectiveness on Figure 1.1).

Measuring success starts with defining success by setting desired outcomes. These desired outcomes flow from the revenue body’s organisational aims, which may be set out as a vision, purpose statement or strategic objectives, to specific objectives in business plans which are then measured to manage performance. Measurement cannot be meaningfully considered before setting the strategic objectives as these set the benchmark for successful performance and define what should be measured.

The planning, design and investment stage is a good point to start considering whether desired outcomes can be measured during and after implementation. This helps to ensure that the information needed to measure performance will be collected, and that redundant information is not collected. Activities which have measurement limitations should be identified to ensure that these are not omitted from reporting and subsequent decision making.

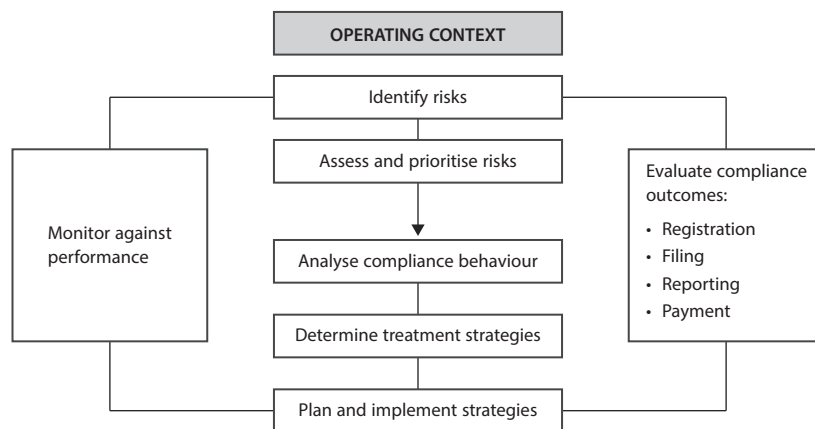
Measurement also needs to take account of how the compliance approach will deliver benefits, not just what outcomes are intended. For example, a revenue body that sets an outcome to collect all taxes that should be collected may find that audit yield (see Chapter 3 for definition) is a useful measure if it relies solely on audits, however if the revenue body has the same objectives but uses a range of approaches then audit yield alone will not be sufficient. At the operational level, consideration of the approach is particularly important because revenue bodies need to know which activities are effective, and which are less so in order to be able to use resources effectively.

Once the revenue body has decided what tax compliance outcomes should be measured and reported, it needs to decide how to measure the desired outcomes and how to deal with measurement limitations. Sequencing measures development in this order helps ensure that what should be reported and included in decision making is reported and included in decision making, rather than what is easy to measure. This is particularly relevant for outcome measures as there are likely to be measurement limitations where outcomes that the revenue body wants to measure are challenging (and perhaps impossible) to measure and attribute in a timely manner. The next principle on comprehensiveness explains why these outcomes need to be covered, and the following principles set out practical guidance to help resolve the measurement and attribution challenges.

After deciding what should be reported on and how to measure it, the final stage of the development sequence is to clearly articulate what level of improvement in outcomes constitutes successful performance. Setting specific goals is also good practice for output measures, but it is much more difficult with outcome measures because outcomes are not directly in the control of the revenue body, and in many cases there are measurement limitations, or limitations in the understanding of what the success criteria should be. For example, it may not be clear what improvement in outcomes would be feasible in what time frame or how external factors may affect the outcome. Articulating goals can help engage people by making clearer what is desired and can help manage performance by differentiating strong and weak performance. However accountability for generating successful outcomes will not be the same as for delivering outputs.

For tax compliance projects the desired outcomes are traditionally set by starting with an articulation of taxpayer compliance risks using the OECD compliance risk management process (Figure 2.1). However, the compliance risk management process is not the sole

Figure 2.1. **Compliance risk management process**



Source: “*Compliance risk management: managing and improving tax compliance*” (OECD, 2004).

means of setting objectives for tax compliance projects. Revenue bodies' strategies, plans, programmes and projects are driven by factors across the SWOT matrix (internal strengths and weaknesses; external opportunities and threats). In particular upstream compliance activities generally involve broader activities which look for opportunities to promote compliance rather than the traditional approach of responding to risks after they have realised.

The compliance risk management process makes clear that strategies evolve with the operating context. Therefore the criteria for success will continue to evolve with the operating and strategic context. However to test whether performance is improving, measures need to be compared against a baseline of previous performance. A pragmatic compromise between the comparability of measures and their relevance to the current context is to refresh the performance measurement framework on a rolling medium-term basis (around 5 years). Horizon scanning (analysing the future to identify potential threats, risks, emerging issues and opportunities) can also help ensure that performance measures will be fit for the medium term.

In summary, there are four stages involved in aligning measures to the compliance strategy: firstly, setting desired outcomes; secondly, prioritising which outcomes to measure; thirdly, deciding how to measure and report on these outcomes (including how to deal with measurement limitations) and finally articulating the goal for each outcome measure.

## Comprehensive in their view of performance

This report recommends that performance measurement should take a **comprehensive view** of tax compliance outcomes. This means measuring compliance as well as non-compliance across the full range of outcomes (revenue, voluntary compliance and integrity).

The main benefit of measuring compliance outcomes, compared to outputs, is to provide a comprehensive view of performance. Many revenue bodies are concerned that their existing measures give a misleading view of performance, particularly as a predictor of future performance, as they are skewed towards current year audit performance rather than upstream interventions and sustained compliance. For example, if taxpayers get it right from the start then output measures, such as audit yield, may decline but outcomes, such as overall compliance and total revenues, may improve. Similarly, if improvements to taxpayer compliance through an audit are sustained in future years, then this is a better outcome than if the improved compliance only occurs in the year of the audit. A comprehensive view values voluntary compliance measures alongside measures of non-compliance, as knowing where there is compliance in the tax administration system is as relevant as knowing where there is non-compliance.

A comprehensive view of performance starts with coverage of all the revenue body's strategic compliance outcomes and approaches. It emphasises that coverage of the whole strategy is required and measurement of elements of the strategy cannot be neglected because they are challenging to measure and attribute in a timely fashion. Bearing in mind the adage that "what gets measured, gets done", if reported results do not have comprehensive coverage of the strategic outcomes then behaviours and implementation may be skewed to achieving easily measurable outputs rather than strategic outcomes. This approach emphasises starting by measuring the right things, before working out how to measure things right. This means measuring not just immediate results but whether impacts are sustained, including coverage of leading indicators of (likely) future results. Where timely measures do not exist lagging measures will also be necessary. The next principles on

attribution and pragmatic measurement provide more guidance on how to measure outcomes and how to use and report those measures.

Revenue bodies' three main compliance strategic outcomes are:

- To sustain and increase the extent to which tax revenues due are collected,
- To sustain and increase taxpayers' voluntary compliance, and
- To sustain and increase confidence in the integrity of tax administration.

These three outcomes are mutually supportive, but not identical. For example, investigating small scale unregistered activity in the underground economy may have a lower immediate return on investment than correcting mistakes from registered businesses, but tackling evasion helps maintain the integrity of the tax administration. While it may be difficult to show an immediate return on investment, maintaining compliance and confidence in the tax administration ensures a sustainable future revenue base.

Revenue bodies' approach to tax compliance has evolved to a diverse range of interventions applied to different groups according to risks and taxpayer behaviour. While this provides for both a broader and deeper set of tools which revenue bodies can choose from, it has also increased the inherent complexity of revenue bodies' performance narratives. Previously a small group of interventions could be measured by narrow output measures however today's wide range of diversified interventions require broader metrics. A comprehensive view of performance now needs to cover multiple activities and multiple outcomes. Most revenue bodies want to collect the right tax at the right time at the lowest cost for themselves and the taxpayer. Traditionally this has been measured through separate output measures for enforcement activities and service activities. However revenue bodies are increasingly making use of approaches that aim to improve compliance, service and reduce costs simultaneously. At a strategic level, this suggests viewing outcomes measures holistically as many activities may have contributed to these outcomes, and so the outcome may not be caused by a specific activity. At operational level, this suggests that measures of intervention's effectiveness should include the full effects of activities (covering the direct and indirect consequences) and be capable of registering unexpected effects, both positive and negative across a range of outcomes.

In summary, a comprehensive view of performance builds on measures that are aligned with the strategic outcomes and approaches by emphasising that outcomes must be covered even where definitive measurement and attribution is not possible. A comprehensive view also requires measures that provide coverage across multiple other dimensions such as compliance versus non-compliance, revenues versus behaviours, and leading and lagging timeframes.

### Attributable to the revenue body's actions

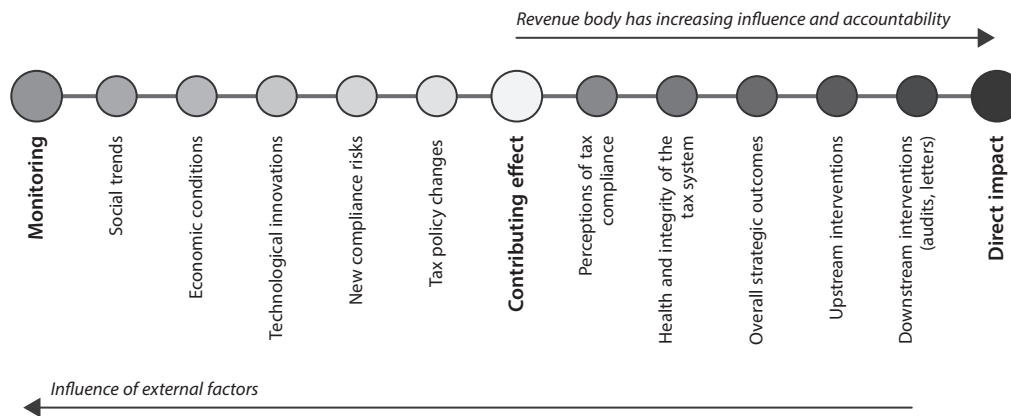
This report recommends that revenue bodies' should distinguish the **degree to which changes in measured outcomes can be attributed** to specific actions.

The primary challenge to measuring tax compliance outcomes is the difficulty attributing outcomes to revenue bodies' activities. Attribution means demonstrating the cause and effect of the revenue body's activities on the outputs and outcome. For an effect to be attributed there must be a clear counterfactual. The counterfactual is what would have happened without the revenue body's activity or intervention. Comparing the observed outcome with the counterfactual outcome shows the effect of the revenue body's actions.

For outputs the counterfactual is trivial as without the revenue body's actions there would be no outputs. However outcomes, such as taxpayers' compliance, are determined by the attitude and actions of taxpayers, which the revenue body does not control. These outcomes are influenced by both the revenue body and external factors (Figure 1.2). Therefore drawing causal links between revenue bodies' outputs and tax compliance outcomes is difficult not just because of the methodological, but because in reality outputs and outcomes are not linked in the simple linear, mechanical fashion suggested by the tax compliance programme logic model (Figure 1.1). The programme logic model suggests that either compliance outcomes are attributable to the revenue body's activities, or they are not. However in reality the degree of causality varies across a spectrum as revenue bodies have more influence over some outcomes than others.

The extent of revenue bodies' influence depends on the type of outcome: for shorter-term, narrower outcomes the revenue body's influence is more likely to be a direct impact whereas for longer-term, broader outcomes the revenue body's influence is more likely to be a contribution to the outcome. Figure 2.2 shows an illustrative span of influence from revenue bodies' actions to outcomes. In some cases strong causal links exist between actions and outcomes (these are shown below as direct impacts) but in other cases the revenue body's actions are only one factor among others (these are shown below as contributing effects). Finally there are cases where the revenue body will want to measure outcomes and external factors affecting outcomes with no claim to causality (these are shown below as monitoring).

Figure 2.2. **Span of influence: attributing outcomes to revenue bodies' actions**



Holding organisations to account for improving outcomes is more challenging than for delivering outputs and has been recognised as such in the OECD's wider work on public governance and performance:

### ***Accountability for outcomes***

**The challenge:** People are generally comfortable with being accountable for things they can control. Thus, managers can see themselves as being accountable for the outputs produced by the activities they control. When the focus turns to outcomes, there is considerably less comfort, since the outcomes to be achieved are affected by many factors not under the control of the manager: social and economic trends, exogenous events, and other programmes.

It may not be clear just what accountability for outcomes can sensibly mean. If outputs are not delivered, one can rightly point to the manager responsible and take corrective action. If outcomes do not occur, and the same action is automatically taken, few in the future will be willing to commit to outcomes. A somewhat different approach to accountability in this case is required. (OECD, 2005)

This report suggests that one way of addressing this challenge is to recognise that accountability for outcomes is not dichotomous. In general, accountability should be higher for those outcomes (and outputs) that are closely influenced by the revenue body's actions, with lower accountability for outcomes that are more distant from the revenue body's actions. For example, audit yield is closely linked to the revenue body's actions so high-levels of direct accountability (such as annual targets) may be appropriate. Conversely, the overall outcomes (such as tax gap estimates) are impacted by a range of external factors as well as the revenue body's actions so direct accountability (or targets) may not be appropriate. While the long-term trend for the tax gap will be influenced by the revenue body's actions, any performance narrative will need to reference the impact of other factors, such as economic activity.

This does not allow revenue bodies to explain away failure as being due to external factors. There will be times when outcomes worsen due to external factors but there will be just as many times when outcomes improve because of factors outside the revenue body's control, for which it should not take credit. Some outcomes can be measured at strategic level but the outcomes cannot be attributed to the revenue body's actions; this does not diminish the importance of measuring outcomes as outcomes are what the revenue body ultimately cares about. At operational level, the same outcome measures may be attributable to the revenue body's specific actions because the impact is concentrated which makes it easier to separate the effect from external factors. There is also a principled argument for greater accountability where a revenue body has a project targeted at a specific group of taxpayers as the revenue body has invested specifically in it and needs to demonstrate a return on investment (in revenues, compliance or integrity) from the project.

For outcome measures to be fit for purpose, they must be based on reasonable evidence to ensure the measurement is reliable (discussed in the next principle). A related but separate issue is attribution reliability. An outcome measure can be fit for purpose without being attributed. Direct attribution cannot be expected of a measure if the cause and effect in reality is not direct. This is particularly so at the strategic level, where outcome measures may be used as indicators of the health of the overall tax administration system. For this purpose an outcome measure does not need to be attributed to the specific actions of the revenue body. For example, overall filing on time can be measured reliably but is not directly attributable to the revenue body's actions. In contrast, at operational level a fit for purpose effectiveness measure needs to have reliable attribution to enable revenue bodies to identify which interventions work and which are not working as intended.

The strength of attribution reliability is not the same for all metrics. For instance, the trend of a metric may be more closely influenced by the revenue body's actions than the actual level of the metric; and in some cases may be possible to measure with more certainty. For example, levels of unregistered taxpayers are difficult to measure and may depend on a wide range of historic external factors, but if the revenue body has initiatives to register these taxpayers the success of these initiatives may be measurable and attributable if a clear uplift is seen in new registrations in targeted sectors. Fit for purpose effectiveness measures are more likely where measurement is designed at the start of interventions, which may require collecting additional data or adapting the intervention (such as by holding back a control group).

Reasonable evidence for causal impacts is likely to draw from a range of sources. In particular, drawing together evidence across inputs, activities, outputs and outcomes in a logical framework is likely to strengthen claims of causality. This emphasises that output measures remain important not only for measuring efficiency, but also as supporting evidence of the causal links between activities and outcomes. Monitoring external factors may also be useful to strengthen attribution. In some cases it may be possible to strip out the effect of external factors on outcomes, or demonstrate that these had little effect, and thereby decompose outcomes into the part driven by external factors and the part driven by the revenue body's actions.

In summary, attribution of compliance outcomes to the revenue body's actions is not a question of whether or not the outcomes were caused by the revenue body, but the extent to which the outcomes were caused by the revenue body. Measures of compliance outcomes do not always need to be attributable to be useful and meaningful, particularly at strategic level, but where possible measures should be designed to enable revenue bodies to attribute effects and identify which interventions are working.

### Pragmatically measurable

This report recommends taking a **pragmatic approach to measuring tax compliance outcomes**, which balances competing demands, and the relative value of performance information. For an outcome to be pragmatically measurable it need not be measured definitively but needs to be defensible (based on reasonable evidence), which includes the use of scientific estimates.

The primary purpose of performance information is to generate better informed decision making which helps revenue bodies manage their activities to achieve their desired strategic outcomes. When revenue bodies decide what performance information would adequately measure success against desired outcomes (and be useful in decision making) they need to balance competing demands. These demands include timeliness, comprehensive coverage, alignment with the strategy, the level of causality, cost-effectiveness, and the precision and reliability of the metrics. Fit for purpose performance measures provide useful information for decision making by pragmatically balancing these factors without placing undue weight on a subset of these factors at the expense of others. For instance, fit for purpose measures need coverage across all strategic objectives, which in some cases is likely to require trade-offs in the reliability of measurement to ensure proper coverage and reduce the bias of reporting only the most reliable measures.

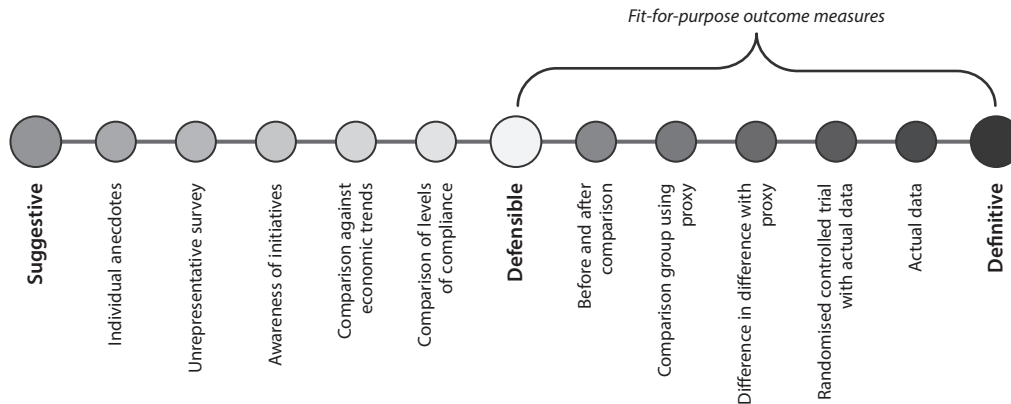
A pragmatic approach to measurement is required because it will not be possible to measure and attribute outcomes to the revenue body as definitively as outputs. As outputs are the direct result of the revenue body's actions they can often be counted. In contrast, outcome metrics may need to be estimated rather than counted, and attribution needs to be explicitly evidenced as the outcomes are not solely linked to the revenue body's activities. As discussed in the principle on attribution, there is no panacea for the challenges of measuring and attributing outcomes because the real world link between revenue bodies' actions and outcomes is more complicated than that for outputs. However revenue bodies should measure outcomes as they are the ultimate desired goals and measuring outcomes is attainable, and useful, if a pragmatic approach is taken.

This report suggests that outcome measurement does not need to be definitive (based on certain fact) to provide useful performance information. Instead it suggests that outcome measurement needs to be defensible (based on reasonable evidence). As Figure 2.3 shows



what is not included in this expanded range of potential measures is just as important as what is included. This principle allows for the inclusion of scientific robust estimates but does not allow the inclusion of weak or unreliable assertions.

Figure 2.3. **Spectrum of measurement reliability**



Source: Based on the Australian Tax Office’s “Conceptual framework for understanding revenue effectiveness” (Box 3.1).

