

Digital Transformation and the Tax Systems

– Learning from the experience of Denmark

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Agenda

- Taxation and tax law in a nutshell
- The digitalization of taxation - beauty or beast?
- Aim of our paper
- Tax simplification, tax compliance and tax transparency
- Taxpayers' rights
- Burning platform?
- The future
- Interim conclusions

The term “tax” is commonly understood as a compulsory unrequited payment to the government

- Compulsory: Not (completely) voluntary
- Unrequited: No specific benefit in return (not a fee for a particular service)
- Payments: In cash or in kind
- Government: Understood in a broad sense

Three main goals of taxation

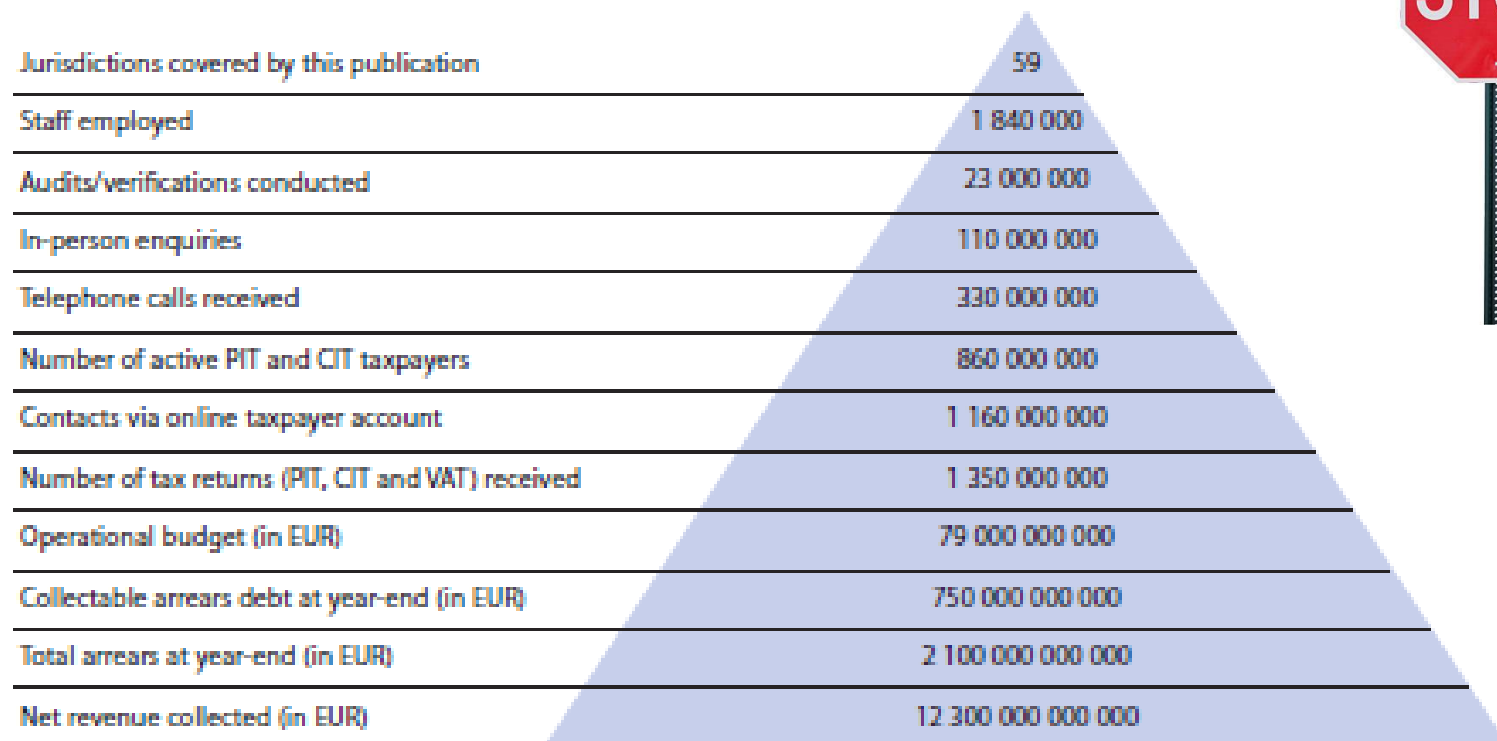
- 1) Raising revenue, 2) ensuring redistribution, 3) regulating behavior

A sub-discipline within administrative law (public law)

- Material tax law: Concerned with the question of who and how to tax
- Formal (administrative) tax law: Concerned with the tax authorities' organization, powers, and procedures

A sub-discipline within administrative law, BUT:

- Inherent incentive/urge for taxpayers to optimize/minimize/avoid/evade
- Largely based on voluntary compliance (self assessment)
- Mass administration



The digitalization of taxation – beauty or beast?

