

# Winning the Fight against Avoidance and Error

Protecting Tax Yield with a Focus on Detection and Prevention



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# Combining Detection and Prevention

# Protecting Tax Yield with a Focus on Detection and Prevention

**Tax is a crucial revenue stream for administrations across the world. While many agencies have already established processes for compliance and enforcement, a combination of avoidance and error is still costing governments billions.**

Capgemini offers tax agencies and inspectors **an effective and powerful solution** to protect tax yield by combating tax avoidance and reducing the tax gap. The value of this offering cannot be underestimated. Recent figures from one organization suggest that tax avoidance and error costs 145 countries, representing over 98% of world GDP, more than US\$3.1 trillion annually<sup>1</sup>.

With such a huge sum failing to reach the public purse, it is no wonder that **almost every tax office is looking to increase the level of compliance** with the tax laws to increase revenue. In the UK, for example, the Government's 2010 Spending Review set the tax agency (HMRC) a target to raise an extra £7bn a year by 2014-15<sup>1</sup>. Likewise in France, the tax and customs offices (DGFiP) reported a 3.5% increase in detected fraud, equivalent to a €97M increase in 2010, bringing the total value to €2.8bn in 2010<sup>2</sup>.

These figures reflect the ambition of other administrations in those countries hit by the recent economic crisis where every

pound, euro or dollar that goes uncollected is money urgently needed for investment elsewhere. But it isn't exclusive to these countries. In rapidly growing economies too, there is a need to **improve tax compliance** so that the development of public services can be properly funded. Emerging markets typically face the challenge of a large informal economy, where workers are paid in cash and spend money with unregistered businesses. In a market like Brazil this unseen economic activity makes up 37% of GDP and helps to create a tax gap estimated at between 42% and 50%.<sup>3</sup>

<sup>1</sup> Tax Justice Network: [http://www.tackletaxhavens.com/Cost\\_of\\_Tax\\_Abuse\\_TJN%20Research\\_23rd\\_Nov\\_2011.pdf](http://www.tackletaxhavens.com/Cost_of_Tax_Abuse_TJN%20Research_23rd_Nov_2011.pdf)

<sup>2</sup> [http://cdn.hm-treasury.gov.uk/sr2010\\_complete-report.pdf](http://cdn.hm-treasury.gov.uk/sr2010_complete-report.pdf)

<sup>3</sup> <http://www.budget.gouv.fr/files/bilan-dnlf-2010.pdf>

<sup>3</sup> "New Estimates for the Shadow Economies all over the World", Friedrich Schneider, Andreas Buehn & Claudio E. Montenegro, International Economic Journal Vol. 24, No. 4, 443-461, December 2010

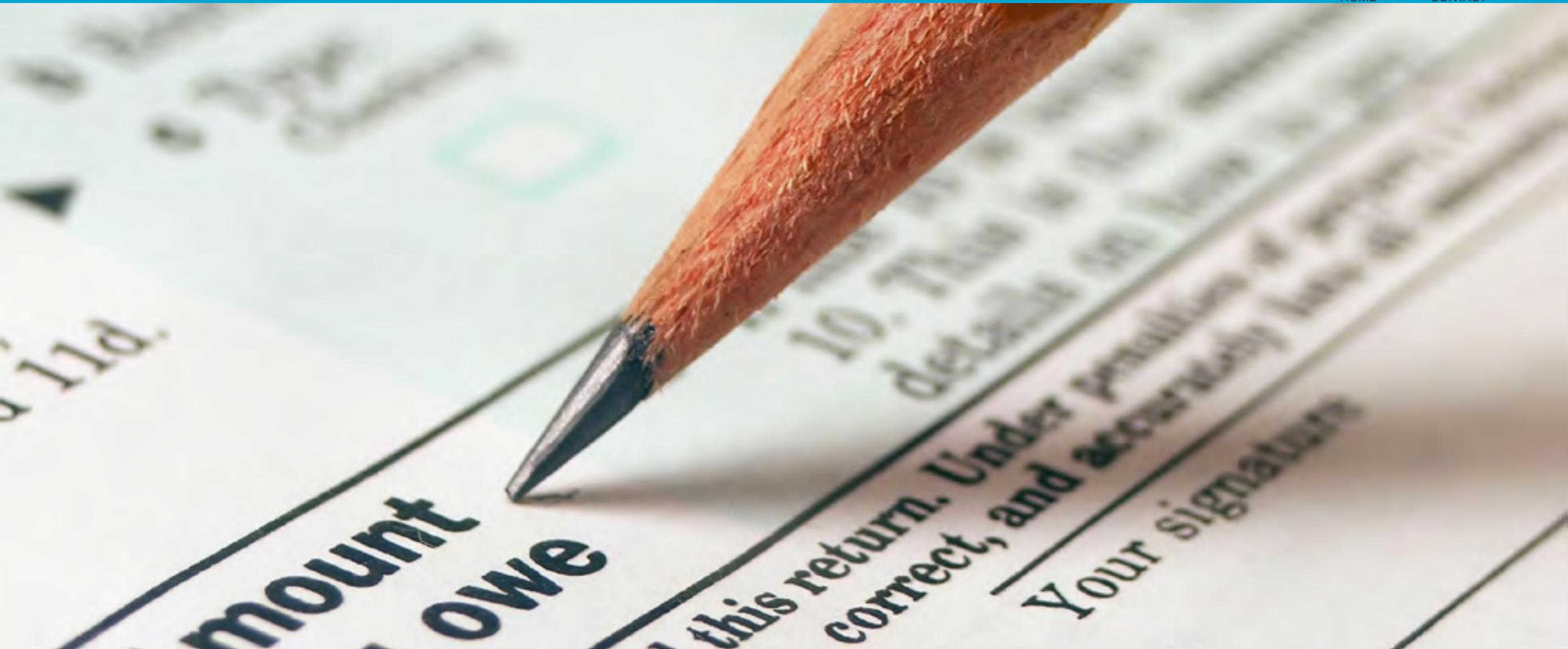
Numerous factors contribute to a drop in tax yield at a time when the public sector is coming under pressure to maximize tax revenues. The current economic environment is just one of them; the downturn has seen tax revenues decline more rapidly than the overheads of running a country, so tax agencies must focus even more on reducing the tax gap to increase revenues.