A pragmatic approach is linked to a comprehensive view of performance. For some elements of performance it may not be possible to find a measure that is defensible in its own right. However combining a range of suggestive measures into a basket of measures may provide reasonable evidence of an effect: while each element is only suggestive, if all elements point in the same direction this may be a defensible indicator of success. This is similar to the approach of strengthening claims of causality by drawing together evidence across inputs, activities, outputs and outcomes. Like the approach to developing reasonable evidence to claim a causal impact, developing reasonable evidence to claim a defensible measure will be stronger if there is a structured framework and governance around the basket of measures. Without this structure there is a risk of selecting, or appearing to select, measures that show positive improvements and ignoring those that are negative.

In summary, outcome measures should strike a balance between timeliness, comprehensive coverage, strategic alignment, the level of causality, cost-effectiveness, and precision and reliability. For an outcome to be pragmatically measurable it need not be measured perfectly but needs to be defensible (based on reasonable evidence), which includes the use of scientific estimates.

## Meaningful for external stakeholders

A performance narrative including outcomes is inherently more complicated than a purely output based narrative. Therefore this report recommends revenue bodies should tailor their performance narrative to make it **meaningful and credible for their audience**.

While the primary purpose of performance information is to help revenue bodies manage their activities, another important use is for revenue bodies to report their performance to external stakeholders. This is recognised in the OECD’s series of reports on governance and performance. For instance “*Government Performance: Lessons and Challenges*” (2005) by Curristine notes, “The provision of performance information is not an end in itself; rather, its

overall objective is to support better decision making by politicians and public servants leading to improved performance and/or accountability, and ultimately, enhanced outcomes for society.”

Revenue bodies have an important role and are therefore subject to wide ranging and at times intense scrutiny. Revenue bodies need to show that they administer the tax system fairly and effectively, and that they have delivered value for money with public funds. Revenue bodies need to explain their performance to a wide range of external audiences such as Parliament, Ministers, the Finance or Treasury department, oversight bodies and the wider public. Revenue bodies’ own performance information should be the starting point for this oversight.

For external stakeholders to use revenue bodies’ performance information they need to have confidence that the measures are credible and relevant. Revenue bodies face many external stakeholders with a range of different interests, each with their own views on what is relevant and what makes a performance narrative credible. However external stakeholders are united in wanting performance narratives that are focused, succinct, clear and based on evidence. This requires revenue bodies to condense multiple measures on a tax system with inherent complexity into a simple narrative.

Compared to output measures, outcome measures are generally more meaningful as they directly address the outcomes that external stakeholders care about. However outcome measures can be more difficult to explain and are more open to challenges of credibility, particularly on attribution. This places competing demands on the external performance narrative for both meaningfulness and simplicity.

Revenue bodies cannot remove the inherent complexity from attributing outcome measures, but they can tailor the performance narrative to the audience. Some of the approaches discussed in Chapter 4 such as effectiveness narratives, can be particularly useful in explaining performance to those without a background in tax compliance. This requires knowledge of what the audience needs from the narrative and how to express the limitations of some outcome measures.

In summary, outcome measures tend to be more meaningful to external stakeholders than output measures but also tend to be more difficult to explain and more open to challenge. External stakeholders require a clear performance narrative which condenses multiple measures into a simple story. Where the revenue body has sufficient knowledge of the requirements of its audience, the narrative should be tailored to address these.

## Integrated into existing and future processes

This report recommends that revenue bodies should **integrate** outcome and effectiveness measurement into their existing and future processes and reporting.

Revenue bodies want to establish organisational cultures focused on effectiveness. Measures of tax compliance outcomes play a part in this. For outcome measures to make an impact within revenue bodies the measures need to be well executed, not just well designed. As such, there is strong demand from revenue bodies for practical guidance on implementation. This comment from one revenue body reflects a common view:

The need for cultural shift within [the revenue body] and externally is possibly the main barrier to a stronger focus on measuring outcomes. Internally, we have sought to address this with a work programme to embed effectiveness thinking into [the revenue body’s] natural systems (governance, risk and people systems) so that it becomes business as usual.

Revenue bodies reported that implementation was one of the main challenges to measuring tax compliance outcomes. However there is good practice within revenue bodies implementing outcome measures. The main theme for successful implementation is that outcome and effectiveness measurement should be integrated within revenue bodies' ways of working and existing organisational reporting, and not an additional standalone process. Integration significantly increases the probability that the measurement framework will be aligned with the compliance approach, which was set out in the first principle. These principles support each other. Taking an integrated approach encourages the measurement framework and the compliance approach to evolve in an organic fashion, one informing the development of the other. As revenue bodies find out which approaches work best in which circumstances, this should inform plans for future resource allocation. An additional advantage of outcome measures, over output measures, is that outcomes are relevant for both risk identification and prioritisation (recall Figure 2.1) to inform the compliance strategy, as well as monitoring and evaluating the performance of the compliance strategy. Integrating outcome measurement into existing processes should encourage collecting data once for multiple purposes (risk insight, business planning and performance measurement) and encourage strong feedback between these interrelated areas, as recommended by the compliance risk management process.

Changes to the performance measurement framework, like other organisational changes, are about people and organisational culture. Successful change requires leadership to set the direction and communicate the purpose of changes across the organisation. It involves drawing on capabilities across the organisation including auditors' knowledge and, increasingly, the improved understanding of what drives taxpayer behaviour that revenue bodies are deriving from functions such as advanced analytics. This change is a refinement of the performance measurement framework, not a replacement, and is driven by the refinement of revenue bodies' compliance strategies. As revenue bodies' compliance strategies have continued to evolve from risk-selected audits to a range of risk-differentiated approaches, refinements are needed to performance measures to cover newer activities and to fully reflect the effects of existing activities (such as the deterrent effect).

Revenue bodies' organisational culture varies widely. Therefore a universal approach to implementing outcome measures is not appropriate even for revenue bodies with similar compliance approaches. In some revenue bodies compliance officers are apprehensive that moving from audit yield to broader outcome measures devalues audit work; whereas in others compliance officers are demanding new performance measures because existing narrow output measures do not reflect the full impact of their work. Chapter 7 outlines common issues for consideration when implementing outcome measures, such as communicating the purpose of the changes across the organisation, but the specific solutions to these common issues need to be adapted to the context.

That said the principle of integrating outcome measurement into business as usual is relevant for all revenue bodies implementing outcome measures. An integrated approach to outcome and effectiveness measurement ensures consistency and efficiency in performance reporting. It applies standardised approaches to similar measurement problems. Recycling existing information or automating measurements where possible reduces the costs of collecting data, particularly on compliance officers.

In summary, successful implementation of outcome measures requires that outcome and effectiveness measurement is integrated within existing ways of working and organisational reporting. This increases the probability that the measurement framework is aligned with the compliance approach, encouraging both to evolve together in an organic fashion. This

requires some changes to cover newer performance activities and fully reflect the effects of existing activities, which like all organisational changes requires leadership to set direction, and to draw on the capabilities of staff across the organisation.

## Applying these principles

These guiding principles have been developed by distilling the insights of revenue bodies' practical experience. This is based on what has worked for revenue bodies, which they would encourage others to do, and also what lessons they have learnt where they would do things differently. These principles have also drawn on insights from the wider public sector such as the OECD Development Assistance Committee and from the academic literature, which is discussed in Box 2.1. For revenue bodies developing outcome measures these are the factors that are recommended for consideration before embarking on development.

### Box 2.1. Academic literature on performance measurement

The Tax Administration Research Centre (TARC) surveyed the academic literature on performance measures across the public sector and wider organisations to inform this project because the challenges faced by tax administrations are not unique. As the OECD *“Government at a Glance 2013”* notes, “While measuring government performance has long been recognised as playing an important role in increasing the effectiveness and efficiency of the public administration, following the economic crisis and fiscal tightening in many member countries, good indicators are needed more than ever to help governments make informed decisions.”

The academic literature recognises that “performance measurement can have a beneficial effect on professional organisations” (De Bruijn, 2007). However the academic literature has also strongly criticised performance measurement, most notably that its focus on accountability and incentives is too narrow. The two main concerns of a narrow focus on a small number of output indicators are firstly perverse incentives to unduly focus on those areas that are measured (which are often easiest to measure) at the expense of overall outcomes and secondly “gaming” where actions are taken that improve the performance indicator without improving performance. One potential solution discussed in the academic literature is “creating *rich pictures* of a professional performance” (De Bruijn, 2007), which is closely related to the first two principles on aligned and comprehensive view of performance.

The academic literature has also noted that performance measures have a tendency to become bloated and burdensome. De Bont and Grit (2012) note that this is a particular issue for the public sector “Because it is hard to define performance of professional work, performance measurement systems tend to grow into complex systems”. Adcroft and Willis (2005) note that this tendency for measures to proliferate can lead to managers spending disproportionate time collecting data. For outcome measures in particular it is noted that “the effects of an organisation are often difficult to measure” (De Bruijn, 2007). These outcome measures also need to be interpreted with context because if accountability is viewed mechanically for an outcome that is heavily influenced by the external environment it may “lead to a target being viewed as a lottery ticket” (Boyne and Law, 2005). As such a pragmatic approach to measurement has been recognised by some academics, for instance De Bont and Grit (2012) find that effective performance measures do not have to be as complex as the practices that they represent.

**Box 2.1. Academic literature on performance measurement** *(continued)*

Finally, in the development and use of performance measures, De Bruijn (2007) emphasises two points closely aligned with the principles on integration and meaningfulness. Firstly, the importance of building trust and confidence within the organisation in the system of performance measures and recommends that “a system of performance measurement should be developed in *interaction* between management and professionals” (De Bruijn, 2007). And secondly, the idea of “*lively* performance measurement” because the benefit of performance information comes not from the production of indicators but by informing conversations that meaningfully challenge performance. De Bruijn (2007) elaborates that “Accountability is a form of communication and requires the information that professional organisations have available to be reduced and aggregated. Performance measurement is a very powerful communication tool: it reduces the complex performance of a professional organisation to its essence.”

The full literature review is available on Tax Administration Research Centre website (<http://tarc.exeter.ac.uk>).

The measurement approaches in the next chapters on revenue outcomes, voluntary compliance outcomes and integrity outcomes are consistent with these principles and will help make the meaning of these principles clearer. The measures are not judged against each principle as that would lead to repetition of much of the principles but were appropriate the links with the principles are drawn out. If a revenue body is developing an outcome measure from scratch then these principles will be a useful reminder of the main issues to consider. They are not a tick-box assessment or a manual for outcome measurement but steers from experience, the benefit of which comes from careful consideration of the relevance of the principle taking into account circumstances.

**Summary of guiding principles for measuring IMPACT****I**ntegrated into existing and future processes

- Revenue bodies should integrate outcome and effectiveness measurement into their existing and future processes and reporting.

**M**eaningful for external stakeholders

- Revenue bodies should tailor their performance narrative to make it meaningful and credible for their audience.

**P**ragmatically measurable

- For an outcome to be pragmatically measurable it need not be measured definitively but needs to be defensible (based on reasonable evidence).

**A**ttributable to the revenue body’s actions

- Revenue bodies’ should distinguish the degree to which changes in measured outcomes can be attributed to specific actions.

**C**omprehensive in their view of performance

- Performance measurement should take a comprehensive view of tax compliance outcomes. This means measuring compliance as well as non-compliance across the full range of outcomes (revenue, voluntary compliance and integrity).

**T**otally aligned with the compliance strategy

- Measures of tax compliance outcomes and effectiveness should start with the strategic objectives (what outcomes are desired) but also considers the main approaches used (how the revenue body will achieve the outcomes).

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## *Chapter 3*

### **Practical approaches for measuring revenue outcomes**

*This chapter outlines three pragmatic approaches for measuring and attributing tax compliance outcomes through revenue metrics. These revenue outcomes relate to collecting the right tax at the right time. The focus is less on taxpayers' behaviour and more on getting the right tax result. This is often expressed as maximising tax revenues or closing the tax gap. These approaches are not exhaustive but draw attention to some of the best current and emerging practice for revenue bodies to consider, drawn from a survey of the OECD Forum on Tax Administration membership.*

This chapter outlines three approaches that use revenue as a metric: audit yield, total revenue effects and tax assured. It begins by explaining audit yield, which is not an outcome measure *per se* but is the most widely used performance metric for compliance activities, and therefore a benchmark to compare other measures against. As the OECD “*Government at a Glance 2013*” report notes, “The dividing line between outputs and outcomes can be blurry; while outputs refer to the amount of goods and services produced by governments, outcomes show the effects of policies and practices on citizens and businesses.” Audit yield is generally considered to be an output measure as it is directly linked to revenue bodies’ audit activities, but it has some features of an outcome measure, to the extent that it delivers additional revenues. Total revenue effects build on audit yield by seeking to include the additional revenues that result from improved voluntary compliance due to the revenue body’s activities. Tax assured does not seek to quantify additional revenues but instead measures the proportion of the revenue base where the revenue body has confidence that the right tax is being collected.

## Audit yield

Audit yield is the additional tax liabilities identified and collected through audit activities.

Audit yield measures the additional tax revenues that are assessed and collected as a result of an audit or similar downstream compliance activity. Historically audit based approaches have been the sole approach to managing tax compliance. Most revenue bodies have well developed measures of audit yield to track the performance of their audit activities and to account for the use of resources. While a range of compliance treatments are now used audits remain a core compliance instrument, and audit yield remains the main performance metric for audit activities.

There are good reasons why audit yield has become so established. Audit yield closely impacts on outcomes such as maximising revenues and tackling non-compliance (required for the integrity of the system) and there is a direct attribution from the revenue body’s audit activities to audit yield. Audit yield also has a number of practical strengths as a measure. Its quantification is relatively straightforward. If an audit determines that the tax liability is \$x rather than the \$y on the return submitted by the taxpayer, then the audit yield is \$(x-y). Because audit yield has been used as a performance measure for a long time, it is generally well understood and easy to compare over time. The rate of return on audit activities, cost to yield ratio, is also relatively easy to calculate.

At the operational level, auditors need to know the additional tax liability for each case to be able to send an assessment to the taxpayer. Therefore performance measures of audit yield make use of existing information without much additional data collection. All that is required to turn the operational information into performance information is to aggregate the audit yield for all cases. This information is therefore easy to verify.

However audit yield is by no means perfect, even for measuring the performance of audit activities. The strongest criticism is that there are scenarios where audit yield can increase whilst revenue outcomes decline, because the increase in audit yield is due to increased non-compliance by taxpayers. Some revenue bodies have therefore questioned the extent to which audit yield measures success (the effectiveness of audits) or failure (the fact that the right tax was not voluntarily paid at the right time).

The particular challenges and strengths of audit yield depend on the setting therefore the next two sections consider application to SMEs (which is also relevant to other high-volume segments) and large business (which is also relevant to other high-value segments).

### **Audit yield: application to the SME segment**

The SME taxpayer population is numerous and diverse both in size and complexity. As revenue bodies increasingly target audit resource at the highest risk cases, audit rates and audit yield vary substantially amongst SME sub-segments. This can make it particularly challenging to distinguish between improvements in the revenue body's audit effectiveness at detecting non-compliance and increases in the level of non-compliance. For example, one revenue body commented that a focus on maximising audit yield led to auditing small and medium businesses, which delivered higher audit yields per case, but led to a failure to appreciate that there was more non-compliance within the micro business segment that vastly outnumber small and medium businesses.

Many revenue bodies have successfully mitigated this issue by using audit yield in conjunction with other measures of the level of non-compliance such as through random audit programmes, comparisons with economic trends or tax gap estimates. The strength of random audit programmes is that by auditing a representative sample the findings can be generalised across the whole SME population, which can be difficult to do with regular audits targeted at the highest risk or highest yielding SME taxpayers.

Previous OECD reports by the FTA SME Compliance Sub-Group have considered SME audits in detail: *“Strengthening Tax Audit Capabilities: General Principles and Approaches”* (2006) considers how best to conduct audits and specifically considers performance objectives and measurement for audit activities. It remarks that, “The fundamental aim of a compliance audit is to address instances of non-compliance. Monetary measures are an essential output measure of the effectiveness of audit techniques.” However the report cautions that no single reliable measure can capture every aspect of audit effectiveness. Therefore audit yield needs to be interpreted in conjunction with other audit indicators such as productivity, timeliness, volumes/coverage and quality.

Three other issues of relevance for the SME and high-volume segment are:

1. Revenue bodies are not resourced to audit all taxpayers within high-volume segments. Therefore revenue bodies need to demonstrate that they have allocated their limited audit resources to the best areas. However, to understand the implications of moving resource from one area to another revenue bodies need to know the marginal audit yield (the audit yield from an extra case), which can be difficult to calculate, and the wider benefits of audits (such as sustained compliance and deterrence).
2. The increasing trend amongst revenue bodies to invest in advanced data analytics to improve audit case selection. The benefits of these investments are intuitive: identifying better cases for audit leading to fewer “no change” cases (audits that do not result in any material change in reportable income and gains) and higher yields. Quantifying these benefits is more challenging as the benefit of improved case selection is not the totality of audit yield from the cases selected by the new system, but the added-value from auditing better cases compared to the counterfactual cases that would have otherwise been selected.
3. Audit yield measures have traditionally focused on assessed liabilities but some revenue bodies are increasingly interested in understanding the end-to-end process: whether these assessments are paid on time and improve revenue outcomes, or become debts.

Audit yield is not internationally comparable as there is no standard definition of what should be included. Revenue bodies use a range of variations (and labels), which are conceptually similar with some noteworthy differences. For instance revenue bodies differ in how they treat penalties, interest, over-declarations of tax and reductions to tax repayments. A more fundamental difference is that some revenue bodies report the additional taxable income identified rather than the additional tax liability identified.

### **Audit yield: application to the large business segment**

The size, complexity and uniqueness of large business taxpayers mean that there are frequent exceptional items and that tax issues often take years to audit, often followed by years for litigation and final settlement. Audits can correct non-compliance but sometimes not have an immediate impact on cash receipts because taxpayers are in a loss making position particularly for direct income taxes; this is especially relevant since the global economic recession. These factors weaken the comparability of audit yield over time and mean that caution is needed to understand the significance of large business audit yield rather than relying on the headline figure alone. That said, high coverage rates and comprehensive individual risking give revenue bodies a good understanding of trends in risks to consider audit yield in context.

Revenue bodies are increasingly using co-operative compliance approaches for large business taxpayers; this creates a dilemma for performance measurement. Traditional measures of success focus on the additional tax liabilities arising from corrective audit activity, but take no account of activities designed to prevent inaccurate reporting. For these revenue bodies, audit yield alone cannot explain the performance of the large business compliance strategy as co-operative compliance forms a significant part of the compliance approach. This issue has become more pressing as co-operative compliance approaches mature. As there is a limited pool of large businesses and risks, reducing these risks upstream will reduce the scope for audit yield downstream. During the transitional period of establishing co-operative compliance approaches many revenue bodies had accelerated audit yield from resolving historic issues. This led to an initial but unsustainable increase in audit yield from large businesses entering co-operative compliance programmes. This often required additional resources in the transition period, but longer-term the overall cost of handling co-operative compliance cases should fall, including the taxpayers' cost of compliance.