Digitalization from a tax perspective

- An instrument to improve the performance of tax administrations?
- A technology that enable taxpayers to avoid taxation where they do business?

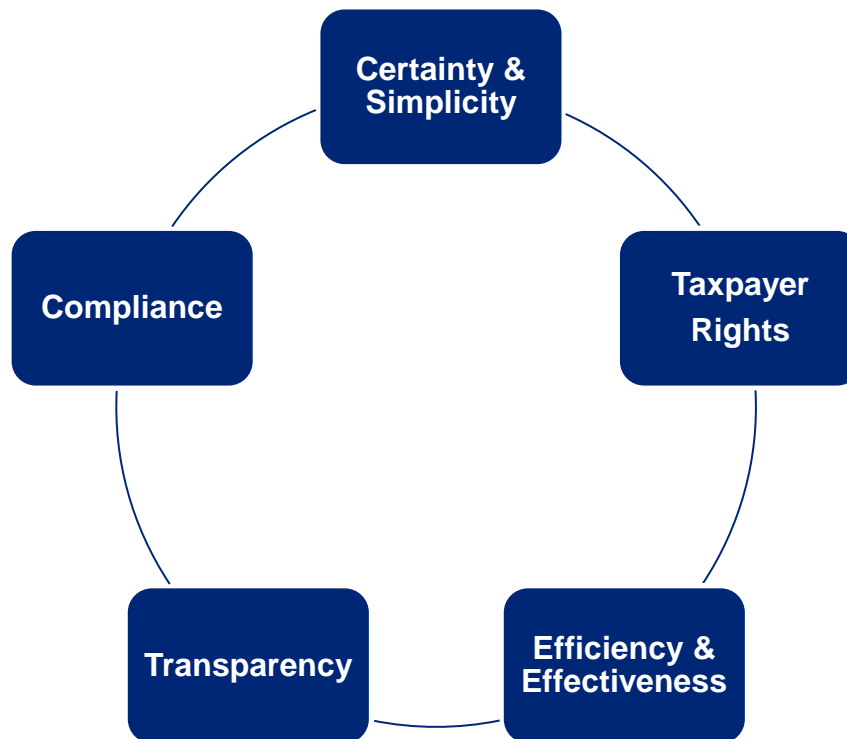
Growing academic literature on tax and technology

- 1) Taxation of the digital economy
- 2) Technology and tax collection
- 3) Technology and tax transparency
- 4) Technology and tax simplification
- 5) Technology and taxpayers' rights
- 6) Technology and taxation in developing countries

Source: Cipollini, A Systematic Introduction to Tax and Technology, ITS 3-2022, IBFD.

Aim of our paper

- To analyze the relations between the state (tax jurisdiction), the citizen (taxpayer) and the general interest (e.g. efficiency of the tax system as a whole) in an increasingly digitalized world



- Denmark as an illustrative example – why?
 - Most digitalized public administration in the world (UN 2018)
 - At the forefront of implementing digital solutions within the tax administration
 - Some initiatives have been successful, and some have been (blatantly) unsuccessful

Tax simplification

Significant trend towards e-administration

- Full or partial prefilling of tax return
 - Online filing of tax returns
 - Online payment of taxes
 - Digital communications tools
-
- 1995: Online filing of individuals' tax returns possible
 - 68% (2004) → 100 % (2015)
 - 2005: Online filing of corporate tax returns possible
 - 18 % (2009) → 100 % (2015)
 - 2019: New Tax Control Act and Tax Reporting Act
 - Adjustments in order to reflect a modern and digitalized tax administration
 - Individuals electronically receives an automatic, prefilled tax assessment notice (obligation to check information)