Other contributory factors particularly of relevance in developed countries include an increase in:

- **Physical mobility**, both at national and international levels, which makes it more difficult to correctly assess liabilities or track taxpayers;

- **Use of social networking** to share information about tax avoidance activities by groups other than organized criminals;
- **Anti-fraud sophistication** in the private sector financial institutions, leading organized criminals to target the public sector;
- **Availability of public sector on-line channels** that make it easier and cheaper for criminals to target tax agencies from anywhere in the world;
- **Sophistication and “industrialization”** of an agile and resourceful criminal industry.

Emerging markets not only face many of the same issues, but in also more fundamental challenges, such as a lack of the data and data management systems needed to raise yields.



# Identifying Tax Avoidance

# Identifying Tax Avoidance

**While tax avoidance is a significant contributor to the tax gap, it isn't the only one. When you add in errors either by the taxpayer or the tax administration, along with other factors, the size of the problem becomes even bigger.**

In the UK, what begins as a £15.2bn problem as a result of tax fraud grows to a tax gap of £40bn<sup>4</sup> when all the variables are brought to bear. Tax avoidance is another factor in the complex tax environment. It allows taxpayers to manage their finances in a way that allows them to pay less tax, for example by paying into a tax exempt pension fund.

Across all geographies, the tax gap comes down to four main factors:

- **International transactions:** as more economic activity globalizes, the easier it becomes to move money around and to therefore avoid taxes;
- **Black market:** non declared revenues and non paid contributions quickly add up. In Italy, for example, Industry Minister Paolo Romani estimated that in 2011 phantom or undeclared income stood at \$320bn;<sup>5</sup>

- **Errors:** while individuals can deliberately omit to report income, non payment can also be due to errors, especially administrative errors within the tax organization itself or submission of inaccurate information without the declaring taxpayer being aware. This is often the result of unclear rules that need to be better defined and communicated.
- **Data:** a lack of good quality data and poor data management combine to prevent agencies gaining a clear picture of who is paying what, who isn't, and what they should be paying.

<sup>4</sup> <http://www.hmrc.gov.uk/stats/mtg-2011.pdf>

<sup>5</sup> [http://articles.cnn.com/2011-11-02/opinion/opinion\\_europe-shadow-economies\\_1\\_tax-evasion-tax-collection-tax-rates?\\_s=PM:OPINION](http://articles.cnn.com/2011-11-02/opinion/opinion_europe-shadow-economies_1_tax-evasion-tax-collection-tax-rates?_s=PM:OPINION)