The need for outcome measures that assure that the correct revenue is paid at the correct time does not make audit yield redundant. Audits remain a core compliance instrument for revenue bodies and audit yield remains the key metric of the effectiveness of audit activities. An effective audit approach is necessary to demonstrate to taxpayers who co-operatively comply that the right tax is paid by those that have chosen not to co-operatively comply. In the longer-term, co-operative compliance approaches should continue to affect audit yield: if successful then revenue bodies should free audit resources from low risk cases to target higher risk cases. These audits should be better targeted and more productive. This might be measured through fewer audits that result in “no change” or immaterial yields.

While there are limitations to audit yield, revenue bodies have learned how to mitigate these limitations or live with them. For instance revenue bodies may distinguish exceptional items in reporting to improve the comparability of results year on year, or make use of a range of indicators to determine whether audit yield is increasing due to audit performance or increasing non-compliance. Audit yield remains a core performance measure for most revenue bodies and its practical usefulness is demonstrated by the high-level of usage across revenue bodies. This demonstrates a wider point that a performance measure does not need to be perfect to be useful and meaningful.

The main limitation of audit yield, which cannot be mitigated, is that it does not cover the full range of activities or the full range of effects. For instance if the revenue body improves taxpayer compliance upstream (before the tax return is filed) through education, this will not be covered by audit yield; nor will the revenue benefits of taxpayers who are deterred from evading due to prosecutions of other evaders. For this reason revenue bodies are looking to enhance their performance metrics for compliance activities with additional measures.

### Total revenue effects: audit yield and estimated wider revenue effects

Total revenue effects are an estimate of the additional tax revenues that result from all of the revenue body's compliance activities, including audits, other direct interventions and improvements to the design of tax administration processes.

While audit yield is a useful measure for audit activities, many revenue bodies are concerned that it does not cover the full revenue effects of all their activities. One response to this is to estimate the full revenue effects of all compliance activities (including specific interventions and improvements to processes). This total revenue effects approach expands the scope of audit yield to the revenue effect of a broad range of activities on current and future year compliance, and to a wider taxpayer population (that may not have been directly subject to an intervention).

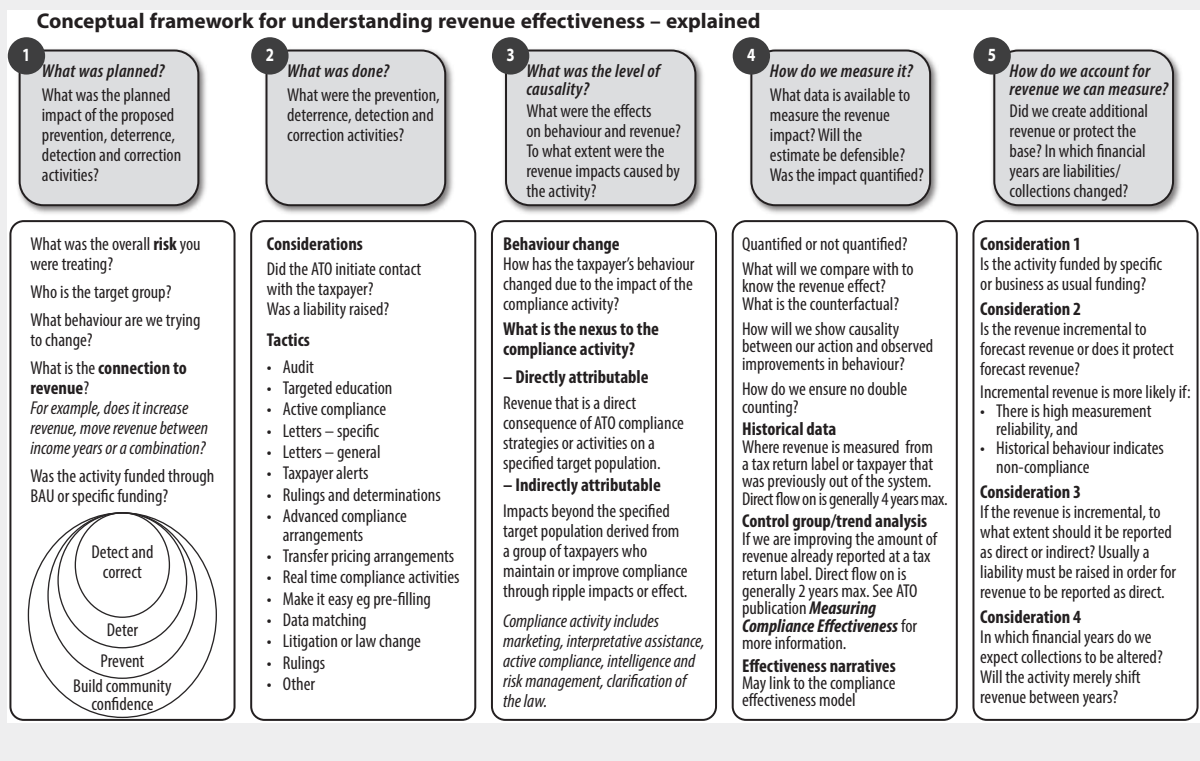
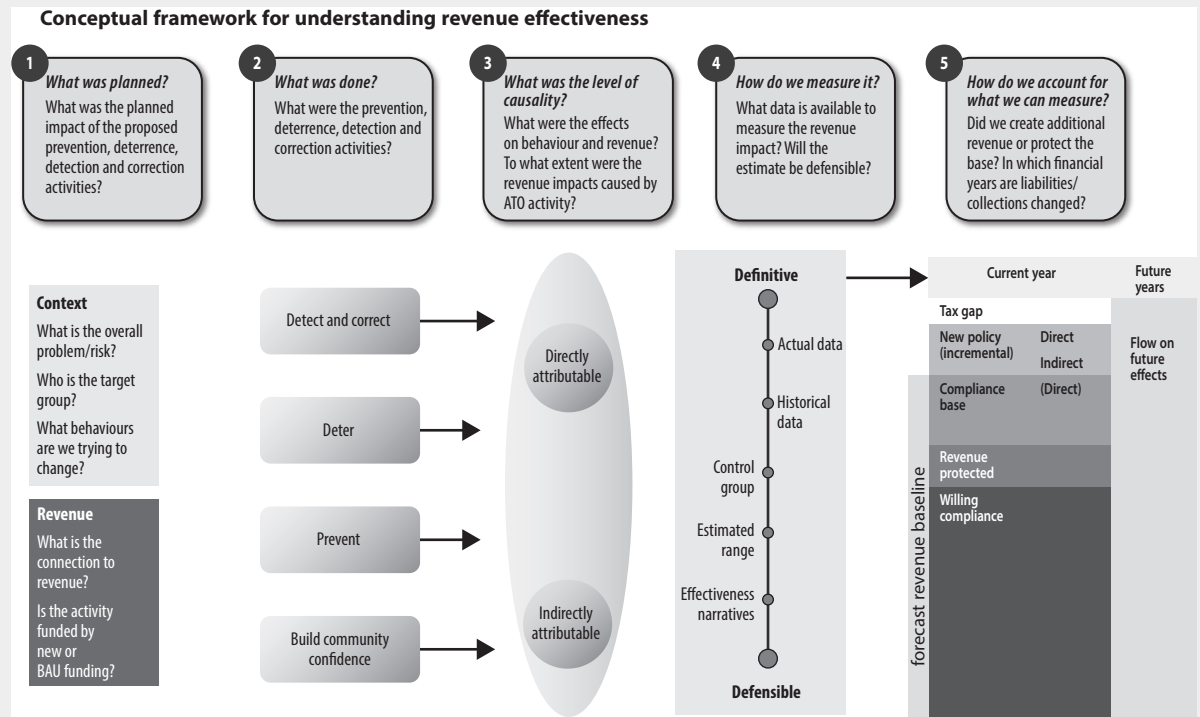
These wider revenue effects generally result from preventative activities which improve voluntary compliance, so that the additional revenue appears on tax returns submitted by taxpayers rather than audits by the revenue body's compliance officers. This shifts the focus from immediate cash receipts to a medium-term period as the measure of success considers the extent to which the intervention has a sustainable impact on compliance. As such the total revenue effect measure (including both audit yield and wider revenue effects) is closer to an outcome measure than audit yield. However total revenue effects are not a direct measure of tax compliance outcomes *per se*, but a measure of the effect of the revenue body's activities on revenue outcomes. Box 3.1 outlines a conceptual framework for considering these effects.

The strength of this approach is that it gives a common revenue currency for all activities. At the strategic level, this helps decision making as it is easier to compare and contrast the headline performance of all activities. In some circumstances, the strongest revenue effect will come from auditing returns that deliver the highest audit yield. In other circumstances, it may be from increasing the number of criminal investigations because of the stronger deterrent effect. At the operational level, it incentivises staff to prioritise activities with the highest impact on revenue outcomes over the medium-term. The total revenue effect measure supports the co-operative compliance elements of the strategy as it rewards operational performance on preventative activities that do not generate audit yield. Finally, it also encourages those administering the tax system to consider how improvements to processes can design in compliance.

Most revenue bodies that use, or are exploring, this approach disaggregate wider revenue effects as there are a diverse range of interventions (audit, letters, education, etc) and effects (this year, subsequent years, deterrent effect). Revenue bodies can also influence taxpayer compliance by changing the design of the system, processes and guidance. Disaggregating revenue effects can help explain the coverage of wider revenue effects and demonstrate

### Box 3.1. Conceptual framework for understanding revenue effectiveness in Australia

The Australian Taxation Office (ATO) has developed a conceptual framework to recognise the broader impacts of compliance activities using revenue as a metric.



specific challenges. A range of categorisation is possible and the figure below illustrates one possible categorisation with examples:

Figure 3.1. Total revenue effects

	Promoting future compliance	Preventing non-compliance now	Responding to past non-compliance
Specific taxpayers directly subject to an intervention	[A] Improved compliance following an intervention	[B] Real-time interventions	[C] Downstream interventions (e.g. audits or letters asking taxpayers to review their return or make a disclosure)
Taxpayers <i>not</i> subject to a direct intervention	[D] Deterrence from interventions and encouragement from wider communications		
All taxpayers using the process	[E] Process changes that make it easy to comply and hard not to		

Process changes that make it easy to comply and hard not to

1. Estimated revenue effects *following an intervention*: Revenue effects from the sustained compliance of a taxpayer, or a group of taxpayers, directly subject to an intervention. This effect generally covers future years.
  - a. A revenue body educates new small businesses about book-keeping, common errors and carries out face-to-face checks of processes before the first return is filed. Subsequent returns have fewer errors than comparable new businesses [A].
  - b. A revenue body writes to businesses that previously reported high expense ratios for their industry educating them on allowable expenses to allow them to check before filing this year's return. On average, the group declare lower expenses on their next returns than a comparable group that did not receive the letter [A].
2. Estimated revenue effects of *real-time interventions*: Revenue effects from a taxpayer, or group of taxpayers, directly subject to a real-time intervention (before the tax return has been submitted). These effects generally cover the current year.
  - a. A revenue body has an ongoing co-operative compliance dialogue with a large business. The revenue body becomes aware of the taxpayer's intention to claim a deduction which it believes they are not eligible for, and due to the revenue body's intervention the taxpayer does not include the deduction claim in the subsequent tax return [B].
3. Estimated revenue effects of *wider deterrence or encouragement from an intervention*: Revenue effects from the wider taxpayer population who have not been subject to a direct intervention. This might cover this year and future years.
  - a. A revenue body conducts a campaign on an industry with problems in the underground economy. An increase in registrations is seen for the industry compared to similar industries that were not included in the campaign [D].
  - b. A revenue body wins a lead litigation case that causes other taxpayers to change their position. Taxpayers in similar positions voluntarily declare more tax on their returns and some make voluntary disclosures for past years [D].

4. Estimated revenue effects of *process changes*: Revenue effects from changing a process that affects a group of taxpayers who are subject to the process but without a direct intervention. This might cover this year and future years.
  - a. A revenue body introduces pre-filling of boxes on the tax return. The amount of income declared rises for boxes where pre-filling is introduced [E].
  - b. A revenue body introduces a new system that means registration of imported cars can only occur once the tax has been paid. Tax revenues from imported cars rise [E].

### Box 3.2. Measuring compliance revenues in the United Kingdom

Since 2011-12, HM Revenue and Customs (HMRC) has calculated total compliance revenue based on a number of key components:

- Cash collected – measures the amount of additional compliance revenue when past non-compliance is identified (discounted for estimated unpaid amounts, for example, due to insolvency).
- Revenue losses prevented – the value of HMRC’s activities that prevented revenue from being lost, for example, by stopping a fraudulent repayment claim.
- Future revenue benefit – assesses the revenue effects of HMRC’s work on taxpayers’ future compliance behaviour.
- Product and process improvement – is an estimate of the value of HMRC’s activities that remove the opportunity for non-compliance, such as closing legal loopholes used to evade or avoid tax.

*Further details are available on the GOV.UK website (<https://www.gov.uk/government/collections/hmrcs-annual-report-and-accounts>).*

The main challenges of this approach are the practical issues of quantification and attribution as wider revenue effects need to be estimated. For all estimates a judgement needs to be made as to whether there is sufficient robust evidence to claim a revenue effect. Care needs to be taken that there is a genuine revenue effect, for instance that the taxpayer is in a taxpaying position for income taxes. Checks are required to ensure that multiple activities do not claim the same wider revenue effect (i.e. that there is no double counting). Care is also needed to consider unintended consequences, for instance that any effect is not offset particularly for avoidance by taxpayer’s displacing one scheme for another.

### Total revenue effects: application to the SME segment

Measuring all outcomes in a common revenue currency is particularly useful for the SME segment as they are frequently the target of a range of potential activities, and being able to compare the returns from these activities on a common basis makes decision making simpler and more likely to select the most effective approach for the situation. For example:

1. Many revenue bodies have introduced one-to-many approaches for SMEs (and other segments) to augment their traditional one-to-one audit approaches, characterised by



### **Total revenue effects: application to the SME segment** *(continued)*

communicating key messages to targeted audience through letters and publicity. Where the taxpayers involved are known, such as for letters, the revenue body can track subsequent returns to see if the intervention had the desired effect on tax reported and paid.

2. Including the sustained compliance impact of audits more accurately reflects the impact of audits on revenue outcomes, and enables the revenue body to make better decisions on the best use of resources, considering the medium-term and wider impacts, and not just the immediate cash receipts.
3. Changes to the revenue body's processes (and taxpayers) are particularly relevant to high-volume segments, such as SMEs and personal taxpayers, due to the prevalence of errors in these segments. Where specific taxpayers opt-in to using these tools the effect may be quantified by tracking their returns as they opt in; if coverage is mandatory then the overall error rate can be tracked before and after the change. Including these revenue effects incentivises changes to process where these can design out noncompliance more efficiently than corrective interventions.

Applying the total revenue effect approach to high-volume populations will often require estimating rather than counting these effects. The OECD FTA report "*Evaluating the Effectiveness of Compliance Risk Treatment Strategies*" from 2010 provides particularly relevant guidance for estimating the impacts on SME taxpayers because it outlines a range of statistical approaches that are relevant when an intervention involves many taxpayers. These techniques can provide robust estimates of compliance outcomes, which can be attributed to operational projects through statistical counterfactuals. Box 3.3 gives examples ranging from definitive to defensible evaluations.

A further challenge with total revenue effects is that working with estimates can be uncomfortable for those used to working with certainty. The limitations of estimates may be no worse than those for existing output measures, but these limitations will be different. These limitations need to be acknowledged and estimates need to be used appropriately. For many activities the only means of measuring effects is through statistical estimation, and a robust estimate is a significant improvement compared to making decisions on partial information for only those activities and effects that can be counted.

#### **Box 3.3. Evaluating the effectiveness of compliance activities in Denmark**

The Danish Customs and Tax Administration (SKAT) measures the effect of compliance projects.

##### **Effects of guidance and information on shareholders compliance levels**

SKAT has initiated compliance interventions directed at shareholders who fail to accurately declare their profit. Guidance letters were forwarded to a randomly selected group of shareholders, who had sold shares and not declared profit/loss. Subsequently the error percentage and the average adjustment (before tax) for the treatment group and a control group have been estimated. The total adjustment (before tax) has been extrapolated to whole target group.

### **Box 3.3. Evaluating the effectiveness of compliance activities in Denmark** (continued)

The project has subsequently been repeated with variations:

- Changing when the guidance letter is sent: before and after deadline for submission of tax return.
- Changing the intervention group, first all shareholders, later only shareholders 60+ years of age.
- Using different wording in the letter: guidance letter versus guidance letter including warning of future audit.

Outcome evaluations of the compliance activities show that providing information and guidance is effective in those cases where failure to conform with regulations is due to lack of awareness and/or inability to comply. A systemic solution was later implemented applying third party data to effectively eliminate the risk.

Further details are available on SKAT's website ([www.skat.dk/getFile.aspx?Id=65023](http://www.skat.dk/getFile.aspx?Id=65023)).

#### **Effects of campaign directed at Danish residents who own property overseas**

Danish residents with property overseas are taxed on the market value of the property. SKAT has initiated compliance projects directed at Danish residents who fail to declare property on their tax return. Guidance letters were forwarded to Danish residents who own property overseas informing them of the tax rules. SKAT also initiated campaigns and press coverage on the matter. Subsequently the error percentage and the amount of expected extra tax income were estimated.

The outcome evaluation of the project directed at Danish residents who own property abroad shows that it has proved possible to influence a large group of the population with campaigns, press coverage and a mass mailing approach in where it would not have been possible to increase compliance through traditional enforcement instruments.

Further details are available on the International Tax Dialogue website ([www.itdweb.org/documents/Measurement\\_report\\_foreign\\_property\\_270509.pdf](http://www.itdweb.org/documents/Measurement_report_foreign_property_270509.pdf)).

#### **Effects of a compliance project directed at driving instructors**

This project was directed towards driving instructors who fail to accurately declare their income tax and VAT liabilities. The project started from a traditional enforcement perspective, but evolved to include press coverage of audits and co-operation with the association of driving instructors.

Outcome evaluation of the treatment directed at driving instructors who fail to accurately declare their income tax and VAT liabilities indicates that warning of a possible tax audit, press coverage of audits, and co-operation with the association prompted driving instructors whose tax returns had not been audited to declare higher turnover. The results thus support the assumption that visibility of compliance interventions has an effect. There is also evidence that compliance increased among audited driving instructors in the years following the audits.

Further details are available on SKAT's website ([www.skat.dk/getFile.aspx?Id=66582](http://www.skat.dk/getFile.aspx?Id=66582)).

There are specific questions and challenges for some categories of wider revenue effects:

- Estimated revenue effects *following an intervention*: Unlike audit yield where revenue is paid on the close of an intervention, future revenue effect can be reported by year of intervention, year of revenue impact or both. While operational managers may be more interested in year of intervention to demonstrate whether they are using current resources effectively, stakeholders, such as the Finance or Treasury ministry are likely to be more interested in when any additional tax revenue will be collected (year of revenue impacts). There is no right answer to this question, and having the flexibility to report both on year of intervention and year of revenue effect, if not too costly, may be desirable to tailor the performance narrative to stakeholders' interests.
- Estimated revenue effects of *wider deterrence or encouragement*: These are often the hardest element to quantify and evidence as the effects may be spread across a large and undefined population. Where the deterrent effect is localised to an area or sector it is likely to be easier to detect.
- Estimated revenue effects of *process changes*: Process changes can be more complicated to value than interventions, as the costs of process changes tend to be front loaded but with ongoing revenue effects. These process changes may have long-term benefits but a counterfactual for calculating ongoing impacts only exists if impacts on specific taxpayers can be measured. Otherwise the counterfactual only exists at the point of introducing the change and the longer since the change has been implemented the more difficult it will be to evidence the current benefit of the system.