Tax compliance

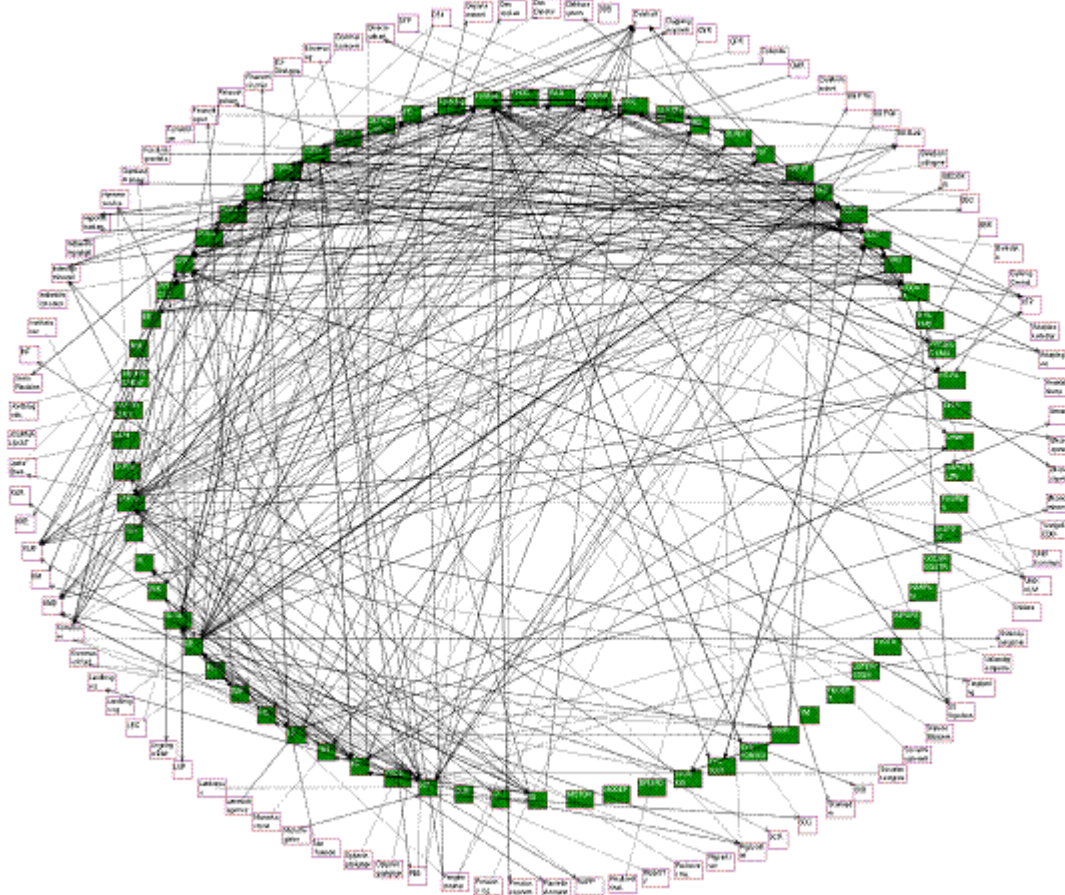
- Widespread use of digitalized pay-as-you-earn withholding and reporting (employers, pension funds, banks...)
- Increasing availability of data
- Digital techniques have enhanced the possibilities for risk management by tax authorities
 - Use of large and integrated datasets
 - Segmenting taxpayers



- 1970: Pay-as-you-earn withholding
- 2004-: Modernization of IT systems, e.g.
 - One tax account (EKKO)
 - One common debt collection system (EFI)
 - Electronic register for motor vehicles (DMR)
 - Electronic filing for corporations
 - New real estate valuation IT system
- 2005-: Tax administration reform (centralization),
 - Staff reductions (10k → 6k), risk-based controls



“The Spaghetti Pot”



Source: Udvidet notat til Rigsrevisionen om skattemyndighedernes It-systemer (2004)

Challenges – New IT systems for the Tax Administration

- Frequent changes of (complicated) legislation
- Changes have to be carried out and tested quickly
- High pressure on the system at certain times
- High requirements for data protection and security
- High requirements for data integrity

Source: Gartner, Vurdering af planerne for systemmoderniseringen i ToldSkat (2003).