The experience of revenue bodies that have implemented the total revenue effects measure is that it is not possible to fully reflect the benefits of all activities. For instance, it may not be possible to establish a strong enough counterfactual to make a defensible claim for a wider revenue effect. Alternatively, a taxpayer ruling may have created confidence in the system and ensured the proper amount of tax is paid, but it may be unclear how a transaction would have been reported without the ruling in place.

#### **Total revenue effects: application to the large business segment**

For revenue bodies that use co-operative compliance approaches with large business taxpayers measuring the total revenue effect can capture some of the benefits of compliance engagement. Measuring these effects can help the revenue body demonstrate that co-operative compliance does not reduce assurance, as might be suggested by reduced audit yield, but that assurance has shifted from after the event audits of specific issues to an upstream systematic approach ensuring the right tax is paid at the right time. For large businesses wider revenue effects of co-operative compliance approaches primarily means quantifying the effect of real-time interventions and the benefits from agreements that take effect in the future.

Large business pre-return adjustments and agreements on future tax reporting tend to focus on the tax treatment of specific transactions rather than influencing the taxpayer's compliance intentions and behaviour. As such the future tax outcomes are fairly certain at the time of the engagement, and the resulting tax outcomes can usually be clearly measured by subsequent tax returns. Large businesses are subject to a high level of monitoring so revenue bodies can evidence that agreements on future tax treatment of specific items (for example advanced pricing agreements) have been implemented. The main uncertainty around the future tax revenue effect of such agreements is that large business settlements mainly relate to corporate income tax, and therefore the business' tax liability depends on whether the business is in a profitable and taxpaying position. While there will inevitably be cases where the outturn effect is higher or lower than the estimate on average these revenue estimates should be reliable.

### **Total revenue effects: application to the large business segment** *(continued)*

The main challenge with estimating the revenue effects of revenue bodies' large business pre-return activities is isolating the counterfactual. While outcomes can be observed, it is not always obvious what would have happened without the revenue body's intervention. Where a large business presents the revenue body with a clear and developed position then this initial stated position is a good counterfactual for estimating the additional tax revenue from the revenue body's intervention (the difference between the final agreed position and the taxpayer's initial stated position). However for engagement at a very early stage it may be clear that the revenue body has influenced the taxpayer, or just that it has assured that the taxpayer has the correct legal treatment, but it may not be possible to estimate the revenue effect of these interventions.

The total revenue effects measure has many of the same strengths as audit yield. It is a monetary value that can be compared across activities, and simply aggregated from operational teams, to segments and the whole of the organisation. Revenue bodies and external stakeholders are used to understanding and working with audit yield and these skills are transferrable to total revenue effects. However some caution is needed for users of this performance information as the headline comparability in a common revenue currency masks some subtle differences in interpretation between audit yield and wider revenue effects. Firstly, comparisons must be on a like-for-like basis or else performance can appear to have improved simply by counting more revenue effects rather than securing more revenues. Secondly, these wider revenue effects will include elements of estimation and therefore some element of uncertainty. However the benefits of a better understanding of current performance are likely to outweigh the costs of limiting historic comparability.

Tax revenue outcomes depend on both the effect of the revenue body's activities and changes in external factors, and the risks of non-compliance are not static but continually mutating. As noted in the previous section, it is possible for audit yield to rise whilst revenue outcomes weaken due to increases in non-compliance. Similarly it is possible for wider revenue effects to increase but revenues to remain flat as the revenue body's activities protect the tax base and prevent growth in the tax gap that would otherwise have occurred. The links from revenue effects of compliance activities to overall tax receipts and the tax gap are complicated, but it is possible to estimate the amount of revenue that a revenue body has impacted through broader interventions along with audits.

In summary, quantifying the total revenue effects of a revenue body's compliance activities is ambitious and brings new challenges; however these quantifications are important for understanding the effectiveness of interventions. One benefit of seeking to estimate revenue effects is that it brings self-imposed discipline to understand what interventions are effective to help improve performance, even if the estimates are not perfect. However revenue bodies using measures of wider effects need to ensure these estimates are defensible, taking care to ensure that there is no double-counting or over-estimation. Revenue bodies also need to ensure that stakeholders understand any changes in the measurement framework and that stakeholders have confidence in the approach.

## Tax assured

Tax assured measures the proportion of the tax base where the revenue body has “justified trust” through its activities or others’ activities that tax is “under control” and so assured as accurate and paid.

Tax assured measures the proportion of the revenue base where the revenue body has “justified trust” that the taxpayer is complying with all tax obligations, and in particular that the information reported in the tax return is reliable. Tax assured is conceptually a very strong measure because it summarises information on core compliance outcomes. It demonstrates where there is voluntary compliance in the tax system, which is just as useful as identifying where there is non-compliance. Measuring where the tax system is working well provides the right incentives to ensure that the tax administration system is designed to get the right revenue outcomes first time. It also helps decision making by showing where audit resources are not required, and can be a useful diagnostic indicator to identify areas of the tax system where revenues might be at risk or where the revenue body has insufficient assurance.

The level of assurance that revenue bodies seek is a “justified trust” that the right tax is reported and paid. This needs to be based on evidence that it is a reasonable judgement that the taxpayer is complying with all obligations and paying the right amount. This is not to suggest that this assurance provides absolute certainty that these revenues are completely accurate, as this level of absolute certainty is not attainable. This judgement can have varying degrees of confidence, which may be higher for some parts of the revenue base than others. For any part of the revenue base to be included in tax assured the revenue body must have justified trust based on reasonable evidence.

At the strategic level, it is useful for the revenue body to know the parts of the tax system where it can have confidence in the compliance outcomes. This is true regardless of whether the outcomes can be attributed to the revenue body as it simply may not be possible to attribute overall outcomes to specific interventions, particularly for upstream activities. Most tax assured measures are strategic measures because they do not attribute the right outcome to specific activities.

### **Tax Assured: Application to the large business segment**

One objective of co-operative compliance approaches is to assure that the right revenue is paid on time. Society is also taking a closer interest in whether large business taxpayers are paying the right amount of tax. Therefore as suggested in “*Co-operative Compliance: A Framework*” the share of the tax base that is under control, or assured, is a good starting point for measuring the success of the revenue body’s compliance approach for large business.

For the large business segment, quantifying this part of the revenue base might be measured by the total value of tax base covered by co-operative compliance agreements, low risk taxpayers or taxpayers with an adequate Tax Control Framework (the business’ system of internal controls that assures the accuracy and completeness of tax returns). These metrics alone will not provide full assurance that the tax base is reliable and will need to be supported by other evidence. Just as taxpayers in co-operative compliance approaches need to assure the revenue body that they have achieved the right tax outcome, so the revenue body needs to demonstrate to external stakeholders (such as oversight bodies and the public) that its compliance approach

### **Tax Assured: Application to the large business segment** *(continued)*

results in large businesses paying the right tax. For co-operative compliance approaches five methods were suggested to validate the headline tax assured measure:

- *Tax gap estimates:* Improved reporting compliance should result in a reduced tax gap for large businesses, particularly those co-operatively complying. However tax gap estimates can be challenging and contentious, particularly for large businesses as most tax issues relate to uncertain or disputed positions rather than unambiguous inaccuracies. More importantly tax gaps are limited as an operational measure because of the time lag in estimation. This time lag is particularly lagged for approaches based on audit results. There are further challenges where tax gaps are based on risk-based audits as the tax gap estimates are not independent of the risk assessment process, and where based on national accounts the tax gap cannot be disaggregated.
- *Random audits:* Many revenue bodies test the level of compliance by the SME segment through a random audit programme. However for the large business segment this approach might not be desirable. Audit coverage rates for large businesses are already very high (unlike the SME segment), the whole segment is subject to regular ongoing monitoring, and the cost of additional large business audits is expensive (both for the revenue body and taxpayers). So the added value of additional random audits where the large business' tax return does not show risks to merit selecting for audit is questionable.
- *Systems review:* An approach that is better suited to timely validation of tax assured might be to review a sample of the systems of taxpayers in co-operative compliance arrangements. This review would not replicate the revenue body's' risk assessment processes but would test whether the business has implemented and embedded the systems and governance required of taxpayers in a co-operative compliance arrangement. This is a verifiable and timely test, and if the taxpayer is operating tax controls as expected, it should not be costly to demonstrate how these work in practice to the revenue body. This approach avoids penalising taxpayers in co-operative compliance arrangements with additional compliance costs from random audits. Measuring the percentage of taxpayers that pass systems based review may be a means of achieving a reasonable level of assurance using a method that is capable of being verified as sound by external stakeholders.
- *Exceptions:* Revenue bodies may be able to evidence that it has correctly risk assessed taxpayers and is applying its co-operative compliance approach to the right businesses by demonstrating the exceptions, such as the numbers of taxpayers removed from the programme. These exceptions can demonstrate that the revenue body has sufficient monitoring to identify taxpayers not meeting its requirements.
- *Evaluation:* It should be possible to provide further validation of tax assured metrics by evaluating them in the future as with the benefit of time more data will become available (see Box 3.4). For example, revenue bodies may see whether their assessments of tax under control are consistent with whether new risks are identified and with finalised audit results.

For revenue bodies that use formal co-operative compliance agreements a range of comparisons can be used to test the effectiveness of the co-operative compliance approach. Firstly, considering large businesses before and after entering into the programme; secondly, comparing how comparable transactions are reported by taxpayers in the programme and outside; and thirdly, considering the trend for taxpayers joining the programme compared to similar taxpayers outside (or the general large business population). For each approach the revenue body would monitor improvements in compliance indicators from taxpayers entering the co-operative compliance agreement. To test the effectiveness of the approach the revenue

### **Tax Assured: Application to the large business segment** *(continued)*

body needs to bear in mind that large businesses entering into co-operative compliance agreements are unlikely to be representative of the general population. Large businesses in the programme may have better compliance outcomes because they started with better controls, rather than because of the programme.

While the focus on tax assured is as a strategic level measure, for specific higher risk areas operational measures of tax assured are also relevant. For instance, significant non-routine transactions pose particular tax risks. Where a revenue body has engaged with the taxpayer and reviewed these before the return and found the tax treatment to be correct, that demonstrates a valuable use of resource (as even though no additional tax revenues were raised there was a risk of incorrect tax that could not be assured without review) and a good outcome. An adaption of tax assured could be used for operational performance management to demonstrate that the revenue body remains effective at identifying and reviewing potential tax risks, and is using resources wisely.

There is no one “right” means by which revenue bodies achieve confidence in revenue streams, and it may be gained through its own actions or through those of third-parties. Revenue bodies can adapt how they come to have confidence in different parts of the revenue base according to the most relevant risks, systems and data available. Regardless of how the revenue body achieves justified trust, this trust requires regular ongoing testing as risks will change over time. Box 3.4 gives an example of how evaluation and research can provide assurance at a programme level.

#### **Box 3.4. Researching the compliance effects of the Compliance Assurance Process (CAP) in the United States**

Determining measures of compliance for the CAP programme for Large Business and International taxpayers continues to be a challenge for the Internal Revenue Service (IRS). For traditional post-filing examinations, the dollars assessed or recommended as a result of the audit has been accepted and used as a proxy measure of the compliance impact of the exam programme. For CAP, since the IRS and the taxpayer work together real-time on how issues should be treated for tax purposes, and the goal is to achieve correct reporting at the time the return is filed, dollars assessed or recommended is not a relevant measure.

However, as the CAP programme continues to expand and the number of participating corporate taxpayers has grown, additional attention has been placed on the compliance measurement challenge. In consideration of this challenge, IRS undertook a comprehensive research project to evaluate effects of CAP that are difficult to assess using traditional means.

The IRS research project was initiated to estimate some of the effects of the CAP that are not directly measurable. Areas of focus for the project were revenue remitted (US taxes paid) and taxpayer benefits (in terms of costs to comply and certainty). Research was conducted for CAP participants as well as a group of comparable non-CAP taxpayers.

Through the study, the IRS found that CAP revenue results were substantially similar to those under the traditional examination programme, providing assurance that CAP is not endangering the tax revenue base. Revenue results for CAP taxpayers and comparable non-CAP taxpayers were compared before and after the beginning of the CAP programme.

### Box 3.4. **Researching the compliance effects of the Compliance Assurance Process (CAP) in the United States** *(continued)*

The comparison controlled for: Firm size, Industry, Publicly traded, Foreign activity, Debt ratio, Capital intensity ratio, Return on assets, Net operating losses carry forward, and Income or loss status.

CAP taxpayers were found to have relatively higher reported US tax rates at the time of return filing than non-CAP taxpayers. This tendency reversed for post-filing rates. In effect, consistent with the goals of the programme, CAP taxpayers paid more tax at the time of filing than non-CAP taxpayers, and a lesser amount after the return was filed and examined. The overall tax rates (amounts paid pre and post filing combined) for CAP taxpayers remained substantially similar to those of non-CAP taxpayers.

The CAP programme was also designed with an understanding that compliance costs may increase during a taxpayer's initial transition into CAP and then decrease once the taxpayer gains experience with the programme. Research results support those assumptions. The IRS's Tax Year 2009 business taxpayer burden survey included sub-samples covering CAP and other larger taxpayers. Regression results provide limited evidence of lower compliance costs for CAP participants compared with comparable non-CAP taxpayers. SEC-based findings also supported this interpretation.

SEC filing data provides information on tax related fees paid by taxpayers who use auditors in preparing their returns. Regression results indicate lower tax related fees for CAP taxpayers once they have been in CAP for at least one year, as compared with comparable non-CAP taxpayers for the same time periods. Lower fees are consistent with decreased reliance on paid preparer signature. Decreased use of paid preparer signatures also suggests increased taxpayer certainty at the time of filing.

In summary, the IRS CAP research project found that CAP revenue results are substantially similar to the traditional programme, achieved sooner and with more certainty. The research is helpful in demonstrating the effects of the CAP programme and complements programme measures based on directly observable outcomes. Periodic updates to the CAP research can then be undertaken as the programme continues to grow and evolve.

Across taxpayer segments both the level of feasible assurance will vary and the best means of achieving justified trust. For high-value taxpayer segments where there is ongoing one-to-one monitoring and insight into the taxpayer on an individual level this is likely to provide the best evidence. In the case of high-volume taxpayer segments this evidence may be from behaviours evidenced at a group level through a range of means.

### **Tax Assured: Application to the SME segment**

The strength of a tax assured measure for SMEs is that it can bring together a range of information into a single metric: the proportion of the revenue base that is assured. There are a wide range of means for revenue bodies to develop justified trust in SME's revenues through additional information (such as the Merchant Acquirer data), compliance agreement tax intermediaries, use of approved software and small business benchmarks. These approaches can be validated through the use of random audits, book-keeping and staff-register checks and systems reviews (see Box 4.3). This may also be supported by wider measures of voluntary compliance.



### **Tax Assured: Application to the SME segment** *(continued)*

The level of assurance possible for a given SME will not be as high as for large businesses that are monitored on an individual basis, but this does not limit the reliability of aggregate measures of tax assured for SMEs.

A particular challenge for tax assured measures for the SME segment is that it cannot assure revenue streams that are completely missing. For the hidden or underground economy, where there is no participation in the tax system, these revenue streams cannot be assured. Revenue bodies will need other measures to identify non-compliance by those not participating in the tax system.

For private taxpayers, the use of third-party reporting, withholding taxes and pre-filing of returns are means of providing confidence that the revenue streams from these sources are correct (see Box 3.6).

Tax assured measures the part of the revenue base that the revenue body has confidence in. There will be parts of the revenue base with the correct outcome that are not included in tax assured, because the revenue body has not actively found confidence in the process delivering the outcome. Therefore measures of tax assured can increase both because the outcomes are improving (more of the revenue base is getting it right) and because the revenue body's understanding and confidence in the revenue base is increasing. However demonstrating that the revenue body understands and is in control of the tax administration system is important in itself. One part of this understanding is the level of relevant information that the revenue body holds on the revenue base (see Box 3.5).

#### **Box 3.5. Tax Information Map in Sweden**

The Swedish Tax Agency (STA) has developed a Tax Information Map, which shows the extent to which the STA has access to tax information, i.e. information with which to settle taxes and check tax returns, over and above the information submitted by taxpayers themselves.

The more reliable information the STA has access to regarding the taxation basis, the smaller the scope for errors and the easier it is for the taxpayer to make a correct tax return. It adds to the overall picture by showing how the risk of non-compliance varies between different parts of the tax system and how it has developed over time.

In the Tax Information Map the various taxes are categorised depending on the extent to which there is access to information regarding the basis for taxation from sources other than the taxpayers themselves. From this categorisation, the average level of information per Swedish Krona in tax revenue is calculated, showing the degree to which taxes were settled and checked using information from sources other than the taxpayers themselves. The Tax Information Map only covers settled taxes, not the theoretical tax liability.

Further details are available on STA's website ([www.skatteverket.se/download/18.15532c7b1442f256baeae28/1395223863738/The+development+of+the+tax+gap+in+Sweden+2007-12.pdf](http://www.skatteverket.se/download/18.15532c7b1442f256baeae28/1395223863738/The+development+of+the+tax+gap+in+Sweden+2007-12.pdf)).

Tax assured is conceptually different to audit yield and total revenue effects. Audit yield, and to some extent total revenue effects, measure the improvement in revenue outcomes from fixing failures in the system. The better the tax administration system is,

the less scope there is for revenue bodies to improve immediate cash receipts. Tax assured measures levels of tax compliance outcomes: the extent to which the right tax is paid at the right time. While demonstrating a high level of tax assured cannot be linked to immediate additional tax revenues, it demonstrates integrity of the tax administration system, which is required to sustain the revenue base.

While both upstream and downstream approaches might be able to achieve the same ultimate revenue outcome of the right tax being collected, the revenue body also wants to know how efficiently this was achieved both for its costs and the compliance costs of taxpayers. The most efficient way of achieving this outcome will depend on the circumstances; for circumstances and taxpayers where upstream approaches are appropriate they are often a more efficient means of achieving the same revenue outcome.

### Box 3.6. Measuring the impact of pre-population in Denmark

The Danish Customs and Tax Administration (SKAT) introduced third-party information reporting for tax deductible charitable contributions in tax year 2008. Charitable organisations report contributions from each taxpayer directly to SKAT and SKAT pre-fill charitable deductions on taxpayers' annual declarations (pre-population). Prior to tax year 2008, deductions for charitable contributions were self-reported and subject to verification only upon an audit.

The effect of the policy change on reported deductions was immediate, large and in some respect surprising. The number of taxpayers claiming a charitable deduction doubled, while the total value of contributions rose only 15%, due to a fall in the mean charitable tax deduction of 42%.

The evaluation provides evidence of substantial under-claiming of charitable tax deductions – and very little tax evasion – under the self-reporting regime.

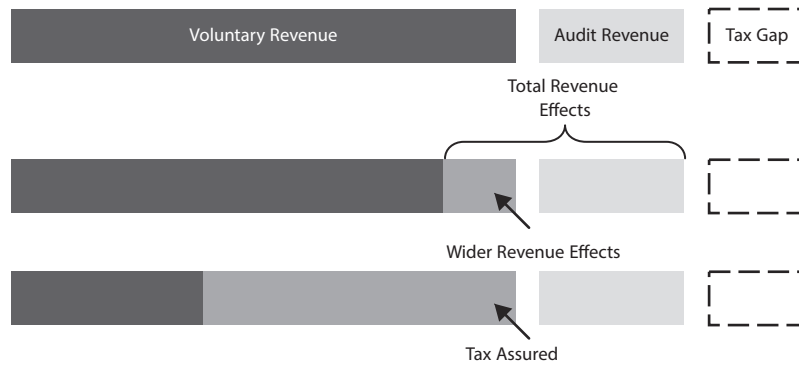
Further details are available in a working paper ([http://web.econ.ku.dk/eprn\\_epru/Workings\\_Papers/WP-13-04.pdf](http://web.econ.ku.dk/eprn_epru/Workings_Papers/WP-13-04.pdf)).

In summary, measures of tax assured are conceptually strong as they summarise information on core compliance outcomes. While tax assured is measured in revenue outcomes it is also an indicator of the voluntary compliance in, and integrity of, the tax administration system. As the examples in this section demonstrate, tax assured can be pragmatically measured and validated as a robust and reliable measure.

## Using measures of revenue outcomes

For a revenue body wishing to build on audit yield with other revenue metrics it may seem that there is a choice between the two newer approaches of total revenue effects and tax assured. Figure 3.2 demonstrates the difference between total revenue effects and tax assured: Wider revenue effects covers only the revenue impacts from improvements in voluntary compliance that directly result from the revenue body's actions; in contrast tax assured covers a larger proportion of the voluntarily compliant revenue base that the revenue body has assured as compliant, including the proportion that was not directly influenced by the revenue body.

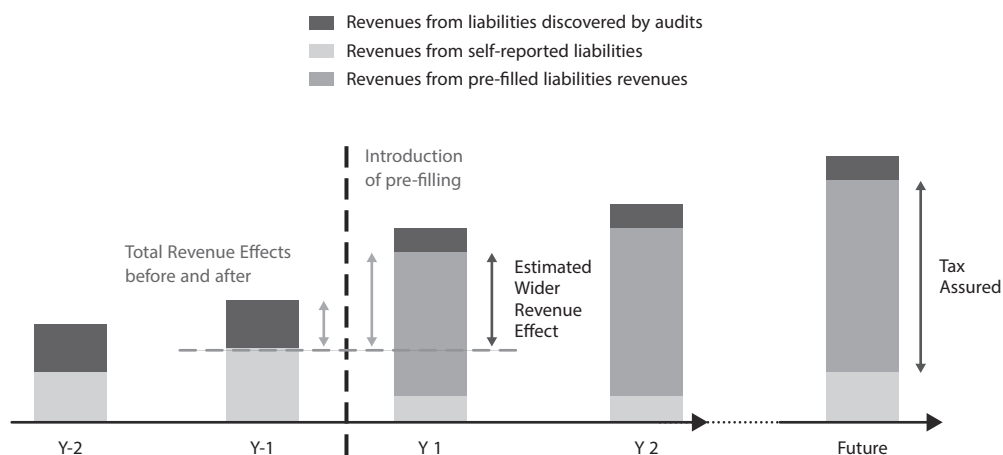
Figure 3.2. Measures of revenue outcomes



However total revenue effects and tax assured are complementary measures. For example, through audits a revenue body identifies high error rates on an area of the tax return. It therefore introduces pre-filling for sources where it has third party information. When the change is introduced the revenue body estimates and reports the wider revenue effect by comparing the voluntary declared tax in the year before and after the introduction of the change. However once the change is embedded it becomes more difficult and less meaningful to evidence the counterfactual, and impractical to continually produce estimates for historic process changes. Therefore once the change is embedded a simpler measure of tax assured can be more useful measure that simply says that pre-filled liabilities are tax that has been assured. Figure 3.3 shows this example where estimated wider revenue effects are used to demonstrate the initial additional revenues, which can be useful for justifying the return on investment, but in the longer-term tax assured is used to demonstrate that the revenue body has confidence in the sustained compliance of this area without attempting to attribute specific additional revenues to this initiative.

Total revenue effects incentivise operational staff to fix compliance issues with the highest return on investment using the most effective and efficient intervention, which is likely to focus on areas of poor compliance. Whereas tax assured measures best practice and encourages administrators to design tax processes (such as pre-population) and wider systems (such as co-operative compliance approaches) to ensure that the right tax will be paid at the right time.

Figure 3.3. Complementary use of revenue approaches



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## *Chapter 4*

### **Practical approaches for measuring voluntary compliance outcomes**

*This chapter outline three pragmatic approaches for measuring and attributing voluntary compliance outcomes. These voluntary compliance outcomes relate to taxpayers' behaviour in complying voluntarily with tax obligations: registration, filing, reporting, payment and any additional obligations. In essence, it is about taxpayers being "in control" of their tax obligations, which covers both what tax results and how the taxpayer got to that result. These approaches are not exhaustive but draw attention to some of the best current and emerging practice for revenue bodies to consider drawn from a survey of the OECD Forum on Tax Administration membership.*

This chapter outlines three measurement approaches that directly measure voluntary compliance: measures of the four domains of tax obligations, measures of systematic compliance behaviour and effectiveness narratives. Direct measures of taxpayers' voluntary compliance have the advantage that they provide more detailed diagnostics, but at the expense of a common currency of revenue. These three approaches focus directly on taxpayer behaviour and changes to taxpayer behaviour. As behaviour is complex, a range of metrics and narratives are used for reporting.

## Measuring taxpayers' compliance in the four domains of tax obligations

Measuring the four domains of tax obligations directly measures whether taxpayers have voluntarily complied with their core procedural obligations.

Improving taxpayers' voluntary compliance is a fundamental outcome for revenue bodies. This can be measured objectively by whether taxpayers have voluntarily complied with their obligations. While specific obligations of taxpayers vary from one tax regime to another and from one jurisdiction to the next, these four universal categories of obligation are likely to exist for almost all taxpayers:

1. To register for tax purposes;
2. To file tax returns on time;
3. To correctly report tax liabilities; and
4. To pay taxes on time.

Most revenue bodies have established indicators for some or all of the four domains of taxpayers' obligations, and external stakeholders are generally interested in these metrics as they are simple to understand outcomes.

A distinction can be made between voluntary compliance where taxpayers comply with these basic obligations voluntarily and enforced compliance where taxpayers comply following a revenue body's intervention. This distinction is highly relevant as enforced compliance often has significant costs. Revenue bodies' ideal desired outcome is for full voluntary compliance but where non-compliance exists enforced compliance is required. Taxpayers who fail any of their obligations may be considered to be "non-compliant", although the reason for their non-compliance may fall along a continuum extending from unintentional error to deliberate evasion.

### Four domains: application to the SME segment

The OECD FTA report "*Compliance Risk Management: Managing and Improving Tax Compliance*" (2004) by the SME Compliance Sub-Group introduced the four domains as an approach for monitoring SME compliance. The distinction between monitoring and operational performance measures is that monitoring does not try to assert any causal link between the observed outcomes and the revenue body's actions (see the principles from Chapter 2 on attribution). Simply understanding these trends can be useful to identify risks where resources should be prioritised.

### **Four domains: application to the SME segment** *(continued)*

The domains of taxpayer obligation are useful indicators of the health of the tax administration system and participation in the tax system. Across many OECD countries SME compliance with the four domains is not as high as desired and there is potential, and a desire by revenue bodies, for improvement on these results for SME taxpayers. Procedural compliance could be improved to reduce late filing and late payment. More importantly, non-compliance with registration, non-payment and inaccurate reporting can lead to significant amounts of unpaid taxes. The four domains can help revenue bodies identify where there are issues in the tax system and where it is functioning well. Therefore it is useful as a diagnostic tool as well as a measure of strategic objectives.

The main limitation of the four domains as performance measures is that the domains are influenced by a range of factors and at the strategic level it is difficult to assign accountabilities. However it can be used with greater accountability at operational level where there is a particular target group. For interventions that target a specific group of taxpayers it may be possible to demonstrate the contribution of individual projects for that group (particularly by comparing against trends for non-targeted taxpayers), see Box 4.2 for examples.

Measuring voluntary compliance is straightforward for some tax obligations but more difficult for others. In general, filing on time and payment on time can be measured easily and timely. Reporting compliance can be estimated through random audit programmes, or trends can be estimated through comparisons with economic data or with business benchmarks of expected reporting. Registration compliance, covering both failure to register and ineligible registrations, is usually the most difficult to assess. Box 4.1 outlines Canada's approach to using measures of voluntary compliance.

#### **Box 4.1. Use of voluntary compliance indicators in Canada**

The Canada Revenue Agency (CRA) uses aggregate measures of voluntary compliance to demonstrate its success in achieving its strategic outcome that “taxpayers meet their obligations and Canada’s revenue base is protected”. The CRA publishes (or has published) several quantitative measures of taxpayers’ voluntary compliance with filing and payment obligations. For the 2012-2013 fiscal year, the CRA published rates for the following:

- Corporations with taxable income that filed their tax return on time (85%)
- Individuals that filed their tax return on time (92%)
- Individuals who paid their reported taxes on time (95%)

Filing and payment rates are calculated on an annual basis, shortly after fiscal year end, and are reported publically in the fall through the CRA’s Annual Report to Parliament and companion Departmental Performance Report. These year-over-year metrics help illustrate taxpayers’ participation in the tax system and provide context as to the overall health of compliance in Canada. In the past, the CRA has also reported rates that show that, of known filers, nearly all corporate and individual returns are filed within five years of the due date – either voluntarily or as a result of the Agency’s interventions. This longer term view has helped to demonstrate the CRA’s fulfillment of its mandate to ensure compliance.

#### Box 4.1. Use of voluntary compliance indicators in Canada *(continued)*

On a quarterly basis, the CRA also monitors a range of internal indicators. A selection of these – total individual returns assessed, total corporate returns processed, total electronic payments processed – track cumulative year-to-date volumetrics. While not outcomes, this data can still provide a view on compliance patterns. The CRA forecasts processing volumes based on historical data, and while variance analysis of actual to forecast volumes supports tactical decision making, the extent to which filing and payments rates are consistent with historical trends can also be inferred. That is, if processing volumetrics are generally consistent with forecasts then, presumably, voluntary filing and payment rates are unlikely to deviate substantially from past results.

The exact nature of obligations varies across taxpayers' roles. For example withholding agents, such as an employer, may be obliged to file and pay taxes on behalf of a taxpayer rather than the taxpayer themselves, such as an employee. These domains can be interpreted broadly, encompassing all tasks required to fulfil the obligations; for instance, correct reporting requires good record keeping.

#### Four domains: application to the large business segment

Compliance outcomes across the four domains of tax obligation are just as relevant for large business taxpayers as SMEs. However, large businesses tend to have dedicated tax teams and procedural compliance is high. Large business taxpayers also often have additional tax obligations, for example, many countries' tax regimes require payment on account or instalment payments from large businesses. Therefore the interpretation of the four domains concept needs to be adapted for the large business segment. For instance, measures of the payment behaviour of the taxpayer should include the accuracy of upfront instalment. Measures of timeliness can be extended from timely filing and payment to the time it takes for the taxpayer to file a return and the time to finalise the tax liability (including resolving any disputes).

For large businesses the focus is primarily on compliance in the accurate reporting domain. Large businesses' size, complexity and number of corporate entities mean that it is not possible to give absolute assurance of the accuracy of a tax return. Nor is it particularly meaningful to consider the absolute accuracy. Instead revenue bodies need to know that returns are materially accurate with no systematic bias (small errors will result in more tax in some cases and less in others). Assessing the accuracy of large business returns is more complicated than for SMEs as large business' tax positions are more often uncertain, disputable or non-commercial tax planning rather than clearly legally inaccurate. It can take years for final legal resolution of complicated tax disputes. Therefore practical timely measures may be better focused on the number of returns filed without material risk issues, rather than the number of returns finally determined to need no adjustment. Most of these indicators are best used for monitoring than as a performance measures: such as levels of voluntary disclosures, benchmarking income, effective tax rates or changes in these metrics compared with the trends of the economy, with peers in their sector, and with expected changes from legislative change.

At the strategic level, it is important to measure and monitor overall voluntary compliance as it is a core outcome. However it is best used as a health check indicator, particularly focusing on longer-term trends, as changes in the outcome are not directly attributable to the revenue body. It is important to understand the reasons for any variations in voluntary



compliance, which can fluctuate due to a range of external factors, such as economic conditions. Furthermore taxpayers' underlying attitudes and behaviours are often slow to change, which is coupled with time lags for measurement, for example returns are often not due until sometime after the activity has occurred. These factors suggest that at the strategic level measures of voluntary compliance should be viewed over longer-term horizons.

Some domains have high and stable compliance which limits the scope for further improvement, particularly for filing on time and to some extent payment on time. However by identifying and monitoring areas of sustained compliance the revenue body can prioritise resources to other risks and justify why resources were used this way.

For many revenue bodies measuring overall levels of voluntary compliance has not been a strong driver to improve performance at the operational level. While measures of tax compliance are meaningful at the strategic level, it is not possible to show how operational teams' activities directly affected the measure. The weak and lagging feedback from activity to resulting outcome means that measures of voluntary compliance do not provide strong incentives to improve operational performance. It will always be difficult to identify how individual operational projects contribute to overall voluntary compliance, and this limits the usefulness of strategic level measures for operational purposes. However if there is a significant initiative for a segment then it may be possible to identify improvements in voluntary compliance for that segment using the four domains, and for revenue bodies to have confidence that specific activities contributed to the improved outcome (for example, see Box 4.2).

#### **Box 4.2. Industry Campaign Approach (ICA) and the Liaison Officer Initiative (LOI) in Canada**

The Canada Revenue Agency (CRA) has introduced proactive initiatives to promote the compliance of various taxpayer segments.

##### **Industry Campaign Approach (ICA)**

The ICA is being piloted as a way to encourage voluntary tax compliance within various industry sectors. Through the ICA, the CRA works with industry associations in various sectors to provide businesses with sector-specific tax information that will help them comply with their tax obligations.

The objectives are:

- to enhance our relationship with selected industry sectors;
- to provide useful information and education for businesses on how to avoid potential tax pitfalls; and
- to identify industry benchmarks that businesses may find helpful in assessing their financial performance in comparison to others in the same sector.

##### **Liaison Officer Initiative (LOI)**

The LOI is being piloted in Canada within various industry sectors to test a suite of innovative compliance treatments to support taxpayers in meeting their tax obligations. This approach will help the randomly selected taxpayers within these sectors avoid common errors and encourage positive compliance behaviours within the SME community. The LOI will use the following treatments to build relationships and work with members of the SME population

**Box 4.2. Industry Campaign Approach (ICA) and the Liaison Officer Initiative (LOI) in Canada** *(continued)*

and their representatives to provide them with information and guidance to support them in meeting their tax obligations “right from the start”:

1. *Small Business Support Visits*: Liaison Officers will visit SMEs on a voluntary, one-to-one basis to provide income tax support and guidance.
2. *Books and Records Reviews*: Liaison Officers will complete limited reviews of the books and records of businesses operating within the SME community. These reviews will ensure that the taxpayer’s records are complete and up to date, with the goal of correcting any discrepancies prior to filing.
3. *Compliance Support Arrangements*: Liaison Officers will enter into protocols with taxpayers in the SME community on behalf of the CRA. These arrangements will highlight the CRA’s responsibilities as defined in the Taxpayer Bill of Rights, outline the benchmarks and common errors applicable to the taxpayer’s industry, and ask that the taxpayer commits to avoiding these common errors.

**Measurement**

A number of specific measures have been developed for each initiative so that the CRA can assess whether these interventions help taxpayers to make the necessary changes to comply with their tax obligations. These include:

***Change in reporting compliance behaviour***

- rate of reporting compliance (established through random audits), trend analysis, comparison to control group where possible or SME population
- trend of revenues and revenue ratios reported by selected taxpayers, comparison to control group (where possible) or SME population
- trend of expenses and expense ratios reported by selected taxpayers comparison to control group (where possible) or SME population
- percentage of taxpayers in the sector that requested a reassessment of past returns, trend analysis, comparison to control sector (where possible) or SME population
- percentage of taxpayers in the sector that have made disclosures through the CRA’s Voluntary Disclosures Program, trend analysis, and comparison to control group (where possible) or SME population
- change in nature of observed non-compliance as established through our Research Audit Program (random audits)

***Change in filing compliance behaviour***

- rate of filing compliance (filing on time rate and average Late Filing Penalty amount) and trend analysis, comparison to control group (where possible) or SME population

***Change in payment compliance behaviour***

- rate of payment compliance, trend analysis, comparison to control group (where possible) or SME population

In summary, the four domains is a fundamental measure of compliance outcomes and are important in providing a comprehensive view of performance. However it needs to be supported by other measures at the operational level to demonstrate how the revenue body's compliance approach contributed to improvements in the four domains.

### Measures of taxpayers demonstrating systematic compliance behaviour

System-based approaches focus on *how* taxpayers attempt to voluntarily comply with their tax obligations. This can be measured by the numbers of taxpayers demonstrating systematic behaviour to comply with their tax obligations.

Revenue bodies are increasingly looking towards a deeper understanding of taxpayer behaviour and system-based compliance approaches, in part enabled by new digital technologies. These new approaches and techniques create new opportunities to measure compliance outcomes and to assess the effectiveness of interventions.

The four domains approach measures the proportion of taxpayers who have complied with the revenue body's procedures at a snapshot in time. Revenue bodies have wanted to understand behaviour more deeply but this has not been previously been possible with the data available. Better data and technology is now creating opportunities for measures that can view individual taxpayer's behaviour in real-time, over longer-time horizons and at life events (such as employing staff for the first time, or making initial international transactions). At the operational level, this allows revenue bodies to quickly determine what actions have an immediate impact and whether that impact is sustained; as well as which interventions work in which contexts, in particular at life-events that present significant compliance risks. While some of this has previously been possible for high-value taxpayer segments through one-to-one engagement and monitoring it is now becoming possible for high-volume segments such as SMEs. Box 4.3 provides an example of how this can be used to measure the effectiveness of new initiatives.

#### Box 4.3. Measuring compliance using advanced analytics in the Netherlands

The Netherlands Tax and Customs Administration (NTCA) has developed a comprehensive "lifecycle" information system, which follows every debt collection transaction or event, by combining data from several internal systems. This system ("incassoketen" or "collection chain") provides insight on the status of each debt of each individual taxpayer (private and company) over time. The system holds four years of historical data, and is updated with new data each week. This enables monitoring taxpayers' payment behaviour in real time and allows the NTCA to monitor the direct effects of interventions on taxpayers' payment behaviour.

Putting historical data in the information set is a crucial step because it allowed the NTCA to learn from earlier actions and gave a head start in measuring compliance. The life cycle information is used in broad analyses on the impact of different types of interventions made by NTCA such as tax assessments, compliance activities and internal performance measurement. The analyses have provided valuable insights:

- A first example is that analysis showed a significant difference on timeliness of payments between businesses that are part of NTCA's co-operative compliance programme and businesses that are not part of this programme.

**Box 4.3. Measuring compliance using advanced analytics in the Netherlands**  
(continued)

- A second example is that NTCA is able to monitor the direct impact of the use of new debt collection techniques (such as a phone call from a tax official instead of a reminder letter).
- The final example is the creation of a “watch-list”: the lifecycle system is combined with other sources of information which enables the NTCA to monitor taxpayers with debts who receive new income.

These actions increase revenue, while structural organisational costs will decrease because the NTCA can make better, more informed decisions on the type and intensity of actions directed towards taxpayers and the amount of employees needed to do so.