Tax transparency

- The Multilateral Convention on Mutual Administrative Assistance
- Directive on Administrative Cooperation in the Field of Taxation, 2011/16/EU (DAC)
- OECD BEPS Project
 - Action 12: Mandatory Disclosure Rules
 - Action 13: Country-by-Country Reporting
- Longstanding commitment to the international standard of transparency and information exchange
- Extensive network of treaties and TIEAs
- Party to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters
- EU Member State – Implementation of DAC 1-7



Taxpayers' rights

- Legality
- Legal certainty
- Equal treatment (non-biased – prohibition of discrimination)
- Simplicity (understandability)
- Fairness (not arbitrary)
- Proportionality
- Access to information
- Right of defense and effective legal remedy

(See e.g. Bentley in van Brederode, Ethics and Taxation, Springer, 2020)

- “Taxpayer rights package III” (2017)
 - Taxpayers can only be held legally responsible for information they have to provide themselves or are capable of changing.
 - New user interface: Possibility to convey disagreement with information in “locked” sections.
 - Possibility to extend deadlines in case of IT breakdown
 - Right of complaint provided to taxpayers that are expelled from accessing the IT system
- The Ombudsman’s investigations (2022)



Taxpayers' rights

The Common Debt Collection System (EFI)

- Adopted in order to digitalize, modernize, unify and rationalize (2004)
- Project initiated (2005) – Expected to be ready in (2008)
- Postponed several times (2008-2013) – Taxpayers' debts rise substantially
- Start of use (2013) – Automatic case handling not in line with the legislation
- EFI finally abandoned (2015)



- Too optimistic
- Layoffs carried-out too fast
- Lack of understanding for the legal requirements for debt collection
- Problematic in the context of **legal equality** (enormous arbitrary write-downs)

The Real Estate Tax Act (amended 2003)

- A flaw in the wording of the law → Extremely low valuations at times (deduction for improvements)
- Detected by a tax administration employee in 2004
- The IT-system was amended to mitigate the problem (2005)
- Discussions at lower levels (2007-2009)
- Legal advisor to the Danish Government concluded that the administrative practice was illegal (2010).
- Giant backlog of cases (complaints)

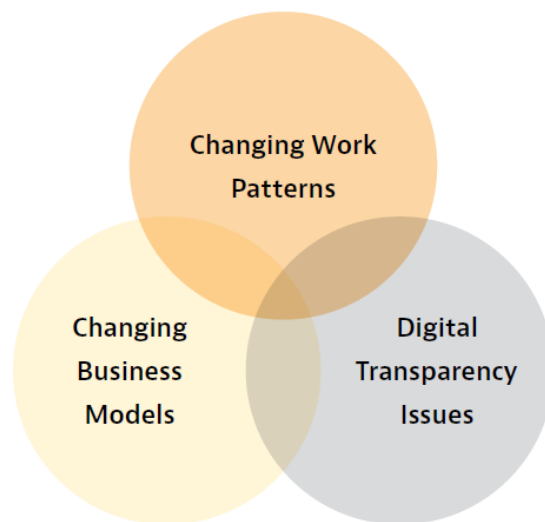
- Lack of quality in legislation
- Too complex rules
- Lack of competencies to understand the IT-system
- **Legality** issues and opaque administrative processes
- Difficult for the Minister to fulfill **inspection duty**

Source: Christensen & Mortensen, Overmod og afmagt – Historien om det nye Skat, DJØFs Forlag, 2018.

Burning platform?

Development stage of tax administrations

- 1.0. Largely paper-based, many manual and siloed processes.
- 2.0. e-administration, use of various digital and analytical tools but siloed and sequential administration.
- 3.0. Moving tax processes into taxpayers' "natural systems"



Source: OECD, Tax Administration 3.0, 2020, p. 21.