The information and analyses are input for innovative approaches in areas of the organisation where the NTCA can increase efficiency and effectiveness (performance management). They are also useful for further profiling taxpayer behaviour.

At the operational level, the same information system is used in a feedback loop in the organisation. By building tailor-made dashboards for each process, sub process, and managerial layer, the direct results of debt collection activities are being shown to managers, teams and employees. With this information, day to day actions and decisions are better informed and aligned with the tactical and strategic choices in the organisation.

**Conclusions**

- Building event based information systems helps with measuring compliance
- Historical data gives a head start in understanding compliance and effects
- Information sets on the lowest or deepest level of detail and in real time provide broad opportunities for measuring compliance and performance management.

These approaches reflect a growing interest in the drivers of taxpayer behaviour: it is not only procedural compliance that matters but whether taxpayers are trying to comply and why those intentions are not always realised. Many revenue bodies are now taking a broader view of compliance, including taxpayers’ environment as one of the main drivers for compliance and one of the most productive areas to influence to produce better compliance outcomes. This system-based approach emphasises checking the reliability of the systems and processes used to comply with obligations rather than specific issues/risks on the return. This is described in the OECD FTA “*Right from the Start*” report:

If we want to have a tax return that is a correct representation of all tax-relevant transactions, it is not efficient, if possible at all, to focus on all single events: a better way to deal with this is to focus on the business processes dealing with these transactions. This implies that especially in a business environment focusing on end-to-end tax processes (from transaction to tax return and payment) is necessary. (OECD, 2012)

System-based compliance approaches focus on the integrity of the taxpayer’s process for getting to the correct figures in the tax return. This shifts the revenue body’s focus from processes to taxpayer behaviour. This suggests new measures of “badges of compliant behaviour”: actions of the taxpayer or a third-party that demonstrate that the process is likely to get to an accurate tax return or that demonstrate an active intention and effort to

do so. This may include measures of use of agreements with the revenue body, tax control frameworks, pre-filing, data matching, use of approved agents, use of approved software, assurance measures of quality from real-time reviews, etc. These approaches build on the four domains measures and expand the focus from the revenue body's procedures to the taxpayers' procedures and together give an end-to-end view of compliance.

### **Measuring systematic compliance behaviour: application to the SME segment**

Since the four domains were introduced, the evolution of compliance approaches together with advances in technology has enhanced revenue bodies' ability to measure taxpayers' behaviour. Revenue bodies are making better use of their data for SMEs and personal taxpayers to understand a complete picture of their transactions with the revenue body and better understand life events in taxpayers' lifecycles. This enables a richer picture of compliance behaviours than was previously possible. For example, revenue bodies can separate persistent deliberate late payers from taxpayers that have a one-off cash flow difficulty. Revenue bodies are increasingly making use of this data to tailor their compliance approach to taxpayers and this information can also provide insights into taxpayers' voluntarily compliance outcomes.

A related trend since the four domains approach was introduced is the move from focusing on the revenue body's processes to "seeing the taxpayers' processes and the revenue body's processes "end to end" and identifying opportunities for building compliance into taxpayers' record and tax returns as they are being created" (OECD, 2014). These approaches suggest measuring the behaviour of taxpayers as they attempt to comply, for instance by opting in to pre-filing or making use of certified software or agents. In the future these changes could also make the traditional return process redundant as data may be reported continuously and automatically (as is already used in some tax administrations). The taxpayer would still be providing information on their tax liability but there would be no need to "file" a discrete return.

These "badges of compliant behaviour" do not give certainty that the taxpayer has got it right but should give some assurance that the taxpayer is on the right track. Revenue bodies will need to learn from exceptions and have appropriate lower level diagnostics to understand what improvements are necessary (see Box 4.4).

#### **Box 4.4. Adopting a systems approach: focus on learning in the Netherlands**

In recent years, the Netherlands Tax and Customs Administration (NTCA) has implemented a co-operative compliance programme (horizontal monitoring) for SMEs. This is based on compliance agreements with tax intermediaries and SMEs can join this programme via their tax intermediary. Under the programme the focus in compliance activities is on securing the quality of the tax return upfront. It includes arrangements for disclosure of tax issues upfront (before filing). The quality of the tax returns is further assured by the quality framework that the tax intermediary is applying.

The NTCA monitors the quality of the tax returns filed under the programme by two key measures:

- The first measure is based on a small number of tax returns selected for sample audits. The tax returns included in this sample are audited immediately following filing and these audits are completed within two months. This provides taxpayers whose tax return is selected for a sample audit, with certainty on short notice.

**Box 4.4. Adopting a systems approach: focus on learning in the Netherlands**  
(continued)

- The second measure can be described as a process review: based on a number of filed tax returns NTCA checks the proper handling of the administrative and tax issues related to these tax returns.

Both measures are meant to serve as systems checks. Although possible mistakes will be corrected, most likely by the taxpayer, the focus is on learning: on which issues does the system have weaknesses or flaws and what measures must be taken by the tax intermediary (or the taxpayer) to make improvements.

The outcomes of these sample audits and other checks are shared not only with the tax intermediary, but on an aggregate level also with umbrella organisations of tax intermediaries. This is a basis for constant improvement and further development of procedures.

This combination of sample audits and process checks helps NTCA in establishing increasing insights into the effectiveness of the NTCA's horizontal monitoring programme. Firm conclusions can't be drawn at this stage due to the limited number of audits and checks over the past two years, but initial results seem to indicate that the quality of tax returns under the programme is better than average and improving.

This wide range of potential behavioural measures provides too much granular competing information for a coherent strategic overview. This is possible either by segmenting the taxpayer base, for instance by the proportion of taxpayers considered at low, medium and high risk. Or by using tax assured measure to provide the strategic level view, and using these behavioural measures for specific programmes and as the underpinning evidence for the revenue body's "justified trust" in the tax assured metric.

**Measuring systematic compliance behaviour:  
Application to the large business segment**

The four domain approaches focus on whether the taxpayer complies with the revenue body's processes. But it is arguably more important that large business taxpayers have systems and processes in place to produce figures for their tax returns which are accurate in all material respects. Most large business taxpayers comply with deadlines for submitting returns and payments on time, and, as discussed in the four domains approach, it is difficult and expensive to definitively measure the accuracy of tax returns. Therefore rather than measuring compliance with the revenue body's processes, the revenue body can directly measure the adequacy of the large business taxpayers' behaviours, processes and systems. This measurement should be multi-dimensional covering capabilities, governance and intentions. These metrics may be too technical for a general audience but can provide firm evidence and support for headline measures such as tax assured.

For the large business segment an important factor in taxpayers' compliance behaviour is the Tax Control Framework (TCF). The TCF is an indicator that the company has processes and governance to be in control of their tax position. For the revenue body to have confidence that the taxpayer is in control it needs to assure that the TCF not only exists on paper but is actually used across the business. Measuring the reliability and robustness of the TCF is a promising indicator, but it needs to be explored more thoroughly if revenue bodies and taxpayers have a common understanding of the concept and the methods for assessing its application in practice.

**Measuring systematic compliance behaviour:  
Application to the large business segment *(continued)***

Where revenue bodies can assure the TCF they can have confidence in the capabilities of the large business taxpayer to deliver on the four domains of taxpayer obligations, and their tax capability and governance. However the TCF says nothing about the risk appetite of the taxpayer and it is consistent with a TCF for a taxpayer to openly take and disclose a considered view on tax positions that differs from the revenue body. So a measure of the success of the TCF might not be the number of uncertain tax positions but the number of material issues detected that were not disclosed upfront by the taxpayer. From the revenue body's perspective, disclosed uncertain tax positions continue to pose a risk but a different type of risk to the taxpayer lacking the capability to identify and control their tax position.

Revenue bodies that risk-assess large business taxpayers may also make use of this information as a performance indicator. This can be a cost-effective measure and is likely to be aligned with the compliance approach as it recycles existing information. However risk assessments need to be used with caution as the risk assessment may change over time due to changes in the assessment criteria or greater insight into the taxpayer. There is some tension between risk ratings as a resource management tool, where the revenue body will want to focus audit resource on the taxpayers with the highest relative risks, and as a performance measure, where the revenue body will want to see a decline in absolute risks for a given taxpayer (which requires consistent criteria over time). Regardless of this, a performance measure based on a risk rating needs an assessment process that is objective (and seen to be objective). A starting point for this objectivity and transparency is to publish the assessment criteria.

These measures of compliance behaviour cover a wide range of metrics, some of which may be close to outcomes if they demonstrate an attempt to voluntarily comply, whereas others are closer to outputs where they are direct measures of the revenue body's activities. Like audit yield, other output measures can be used as proxies for the desired outcome if a good causal link can be evidenced between output and outcome. This is particularly relevant where it is difficult to find a timely outcome measure, where an output measure with supporting evidence of the link to outcomes may be a good compromise.

In summary, direct metrics on taxpayers demonstrating systematic behaviours to voluntarily comply are aligned with the emerging compliance approaches that seek to design compliance into the tax administration system. At the strategic level this may be best measured by tax assured but measuring taxpayers' behaviour may provide insights at operational level to make interventions more effective. These measures are an area of likely future development.

## Effectiveness narratives

Effectiveness narratives are timely qualitative evidence of performance of compliance initiatives. Effectiveness narratives can either provide an avenue to report outcomes which cannot be properly measured or attributed quantitatively, or they can complement quantitative measures by explaining the broader context.

Measures by definition are quantitative information but qualitative information also has a role in explaining performance. For many people narratives, stories and ideas are easier to grasp than numbers, tables and charts and when used appropriately, can be a powerful tool to aid understanding among internal and external audiences. There are two

main roles for effectiveness narratives: complementing quantitative measures with context, and expanding performance reporting to report a fuller picture where outcomes cannot be properly measured or attributed quantitatively.

Effectiveness narratives need not be purely qualitative and can include quantitative evidence. These narratives provide an outlet for quantitative evidence which may be highly robust but not suitable for performance measures if it is only available on an infrequent and ad hoc basis, such as information from a one-off evaluation.

#### Box 4.5. Effectiveness Narrative example: GST audits lead to sustained compliance in Australia

The Australian Taxation Office (ATO) uses effectiveness stories to show how positively the ATO's activities affect willing and sustainable participation in the tax system. An example of this is the sustained compliance the ATO observes when it corrects businesses' tax returns through audits.

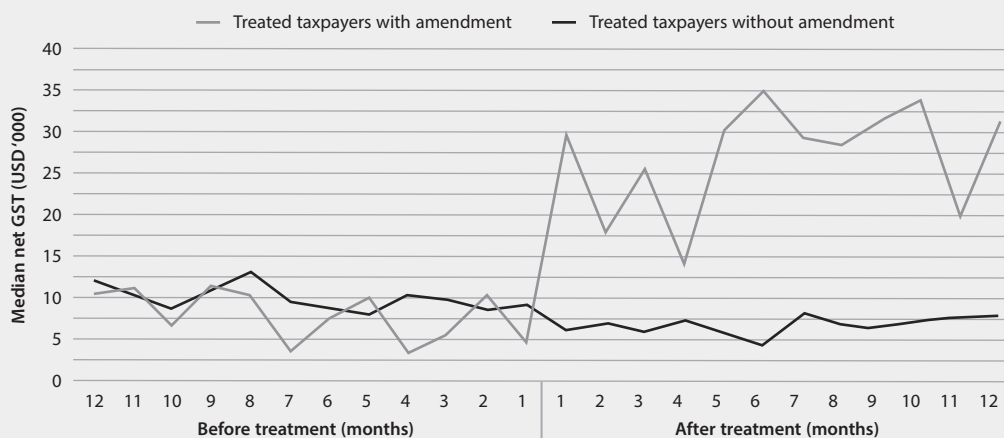
The ATO analysed the Goods and Services Tax (GST) compliance behaviour of businesses in 2012–13, and found that businesses that had their business activity statement (BAS) amended by the ATO showed improved compliance in subsequent GST returns – in fact for the next two years. This held true for both monthly and quarterly BAS lodgers.

As part of compliance activities, the ATO raised AUD 2.3 billion in GST audit liabilities in 2012–13. To understand the impact of audits and BAS amendments on those affected, the ATO analysed the median net GST recorded by quarterly and monthly BAS lodgers who had their GST returns amended across an array of GST risks.

As illustrated in the figure below, the reported GST liabilities increased in the period immediately after compliance intervention for monthly BAS remitters (and a similar picture holds for quarterly BAS remitters).

The ATO also compared taxpayers who had their BAS amended, to taxpayers reviewed but found to be compliant. The analysis shows that taxpayers who had their BAS amended as a result of compliance activity subsequently reported a higher level of net GST than those not directly affected by the compliance activity. This increase is typically sustained for subsequent lodgements.

##### GST position before and after 2012–13 compliance action – monthly lodgers



Further details are available on the ATO website (<https://www.ato.gov.au/About-ATO/Access,-accountability-and-reporting/Informing-the-community/Our-effectiveness/>).



In the role of complementing quantitative measures, narratives can bring the performance measures to life by explaining why and how the outcome came about. Improving voluntary compliance outcomes is essentially about changing people’s behaviour, so a better understanding of behaviour can help develop more effective initiatives. People’s behaviour is complex and nuanced, which may be better suited to narrative, for example, some interventions may improve voluntary compliance outcomes overall but at the same time weaken outcomes for certain taxpayers, which would be lost in aggregate figures. Effectiveness narratives can explain nuanced changes in taxpayers’ behaviour and whether these changes are sustained in future compliance.

This narrative can also help engage staff and stakeholders, and provide a hook into appreciating the formal measures and help broaden conversations from being narrowly focused on output targets, to understanding a more nuanced picture of compliance outcomes. Using complementary qualitative information does not lessen the rigor of performance reporting and in fact it is recognised by most statistical authorities as good practice, as commentary and analysis aid the interpretation for the reader. Narratives may be particularly helpful for an audience without a tax background as the meaning of many technical terms may not be intuitive, and many people find abstract concepts more meaningful once they can relate them to specific examples that they understand.

#### Box 4.6. National Tax Agency Report in Japan

The National Tax Agency (NTA) places high priority on providing easy to understand information on the effectiveness of the NTA. By improving external communication the NTA intends to improve taxpayers’ understanding of, and trust in, the tax administration.

The NTA provide easy to understand information on the NTA’s creation and implementation of effective plans for various issues, measures, policy initiatives and on evaluation and verification of the results of their implementation through websites, press releases, etc.

The National Tax Agency Report (annual report) is one of such efforts and describes the NTA’s activities of the past year, including the topics of the year in clearly understandable terms.

Further details are available in English on the NTA’s website ([www.nta.go.jp/foreign\\_language/Report\\_pdf/2013e.pdf](http://www.nta.go.jp/foreign_language/Report_pdf/2013e.pdf)).

While quantifying the return on investment (in terms of additional tax revenues, improved voluntary compliance and increased community confidence) is desirable there are occasions where this is not possible. This may be because the outcome can be observed (but not measured) or where measurement is possible but attribution is too complicated. For situations such as these quantitative measures may not be the best means of communicating a nuanced performance narrative (and if interpreted without context may even be misleading).

Where measurement limitations exist, but outcomes and effects are important, narratives can be used to report estimated or suspected outcomes, therefore in some cases narratives are viewed as less rigorous or less scientific than the numbers. Despite this, reporting a complete picture is important to reduce bias towards only things which can be measured (as was outlined in the principle on comprehensiveness in Chapter 2).

### **Effectiveness Narratives: application to the SME segment**

The range of compliance projects and programmes used for SME taxpayers make it difficult for any performance measurement framework to cover all achievements and lessons learnt, so effectiveness narratives may be particularly suitable. While at team level additional performance measures may be needed to manage operations, these many metrics would be overwhelming and confusing at the strategic level. Effectiveness narratives for a selection of examples may be useful both to ensure that stand-out successes are not lost in the strategic level performance measures and to help people understand the breadth and diversity of SME compliance work. Case studies also have benefits for motivating staff as they are a means of celebrating specific successes which can feel lost in the numbers. One risk with this approach is that if narratives are only used for good news they may be seen as lacking objectivity and credibility. Particularly internally, effectiveness narratives can be a usual way of sharing lessons learnt which have wider application so that learning from one part of the revenue body is shared across other parts of the organisation.

Where effectiveness narratives are used to expand performance reporting their role is essentially exploratory. By covering areas that would otherwise be neglected the revenue body may identify fresh insight and unanticipated effects. The knowledge gained from a qualitative approach may also allow the revenue body to develop formal quantitative measures where it was previously not considered possible. Therefore effectiveness narratives can be a good pilot for areas where performance reporting should expand but where there is not currently an obvious quantifiable performance measure.

### **Effectiveness Narratives: application to the large business segment**

Effectiveness narratives have featured less for large business than for SMEs. This may in part be due to concerns around confidentiality where interventions are for a single or small group of taxpayers. In some cases these narratives will only be suitable for an internal audience.

However, a number of countries publish surveys of their large business taxpayers. These surveys can be used to establish trends in the compliance burden for business and also to gather qualitative information about taxpayers' perceptions of the revenue body in terms of openness and transparency, customer satisfaction, responsiveness and ability to deal with complex issues competently and in a timely fashion. Staff surveys are also valuable sources of information about internal perception of the validity of the overall compliance strategy being followed.

There are clear links between effectiveness narratives and impact evaluations (those evaluations that seek to attribute cause and effect to specific projects) as both seek to understand the effectiveness of interventions. Traditionally, impact evaluation has focused on delivering definitive evidence primarily to improve future initiatives and has been seen as separate from performance reporting because findings are too lagged. In future, there will be more compliance projects where results cannot be directly measured through simple outputs. Therefore impact evaluation will have increasingly important roles, firstly, to provide more timely evidence directly for performance reporting through effectiveness narratives, and secondly, to build the supporting evidence base for outcome measures that are inherently more complicated.

#### Box 4.7. Attitudes towards compliance among Norwegian businesses

The Norwegian Tax Administration (NTA) has commissioned a survey of the compliance attitudes and behaviour of VAT registered businesses and the link to NTA's compliance activities. Three VAT registered business segments were covered by this survey:

1. A representative sample of businesses
2. Businesses that had been audited and errors found
3. Businesses that had been audited and no errors found

The survey was used to answer three questions:

1. Is it possible to group taxpayers in Norway by their attitudes towards compliance?
  - Attitudes towards compliance among the audited businesses were quite similar to the attitudes among the businesses in the representative sample: around 3 out of 4 report that they will never accept evasion and have sufficient knowledge.
2. How do audits affect the perceived probability of detection?
  - Businesses that had been audited thought it was more likely that the NTA would detect businesses not reporting all their taxes.
3. How do audits affect future compliance?
  - Among the businesses that remembered both the audit and the misreporting, 8 out of 10 answered that they improved their routines after the audit.
  - During 2007-2012 43% of audited businesses which were active in 2006 ceased to be active after the auditors uncovered misreporting; in comparison 35% of the businesses which were active in 2006 ceased to be active during 2007-2012.

Further details are available in English in a working paper from the Nordic Workshop on Tax Evasion 2013 ([http://ucfs.nek.uu.se/digitalAssets/238/238407\\_1anders-beraset.pdf](http://ucfs.nek.uu.se/digitalAssets/238/238407_1anders-beraset.pdf)).

Some revenue bodies have started to use emerging findings from impact evaluation to inform a broader performance narrative alongside the quantifiable performance reporting. Phased evaluations, which report timely interim findings as they emerge, may be more useful for operational decision making, with definitive findings following later for the traditional roles of learning and accountability.

In summary, effectiveness narratives can be seen in two lights. The first is a detailed case study focus on explaining the rationale for activities that are not captured by measures. They can, however, also be used for a wider purpose, setting out for stakeholders what the revenue body does, and why. Explaining this overall performance narrative could help to increase confidence in the revenue body and its actions.

### Using measures of voluntary compliance outcomes

These three approaches focus on different aspects of voluntarily compliance outcomes all of which are linked with taxpayers' behaviour (which may or may not have been influenced by the revenue body). The four domains provide a health indicator on taxpayer participation with the revenue body's processes, but do not say why taxpayers comply, or fail to comply. As the span of compliance work broadens further upstream, measures of

systematic compliance behaviour are required to recognise the effect of influencing the wider compliance environment. Measures of systematic behaviour measure the actions and behaviours of taxpayers in attempting to comply; whereas the four domains measures the resulting outcomes further downstream in the process. The effectiveness narrative is a versatile tool that can play a supporting role in explaining the existing performance narrative and expanding the performance narrative to cover new activities and effects.

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## *Chapter 5*

### **Practical approaches for measuring integrity outcomes**

*This chapter explores approaches for measuring integrity outcomes. These integrity outcomes cover that the revenue body administers the tax system fairly and that the community has confidence in the revenue body's administration of the tax system. Therefore this chapter explores two types of measures of tax compliance integrity: the internal quality and governance measures to demonstrate that the revenue body acts with integrity and its actions are procedurally fair, and the external measures to reflect how these actions build community trust and confidence.*

A further type of outcome, distinct from revenue and compliance outcomes, is that the community has trust and confidence in the tax administration. This trust and confidence is necessary for a tax system to work, and plays an important role facilitating voluntary compliance therefore a sustainable revenue base. This is most often measured through surveys. Revenue bodies can build this trust and confidence by acting with integrity and administering the tax system fairly. This can be measured, for example by reviewing case quality, and reported through governance publications.

Many revenue bodies have established some measures of integrity, and while this report recognises the importance of integrity outcomes as distinct from revenue and compliance outcomes, it has not focused on them. Rather, this chapter outlines some initial thinking as a starting point for further exploration. As acknowledged in Chapter 1, integrity outcomes have as their foundation the trust and confidence of the public and practitioners in the fair and objective administration of the tax system. Integrity also implies, at a more practical level, that information provided in confidence is treated with the appropriate level of security and protection and that the staff who work within the revenue body exercise the highest level of personal integrity and remain free of any undue or inappropriate influence.

Approaches for measuring integrity outcomes are thus derived from, and should reflect, this duality: the revenue body's actions that contribute to the integrity of the tax system, and the community's perception of it. In other words, measurement should consider both internal (institutional) and external (societal) perspectives. Together, these complementary dimensions offer a helpful framework for scoping out a more definitive set of approaches for measures of integrity.

### Acting fairly and with integrity

These measures focus on the actions of the revenue body: that it has administered the tax system fairly and with integrity. This may include measures of quality, governance, taxpayer experience and the costs to taxpayers of complying with tax obligations.

It is generally accepted that fairness is an overarching quality that must be present for self-assessment to work, which is important given the prevalence of self-assessment in taxation. For revenue bodies, fairness amounts to a delicate balance between upholding taxpayers' rights, both codified and intrinsic (fairness to the individual) and exercising its authority when warranted (fairness to the group). In this sense, there is no singular concept of fairness, but rather, fairness is broad and comprises multiple dimensions; arguably, this breadth and complexity brings with it some challenges for its practical and meaningful measurement. Still, how revenue bodies demonstrate that they are indeed fair in executing their mandate likely starts with evidence of the consistent, objective and just application of relevant laws (including those related to safeguarding the privacy and confidentiality of taxpayers' information), and that revenue bodies deal firmly and consistently with non-compliers to ensure a level playing field for all. It may be that a test of fairness lies not only in where self-assessment functions well, but also where self-assessment breaks down.

Key to this notion of fairness is that audits should be procedurally fair. The OECD FTA report "*Strengthening Tax Audit Capabilities: General Principles and Approaches*" (2006) sets out a range of principles for designing audits and measuring their performance. "A good quality audit is one that is: 1) focused on the targeted risks; 2) technically correct; 3) procedurally correct; and 4) referenced correctly." This can be measured by reviewing a sample of cases. Some revenue bodies publish this information to help build community trust and confidence through transparency.

Fairness equally implies that taxpayers have access to objective and transparent mechanisms for raising objections or complaints, so the presence and proper functioning of a redress system may be a helpful indicator of a revenue body’s integrity performance. In fact, the presence and proper functioning of a revenue body’s full suite of integrity processes and controls may help round out a comprehensive view of its integrity performance, much in the same way that system-based approaches can be used to check taxpayers’ compliance systems and processes.

Increasingly, revenue bodies also view the administrative burden associated with compliance as an element of fairness. This acknowledges that there are (or should be) reasonable limits on the efforts that taxpayers need to undertake to dutifully meet their tax obligations; anything beyond that threshold is then, at least in theory, “unfair”. What those reasonable limits are, however, is not easily defined and can be highly dependent on the context within which they are operating. Still, there is likely scope for some measure of the burden imposed on taxpayers within a broader suite of integrity measures.

Consultation with taxpayers is one way to understand the administrative burden of compliance. Furthermore, the costs of administrative burdens for business can be quantitatively estimated, for example by using a “Standard Cost Model”. Revenue bodies may also wish to separate out the elements of cost changes that are due to factors within their control and those related to wider government policy. These measures need to be interpreted sensibly as it is possible for business costs of complying with tax obligations to increase due to changes that they support; for instance the introduction of a new relief that requires additional information to be provided to support a claim.

Finally, the fair administration of the tax system presumes that ultimately, taxpayers meet their obligations. Measures of obligations met, like tax assured, and measures of voluntary compliance outcomes, like the four domains, can then also be useful as context for more direct observations on the revenue body’s fair administration of the tax system, and taxpayers’ perceptions thereof.

## To build trust and confidence

These measures focus on the perceptions of society about tax compliance and the revenue body. These are primarily based on surveys around confidence in the revenue body, attitudes to, and perceptions of, tax evasion.

The willingness of taxpayers to fully meet their tax obligations is widely presumed to be in part an expression of their trust and confidence in the administration of the tax system. That is, that compliance, and by extension revenue, flows from taxpayers’ belief in the willingness (trust) and ability (confidence) of the revenue body to conduct its business fairly and objectively. Maintaining this trust and confidence is often among a revenue body’s implicit goals, some might even refer to it as “brand value”, and while some revenue bodies have probed community attitudes to tax compliance, the concepts of trust and confidence are generally difficult to define for measurement purposes. It is far more practical to gauge attitudes and perceptions related to the more tangible aspects of fairness and objectivity.

Taxpayers’ own assessment of their fair treatment by the revenue body, the treatment of others, and the fair and objective administration of the system are a necessary complement to any institutional measures. Public opinion research is an obvious means of collecting and tracking this type of data, and an increasing number of revenue bodies are making use of surveys to gauge perceptions and attitudes, and establish trends. Examples of metrics include:

- The percentage of taxpayers that believe they are treated fairly by the revenue body

- The percentage of taxpayers that believe they can resolve a dispute with the revenue body
- The percentage of taxpayers that believe that “cheaters” will get caught
- The percentage of taxpayers that believe the revenue body is putting sufficient effort into reducing non-compliance
- The percentage of taxpayers that believe that the revenue body is likely to identify and address failures to comply

The OECD’s wider public governance work on “Trust in Government” recognises the importance of openness in building trust: revenue bodies need to not only act with integrity but be seen to do so. For example, some revenue bodies publish information on how they have handled and resolved tax disputes to develop public confidence that all taxpayers are treated evenly and fairly (in particular to demonstrate that preferential treatment is not given to any taxpayers).

Moreover, the degree to which a revenue body is considered by stakeholders to be fair can be evidenced in a wide variety of indirect ways. Levels of voluntary compliance can provide such evidence. Reasonable inferences can also be drawn from qualitative sources such as media reports, political queries and private business association feedback, and this type of information can be helpful not only as an aid to understanding, but also as a way of capturing emerging or unanticipated elements of the integrity performance narrative.

### **Using measures of integrity outcomes**

An integrity performance story likely has a number of audiences: external stakeholders (and ultimately, the broader taxpaying public) looking for assurances that the revenue body’s considerable powers are used appropriately and uniformly, and that the right checks and balances are in place; senior revenue officials assessing the integrity landscape as part of horizon scanning and enterprise risk management efforts; and, programme managers needing to factor considerations of integrity into programme decision making and resource allocations.



## *Chapter 6*

### **Choosing and designing outcome measures**

*This chapter explores the costs and benefits of the various measurement approaches, and covers some of the considerations when choosing or designing outcome measures. It emphasizes that rather than there being one right set of performance measures, revenue bodies need to consider they need to include in a fit-for-purpose basket of measures and what approaches would have most added-value to enhance their current performance measurement framework.*

The last three chapters have surveyed a range of measurement approaches. This report does not recommend one approach over another as there is no perfect measure. Each measure has a potential role with different strengths and weaknesses, and many of the approaches complement each other. In general, a basket of measures will be required to provide a comprehensive view of outcomes and effectiveness.

### Choosing the “right” measures

Any revenue body is likely to struggle to implement all of these approaches, particularly given that these approaches should be used alongside other output measures. Instead revenue bodies need to consider what enhancements to their existing performance measures framework would add the most value. In doing this, a revenue body may want to consider their operating context, strategic compliance objectives, strategic compliance approach, existing measures, and available information. The tax administration diagnostic assessment tool (TADAT) may prove helpful in such a review (Box 6.1), as this tool provides a comprehensive view of the performance of tax administration. A final piece of advice, from oversight bodies, was that a revenue body should start with the measures it needs to run its business.

#### Box 6.1. Tax administration diagnostic assessment tool (TADAT)

The Tax Administration Diagnostic Assessment Tool (TADAT) provides an objective and standardised performance assessment of a country’s system of tax administration. It is an integrated monitoring framework that measures performance of a country’s tax administration at a point in time. TADAT is an efficient way to provide a comprehensive assessment across the whole tax administration using a manageable set of core performance outcome indicators. The tool addresses questions of “what” and “why” with respect to performance.

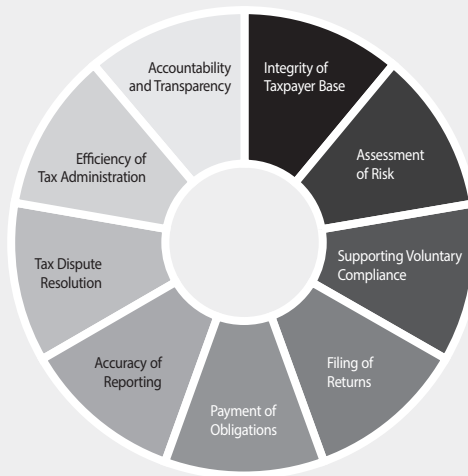
The Tax Administration Diagnostic Assessment Tool (TADAT) is designed to deliver an objective and standardised assessment of the most critical outcomes of a country’s system of tax administration. It is an integrated monitoring framework that measures performance at a point in time. The tool is comprehensive yet straightforward, so as to enable delivery by accredited assessors from any agency and to be applied across countries and with repeated assessments over time. TADAT focuses on the performance of major national taxes and is an efficient way to provide a comprehensive assessment across the whole tax administration using a manageable set of core performance outcome indicators. The tool addresses questions of “what” and “why” with respect to performance and is particularly helpful in:

- Identifying the relative strengths and weaknesses of systems, processes and institutions.
- Facilitating a shared view among all stakeholders (such as country authorities, international organisations, donor countries and technical assistance providers).
- Setting the reform agenda, including objectives, priorities, initiatives, and sequencing.
- Facilitating management and co-ordination of external support for reforms, and achieving faster and more efficient implementation.
- Monitoring and evaluating reform progress by way of subsequent repeat assessments.

### Box 6.1. Tax administration diagnostic assessment tool (TADAT) *(continued)*

The TADAT framework comprises nine performance outcome areas, shown in the “TADAT wheel” below. Linked to these are close to 30 high-level indicators that are scored and reported on; for each of these there is between one and four dimensions that are taken into account in arriving at each indicator score. The scores are predicated on evidence based measures which utilise standardised data as much as possible. TADAT uses the same scoring system as the Public Expenditure and Financial Accountability (PEFA) programme.

#### Performance Outcome Areas



TADAT is not designed to assess the administration of special tax regimes, such as those applying in the natural resource sector, nor does it assess customs administration.

Following extensive piloting that began in 2013, full launch of TADAT is expected near the end of 2015.

TADAT is a tool for the international community. It is supported by the European Commission, Germany, Japan, Netherlands, Norway, Switzerland, United Kingdom and the World Bank, through a Secretariat hosted by the International Monetary Fund. Further details are available on the TADAT website ([www.tadat.org](http://www.tadat.org)), and the secretariat can be reached at: [secretariat@tadat.org](mailto:secretariat@tadat.org).

In choosing the right measures revenue bodies need to be realistic about the pressures that they face and culture of their organisation and stakeholders. For example, many revenue bodies set out with intentions for a balanced scorecard covering all outcomes but find that internal and external pressures lead to a focus dominated on generating immediate cash receipts, most obviously through audit yield. As compliance outcomes usually involve revenue impacts of some kind it is a natural metric for most compliance activities. However, compliance revenue outcomes which are more difficult to measure can become neglected from reporting and broader metrics which are more difficult to link back to revenue outcomes may struggle to gain the same attention as revenue outcomes. For revenue bodies with this predicament expanding the coverage of revenue metrics beyond immediate monetary impact to measures of wider revenue effects or tax assured may be one way to move towards a comprehensive approach while maintaining engagement.

However this still leaves gaps in reported outcomes (such as voluntary compliance) which skew results and misleads decision making.

Revenue bodies also need to consider the timing and reporting of measures. Some measures may only be useable on an annual basis, and some outcomes may have delays in measurement. Where a timely pragmatic measure is not feasible then the best available approach might be to measure the implementation in real time and measure the outcome afterwards, for example for a new intervention, without a precedent, designed to improve compliance in future years.

### **Line of sight from operational measures to strategic measures**

Tax compliance risks vary across segments and the information available for measurement varies across segments. Therefore some measures may be better suited to certain segments. There is also likely to be a need for a range of different measures for a team level, segment level and organisational level. For example Box 6.2 shows a tiered framework of measures.

One particular concern with pure outcome measures (particularly voluntary compliance outcomes) is that they are hard to attribute to specific activities of the revenue body. This can make it harder to set accountability for them within the organisation. While the revenue body is responsible for ensuring taxpayers comply, compliance behaviours are complicated and many parts of the revenue body contribute to influencing voluntary compliance. Therefore pure outcome measures, such as the four domains, may be best used as health check indicator at the strategic level.

At the operational level, effectiveness measures (such as total revenue effects) may be more useful because they can attribute effects to individual projects or teams. For example, a revenue body may have an overall target for the proportion of returns that should be accurate. This could translate for specific projects, such as pre-filing, into targets for the uptake and level of accuracy of these pre-filled returns, which together could be used to estimate the additional number of returns that are accurate because of pre-filing. This approach can help avoid the issue of a “missing middle” that the outcomes desired at organisational level do not align with performance metrics and behaviour at project and team level.

Measures need to be flexible enough to adapt to new compliance strategies but also be consistent to allow comparability to past performance. This can be achieved by fixing outcome measures at the strategic level, for a period of around five years which gives consistency and comparability; but giving flexibility for operational level measures to evolve over time and adapt to specific segments. This works because the desired strategic outcomes are generally fairly constant but how these are achieved changes faster over time as new activities and techniques become available. Therefore strategic level outcome measures are likely to have less pressure to change than more operationally focused measures on successful implementation and effectiveness of the current compliance approaches.

### **Costs and requirements**

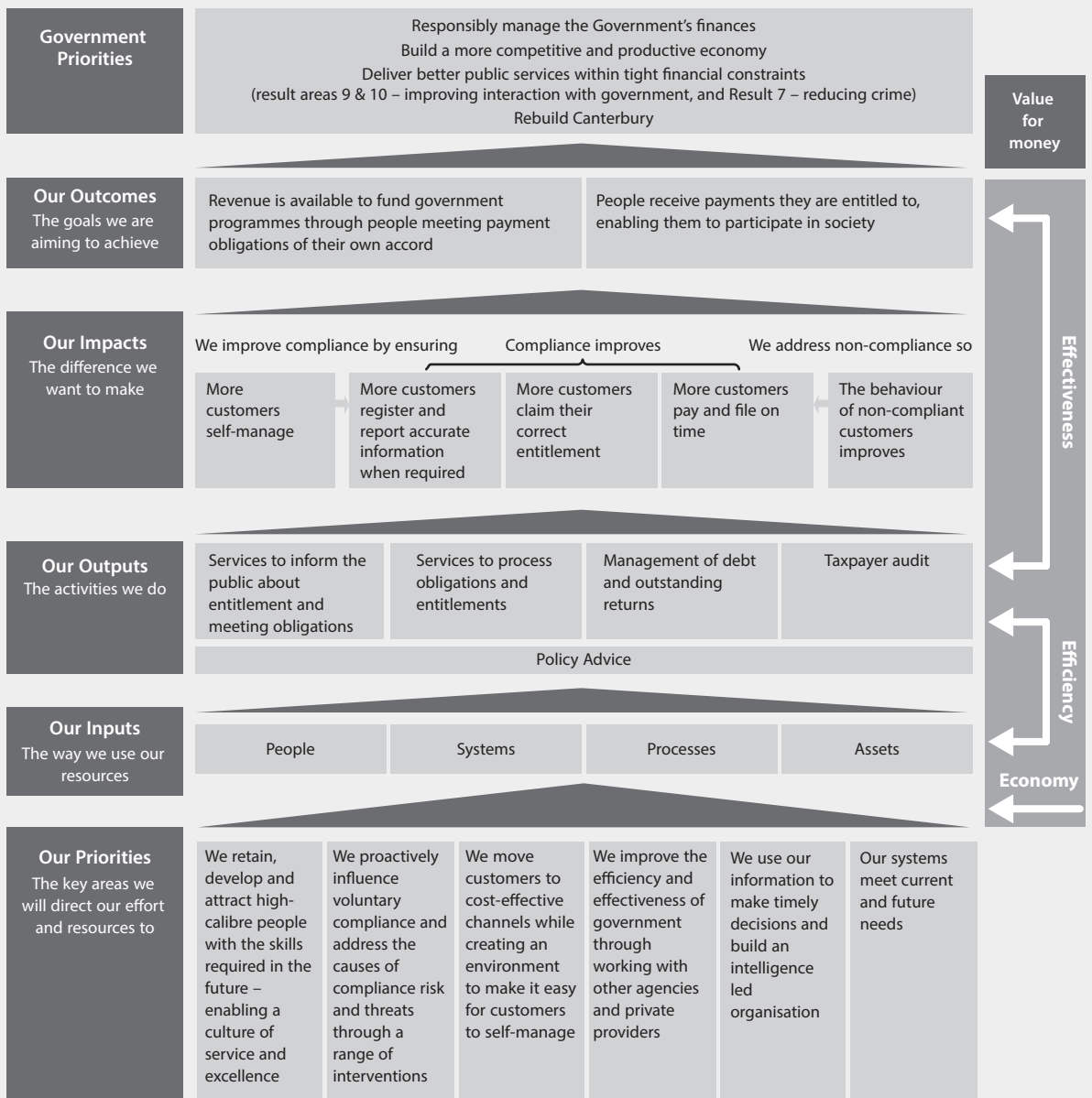
Well chosen outcome measures are a good investment as they help revenue bodies make better decisions and use their resources more effectively. However, revenue bodies need to prioritise what information to report (to keep focused on strategically important information) and to collect, because of the opportunity cost of using resources to collect

information which could otherwise be used to improve tax compliance. Therefore performance measures need to be cost-efficient and proportionate, for example, by automating collection and recycling information for multiple purposes.