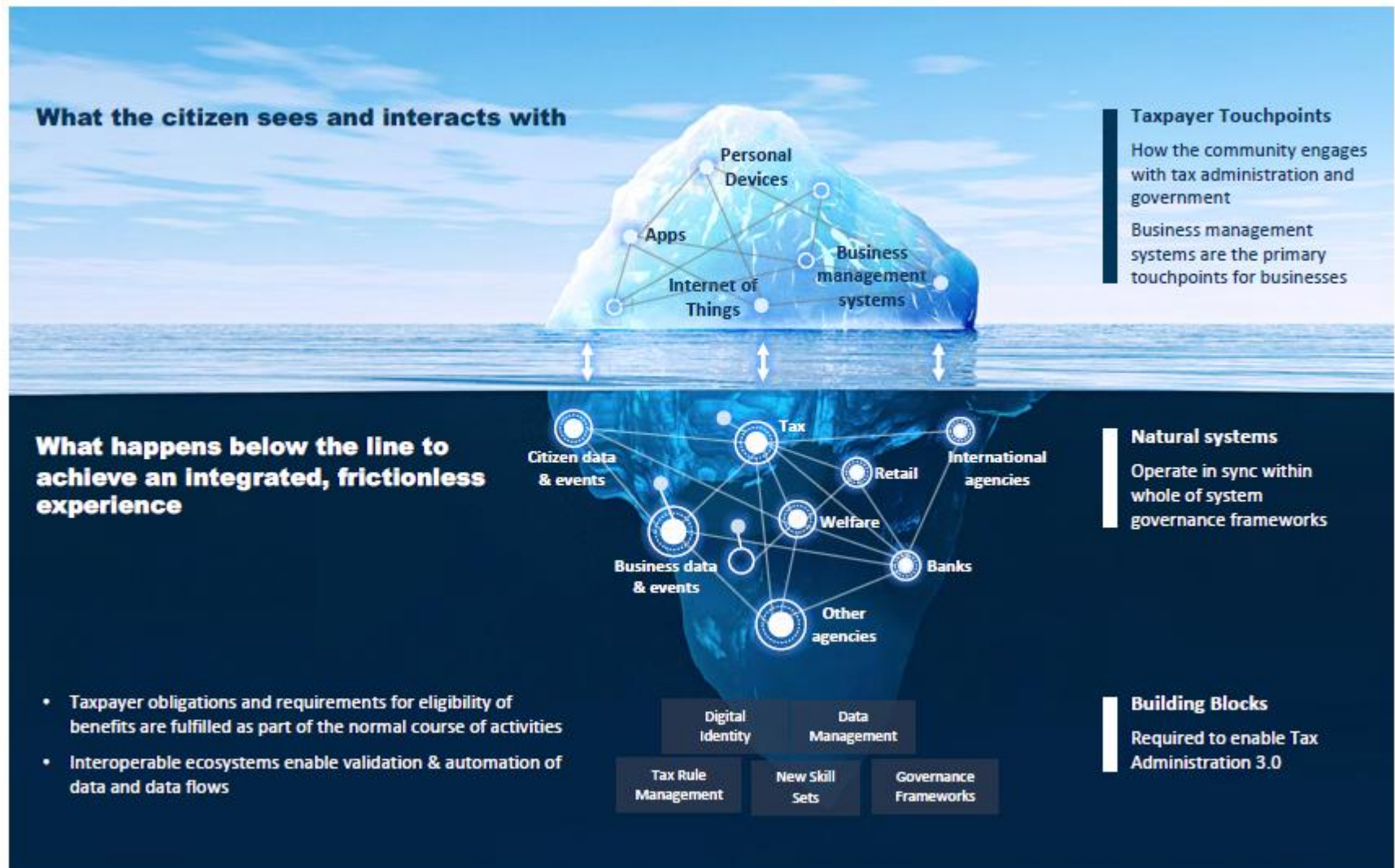
The future

Tax Administrations 3.0 (OECD)

- 3.0. Moving tax processes into taxpayers' "natural systems"
 - Build-in compliance
 - "Taxation in real time"
 - Machine-learning
- As of 1 January 2022 (L 73 2021/22) – Strengthening of tax control (data driven and intelligent approach)
 - Legal basis for gathering, processing and integrating taxpayer information in order to develop machine learning and analytical tools
 - Access for the tax administration to gather and process information from other authorities/agencies
- Permission to continue/extend "money transfer project" (2022)
- Permission to obtain info from crypto currency exchanges (2022)
- Compulsory use of digital sales registration systems for all businesses (2024)



The future



Source: OECD, Tax Administration 3.0, 2020, p. 13.

Beauty or beast?

- Great potential
 - Mass administration
 - High frequency of events suitable for “standardized” processes
 - Simplicity (and efficiency gains) from lower administrative burden
 - Taxpayers and tax administrations
- ... but risk of pitfalls
 - Complex rules and “unique” events
 - High development costs and technical uncertainty
 - Legal concerns
 - Legality
 - Inspection duty (combined legal and technical competencies)
 - Understandability
 - Privacy

Interim conclusion