The measurement approaches outlined in Chapters 3, 4 and 5 have different requirements. Some measurement approaches are centralised and can be carried out without any involvement

### Box 6.2. Outcomes framework in New Zealand

New Zealand Inland Revenue uses a tiered framework of outcomes, impacts and outputs with measures at each level.



Further details are available on the IRD website ([www.ird.govt.nz/aboutir/reports/annual-report/](http://www.ird.govt.nz/aboutir/reports/annual-report/)).

of operational staff, some require additional data collection from operational staff and some may require additional programmes in addition to data collection. However staff involvement in performance measures should not just be considered a cost, as where staff are involved in performance measurement they are more likely to act on the measure to improve performance.

The costs of each approach will depend on what information is currently available to the revenue body. For instance, if a random audit programme already exists then this information can be utilised at no additional cost but if it does not exist then it would be costly to set up a new programme.

#### **Requirements of compliance outcome measurement approaches**

- *Audit Yield:* Recording audit yield requires all auditors to record case by case information, but recording this information has limited additional cost as all auditors need to record the additional tax liabilities on accounting systems.
- *Total Revenue Effects:* This requires compliance officers to record additional information by each case and for potentially more cases; and some revenue effects may be reported at project level. The additional recording for audit staff may require IT changes to case management systems and additional governance of the figures reported, which unlike audit yield are not used for a direct operational purpose. Even though total revenue effects has a footprint in reporting costs this comes alongside benefits in embedding new compliance approaches on the ground as it encourages case workers to consider the medium term impact of their interventions.
- *Tax Assured:* Measures of tax assured are likely to build on existing information. In some cases this may be sufficient to estimate tax assured. For others existing information may not be sufficient but given the range of ways of assuring the revenue base, which vary significantly across taxpayer segments, additional costs are difficult to estimate as they will depend on the revenue body's starting position.
- *Four domains of compliance:* Many revenue bodies already collect data on overall levels of tax compliance across some of the four domains of taxpayer obligations so could produce performance measures at no additional cost. However some of the domains may be difficult to measure such as registration and reporting compliance. Random audits give an indication of reporting compliance within a population but are costly to undertake, in particular there is an opportunity cost in using audits on cases selected randomly that could bring more yield if used on cases selected through risking techniques.
- *Measuring taxpayer behaviour:* Traditionally these approaches have been seen as expensive because of the need to commission bespoke surveys for performance measurement. However where revenue bodies are developing data driven analytics it may be possible to estimate taxpayer behaviour directly from existing administrative data.
- *Effectiveness narratives:* These build on existing evaluation approaches, but are focused on timely and less definitive information. As they are focused on specific projects and programmes there should be limited additional costs in producing effectiveness narratives.
- *Integrity:* Procedural correctness and fairness is most commonly measured by internal quality reviews of cases. This type of manual review is expensive but an element of it has always been necessary, and therefore efficient measurement may build on existing work such as Internal Audit reviews.
- *Trust and confidence:* The most common and reliable measure is from commissioned external surveys, which have additional costs, but are increasingly common amongst revenue bodies. These costs may be reduced by combining questions with other surveys. Innovative techniques are also emerging such as tracking media and social media trends.

## *Chapter 7*

### **Implementing measures of outcomes and effectiveness**

*This chapter provides practical advice for revenue bodies seeking to develop and implement outcome measures. It reiterates the importance of the principle of integrating performance measures into the revenue body's processes. It also emphasises the importance of communicating why changes are happening.*

In a survey of the OECD Forum on Tax Administration membership for this report, revenue bodies were asked about the constraints to using outcome measures. Some of the most common themes were about practical issues of implementation: the limitations of existing data collection and recording systems, skills, culture, longer time-horizons, costs and demands of external stakeholders. During discussions for this report the question was raised, is the issue with measuring outcomes one of execution rather than a lack of knowledge?

Revenue bodies therefore wanted practical guidance on implementation. This chapter draws on the experience of those revenue bodies that have embarked on using outcome and effectiveness measures, and on revenue bodies' experience of other changes that are transferable to measuring outcomes.

## **Implementing changes to include outcome measures**

The focus on measurement challenges in earlier chapters may falsely give the impression that the challenges are over once outcome measures have been developed and decided upon. Taking good ideas from paper and putting them into practice presents a new set of challenges, which are discussed in this section: testing that these measures will work as intended, managing the transition between measures, and leading and communicating to generate engagement with the measures. Changes to performance measures may be difficult during the transition period, but if they more accurately capture the outcomes that the revenue body wants to improve then they will ultimately be worth it.

## **Test, learn and refine**

This section starts from when the revenue body has a good idea of the outcome measures it may want to use (i.e. after the conceptual design stage). It is likely to have already invested significant time and resource in the development of performance measures. At this point, most revenue bodies consult with stakeholders, such as the Treasury and Finance ministry, and refine the conceptual measures to ensure that they will meet requirements.

However a stage that is more often overlooked is testing and piloting measures in practice to ensure that they work as intended. It is sometimes argued that this is not feasible due to timescales dictated from outside the revenue body's control. While this may be true, revenue bodies can attempt to pre-empt this problem by piloting promising potential measures on a small-scale in advance of committing to them. This test and learn stage needs to have built in review and feedback as pilot measures may not work and may need to be adapted or ceased. As such it is good to have a pool of initial ideas, drawing on experience of operational areas or performance teams, to provide options should some prove inadequate.

The strongest test of revenue body's performance frameworks is often the detailed reviews by national oversight bodies that generally review frameworks after they have been implemented. By which time it may be too late to change course if measures are systematically failing, and any mistakes will be harder to correct than if they were dealt with early on. At a meeting of the OECD FTA Large Business Network in February 2014 some oversight bodies discussed their approach to auditing the performance of revenue bodies. Oversight bodies emphasised that they have to ensure that they remain independent: this means that they cannot be involved in the development of performance measures, either to suggest performance indicators or to suggest how to measure outcomes.



However oversight bodies made two main suggestions, which continue the theme of anticipating risks and testing for them early on to address and mitigate them before they realise. Firstly, revenue bodies should know from experience the sorts of questions and challenges that oversight bodies will pose, and oversight bodies may be able to suggest questions that revenue bodies should be considering. Anticipating these questions at design and development stage gives revenue body's time to take actions to address risks and weaknesses. Secondly, oversight bodies' audits of revenue bodies build on the work of internal auditors to avoid duplication. Internal auditors have similar skill sets and use similar approaches to oversight bodies. As such, revenue bodies' own internal audit functions are able to provide similar scrutiny as oversight bodies, and may be best placed to test and challenge measures for potential weaknesses.

The challenges of measuring outcomes are not unique to a revenue body, and are faced by the wider public sector and other revenue bodies. Oversight bodies' audits across the public sector may be a source of useful information, both to learn from best practice and other's mistakes. The most informed external review may be from other revenue bodies that have experience of similar challenges. This could be through the OECD Forum on Tax Administration, making use of the diagnostic tools such as TADAT (see Box 6.1) or informal bilateral discussions.

### **Transition to new performance measures**

One of the main lessons from experience was that changes to performance measures can be more complicated in practice than expected. Therefore the next stage following the testing of measures is not full implementation but the transition to the new measures. This stage is not about changing the measures but making sure the revenue body fully understands the measures: testing the reliability of data, systems and governance.

The best advice for a smooth transition was to run new measures as shadow internal measures for at least a full annual cycle parallel to the current measures that continue to be used externally. The purpose of this transition period is to ensure that measures are understood by staff, implemented correctly and where necessary to collect information on the baseline level of performance. For some measures it is possible to retrospectively baseline data but for other measures the required information will not have been collected to do a retrospective exercise. Running two measures in parallel has costs of delaying the start of the new metrics and introduces a year where two sets of measures are used. However where revenue bodies are making significant changes to the performance framework it can significantly reduce risks of implementation going wrong and allow transitional issues to be worked through before formally committing to the measurement approach. These costs, and the potential weakening of comparability, mean these sorts of significant changes and shadowing should not be done too frequently; for example tied to a five year spending or parliamentary period.

This transitional period can help test guidance, develop and test communications, and generally give staff time to understand and embed changes. This also allows the organisation to focus on getting the message right internally before taking it to external stakeholders.

## Communication and engagement

In changing the currency of success (from outputs to outcomes) revenue bodies need to be able to clearly articulate why they are doing so and how the alternative measures are reliable indicators of their performance. This was one of the main lessons learnt from those that had experience of changing their measures: the importance of communicating why this is happening is underappreciated and underutilised. The communication plan needs to be at the centre of changes to measures, because these changes like other organisation changes are ultimately about people.

This communication starts from the top with leadership owning the changes, explaining why they are desirable and demonstrate through actions that they support the changes. This message needs to get to the frontline and engage with staff. In large organisations this requires conscious effort and planning. For the same message to reach everyone there needs to be a simple core narrative with every message explaining why this is happening and what success means under these measures. While the narrative of why and how the measures have changed may be universal, briefing needs to be tailored to the audience to explain what the changes means for them. To get the message about changes to staff at all levels will require multiple channels of communications, for example intranet announcements are never read by all staff. This takes time and resource, for example preparing briefing material for operational managers in advance of general announcements so they are capable and confident to answer their staff members' questions. As changes to performance measures are often part of wider changes (but one of the most visible parts), where possible it is desirable to communicate a joined up message that builds on the other changes that are happening in tandem.

For any change to be successful it needs to draw on the capabilities, skills and knowledge across the organisation. Therefore the desired outcome from communication is not just to inform but also to engage, this is most likely if communication is a two-way conversation with staff. Operational managers and staff are likely to be best placed to apply measures to their work, and there is likely to be tiers of operational team measures below the main strategic measures. Therefore engagement should encourage them to take ownership and responsibility for the measures at operational level, developing their operational measures to align with the strategic measures. Where appropriate this will involve feedback on the strategic measures to influence and improve them.

For staff to be capable and confident with new measures, they may need training, support and encouragement. One idea used by revenue bodies in the implementation of compliance risk management approaches was to train some supportive staff who then led by role modelling and advocating the new approach as well as providing practical support for other staff.

External stakeholders (such as Ministers, Treasury or Finance department) also need to understand why changes are occurring and have confidence in them. This communication will need to cover the correct interpretation of measures, and issues such as comparability with previous measures.

## Maintaining good usage of outcome measures

Revenue bodies that used outcome measures emphasised the importance of integrating them into existing and future processes. The sections below consider what this means in practice.

## Embedding

An effective performance management framework needs to influence decision making and drive the right behaviours within the revenue body. If performance measurement is an after thought then it will have missed the window of influence, and no matter how good the performance measures are they will not have any practical impact on the revenue body's performance. Therefore the best advice from revenue bodies that have embarked on using outcome and effectiveness measures was to embed performance measures into existing systems, processes and ways of working. This is summarised by this quote from one revenue body:

“The need for cultural shift within [the revenue body] and externally is possibly the main barrier to a stronger focus on measuring outcomes. Internally, we have sought to address this with a work programme to embed effectiveness thinking into [the revenue body's] natural systems (governance, risk and people systems) so that it becomes business as usual.”

Integrating performance measurement into regular systems is more likely to result in the measures being aligned to the compliance approach and to encourage the compliance approach to evolve by learning from past performance. Embedding performance measurement into existing systems is also more efficient as it encourages data to be collected once – with performance information that builds on existing operational information. Only information that needs to be collected should be collected and where possible this should be done automatically to minimise costs. Despite this, many effectiveness measures require additional information to be collected along with additional costs and a cultural shift may be required to recognise the longer term value in measuring effectiveness along with efficiency. The collection of performance data must not overburden staff as that would impact on core performance, likely lead to unreliable data quality and frustrate staff. But the right information must be collected and reported to ensure a balanced performance measurement of effectiveness and efficiency is reported.

Performance measurement is not an isolated activity and should feedback both ways with other activities such as monitoring compliance, forward looking risk insight, impact evaluation, resource planning and process design. For example, where a risk is identified and addressed by a specific project, performance measurement may feed back into future assessments of risk (or provide a timely indicator of risk), the design of future interventions or changes to tax administration processes. While these roles are interrelated they are distinct, and performance measurement needs to remain focused on timely information for managing performance. Performance measurement should not try to do the work of other functions; in particular there are questions that are best addressed through impact evaluation or through monitoring compliance. For example, evaluation can help overcome the difficulties in identifying to what extent compliance is better for large business taxpayers in co-operative compliance programmes because of the programme or because more compliant taxpayers are willing to engage in the programme. This sort of analysis may be expensive and difficult to produce for timely reporting and may therefore be best run as a separate exercise but presented alongside performance reporting as a wider performance and effectiveness narrative.

## Support, guidance and governance

Outcomes are inherently more complicated than outputs to measure and attribute, therefore operational compliance officers and project leads cannot be expected to measure outcomes without support and governance. As a starting point, revenue bodies need to ensure consistent methodologies for their performance measures – information reported by one part of the organisation must be comparable with that reported by other parts of the organisation. Some revenue bodies use standardised approaches, frameworks, templates, questionnaires and formulas to ensure that the sufficient evidence will be collected and that methodologies will be applied consistently. This guidance will need to be tailored for the audience as the needs of compliance officers will differ from those of project leads.

However measurement requires more than having the right guidance and templates. It needs people with expertise as some measurement questions require technical knowledge, such as data and analytical skills. Other questions require professional judgements where there is no “right” view and a range of reasonable views are possible. These judgements need to be not only reasonable but consistent with judgements on the measurement approach made elsewhere in the revenue body. These types of exceptions mean that it is not possible to quantify and evidence outcome measures through a tick-box approach, but rather a more conceptual approach is needed.

A model used by some revenue bodies was to have a small centre of expertise to help project leads design and implement good evaluations and consistent measurement. In this model, responsibility for measurement stays with project leads (where possible) but a central team provides an internal consultancy service. The rationale for a central function is that many parts of the organisation need occasional specialist measurement support but do not have the demand for full time specific measurement roles. A central function can also help build a corporate memory so that best practice becomes standardised.

Attributing outcomes requires more judgement than counting outputs. This requires governance of the measure (and the underlying data), and integrating this into existing process as the best approach to minimise bureaucracy and ensure that it happens. While all performance measures need to be verifiable and auditable, applying these standards to outcome measures is not the same as for output measures. Audits of output measures might check for well-defined formula and data integrity, and check the veracity of the measure by mechanically replicating the metric. Audits of outcome measures might check that the estimates were based on the best available evidence, measured performance against the desired outcome and are well documented, and that judgements are reasonable and subject to appropriate governance. However it is not possible to mechanically determine that an outcome is attributable to a revenue body’s actions. Verifying an outcome measure therefore is a judgement that there is clear reasonable evidence for the claimed attribution.

Where measurement is on a case by case basis the most efficient quality assurance of the performance information is likely to expand existing quality assurance processes such as line-management assurance and sampling checks. For performance information measured at project level an approach used by some revenue bodies was to keep ownership of measurement with the project leads but ensure that any estimates are subject to independent governance and challenge. This keeps responsibility for measurement at project level where the information can be acted on, limits central bureaucracy but still gives independent assurance and overarching oversight to build up and share corporate knowledge.

## Future developments

Performance measurement will continue to evolve, as new activities bring with them new data sources and the need for new measures, especially in the digital space. Therefore measures need to be reviewed regularly to check that they are working as intended and that they will remain fit for purpose for upcoming activities. For instance, a move towards pre-filling returns should trigger the revenue body to test whether their performance metrics accurately reflect the benefits of this change and, if necessary, to adapt measures to capture the benefits.

Those responsible for measuring performance need to engage with staff developing new activities so that they consider how they will measure the outcomes of their intervention at an early stage; as this may require collecting additional data, piloting the intervention or adapting the intervention (such as holding back a control group). For example, an online calculator is developed to enable taxpayers to correctly self-assess the correct tax on a complicated area of the return. To be able to measure the benefit of this support, data needs to be collected on how many taxpayers used it, whether they this has enabled them to report correctly and whether they would have made an error without it. There are multiple ways of measuring the value of new activities but most of them are easier if measurement is considered before implementation.

Digital technology is likely to open up new sources of data for a richer set of measures, but this opportunity won't realise into better measures unless a conscious effort is made to utilise it. Closely linked to this, is the increasing sophistication of data and data driven segmentation techniques. Current segmentation of taxpayers tends to be tailored towards a sub-group, however in the future it may be tailored towards individual taxpayers. In future, measures may need to be developed which are relevant to particular taxpayers as opposed to measures which are applied across the board.



## *Chapter 8*

### **Conclusions and recommendations**

This report has surveyed current and emerging practice, and from real world experience developed guiding principles for international best practice in measuring tax compliance outcomes. Revenue bodies have wanted to measure outcomes for some time and yet few are completely satisfied with their current measures. In particular, revenue bodies reported three main limitations with current measures around decision making, executing the strategy and explaining performance to stakeholders. Given these challenges still exist after sustained efforts to strengthen outcome measures, should revenue bodies continue to invest in developing outcome measures or is it just too difficult?

This report has not identified a panacea for these challenges, and any search for a conceptual ideal will not only fail, as there is no single “right” set of measures, but risks distracting efforts from real progress. The practical work of measures development is not a one-off effort but requires continuous incremental improvement, which will continue to be needed as strategies evolve and operating contexts change.

Many of the difficulties with outcome measurement are not with the theory of measuring outcomes but with the practical implementation. Therefore measurement cannot be seen as simply a technical question; measures have an important linking role translating the strategy into actions. Changes to performance measures may not be easy, both from technical and cultural perspectives, and should not be rushed, but the benefits of developing and implementing better measures are likely to outweigh both the costs and risks.

Progress on measures development has been gradual but real, and may not be obvious to those immersed in current challenges as the developments are evolutionary. Viewed over the longer-term, considerable progress has been made, and there are lessons shared in this report to learn from others’ practical experience. This includes good work that revenue bodies should be proud of, lessons to learn for future development, and exciting new ideas. In summary, revenue bodies have made progress with the difficult task of measuring outcomes and are on the right track to continue this progress.

### **Recommendations**

1. Revenue bodies should continue to develop outcome measures. While challenges are real, they are not insurmountable; while perfect measures do not exist, real progress has been made; and while this development has costs in time and resource, the benefits are informing better decision making, helping execute the strategy and helping explain the performance narrative.
2. The development of performance measurement approaches is a matter of building on, rather than abandoning, revenue bodies’ current approaches.

3. When revenue bodies review their measures for the medium-term future (five years or so), they should consider whether the approaches in this report would help address some of their current limitations.
4. Measures will continue to require ongoing development as the compliance strategy evolves and new data and techniques become available, which should be aligned with the guiding principles rather than seeking some notion of perfection.



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# Measures of Tax Compliance Outcomes

## A PRACTICAL GUIDE

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Consult this publication on line at <http://dx.doi.org/10.1787/9789264223233-en>.

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