So who is avoiding paying their taxes, whether purposefully or through human error? Non-payers come from every area of the taxpaying community. They include private citizens who don't declare rental income on a second property, buy their cigarettes on the black market, or fail to declare their earnings. They can be micro firms that fail to register for certain taxes or have undeclared income, medium-sized companies that fraudulently claim tax deductions for R&D activities, or large groups and companies that have found corporation tax loopholes. In the UK, HMRC attributed half of the 2009-10 tax gap to Small and Medium Enterprises.<sup>ii</sup>

<sup>ii</sup> <http://www.hmrc.gov.uk/stats/mtg-2011.pdf>

# Our Offer to Tax Agencies

# Capgemini's Offer to Tax Agencies: Prevention and Cure

In March 2010, the UK National Fraud Authority's publication "A fresh approach to combating fraud in the public sector"<sup>iii</sup> compared the public and private sectors. It observed that the private sector's main focus was on fraud prevention. This consisted of identifying high risk activities and refusing the provision of a service or product, or flagging high risk cases for investigation before a transaction was completed – so called **upstream activities**. The report identified a stark contrast to the public sector approach, which is predominantly concerned with detection, investigation and prosecution of fraud that has already been committed – **downstream activities**. The report urges more widespread use of private sector **upstream techniques**. In

downstream processes, once repayment is made, recovery of monies requires time and cost, most notably in people. In addition, such activity may not be successful, especially in identifying fraudulent cases. Bearing this in mind, it has become necessary to take the idiom of "prevention being better than cure" at face value. A successful approach requires the application of a combination of upstream and downstream techniques; capitalizing on the existing and future investments in people, organization, processes, information and technology.

In other words, to tackle the tax gap problem, governments need to adopt a **targeted and holistic approach that**

**combines cure and prevention**. On the one hand, the cure has a quick impact and removes avoiders who are already in the system. In Australia, for example, the Australian Taxation Office reported that for the quarter 1 July to 30 September 2011, 356 people and 122 companies were prosecuted and convicted of taxation and superannuation offences. Some 12 people received custodial sentences, ranging from two months to five years. Thus the fraudsters were removed from the system<sup>6</sup>.

On the other hand, prevention is less costly and ensures a progressive reduction of the tax gap. Technology combined with evolution of existing business processes can provide solutions to detect evasion and

<sup>iii</sup> <http://www.eurim.org.uk/activities/psd/A-fresh-approach-to-combating-fraud-in-the-public-sector.pdf>

<sup>6</sup> <http://www.ato.gov.au/corporate/content.aspx?doc=/content/00299856.htm>

act on both prevention and cure. It can evolve constantly to fight fraudsters who are increasingly skilful and well-informed. A holistic approach at a national level allows inter-agency cooperation and enables a single view of the customer, which allows taxpayers to comply with their obligations and tax agencies to effectively manage their compliance regimes.

Successful management of avoidance depends on effective gathering and analysis of data. In some countries agencies have already been given more power to ask potential avoiders for additional details that can be checked against their tax returns. However, any new data sources have to be factored into the analysis inspectors perform without rebuilding the IT system every time. Capgemini can help. We have worked with tax agencies to put in place **fraud detection systems and processes** that sit within a defined **anti-fraud framework solution for tax agencies**.

This technology-enabled framework comprises:

- **Data management:** data is collected from multiple sources, cleansed and then analyzed;
- **Modeling:** statistical methods (based upon known cases) are used to track fraudsters and explore new methods of defrauding the tax agency, essentially due to the constantly evolving skills of the fraudsters;
- **Alert detection:** regular fraud scenarios detect anomalies and generate alerts;
- **Investigation:** analysis of suspicious cases using available data allows the agency to track suspicious cases;

- **Results:** analysis of results on a case-by-case basis to identify potential improvements and follow up global fraud activity. This last stage leads us to the prevention.

At the same time, further measures should be built around multiple independent defenses against evasion, including identity management, risk profiling, watch-lists, and advanced business and transaction rules. Tax agencies need processes that don't just make it easy for citizens to understand their obligations and comply with the rules, but also make it difficult for them not to comply. Above all, systems must be flexible enough to allow prevention and detection strategies and business rules to change regularly, so that agencies are not outmaneuvered by the constantly evolving tactics of tax evaders.



# Capgemini's Unique Solutions

# Capgemini's Unique Solutions for Tax Agencies: Tailored for Individual Levels of Maturity

Capgemini has extensive experience as a trusted advisor to tax agencies world-wide. We recognize that the labor intensive nature of tax investigations demands a solution for automating as much of the analysis as possible to generate new leads for investigators.

We help our clients accomplish this and reduce the tax gap by cutting avoidance and errors. At one level we work with our clients to look at the way in which they detect systemic error and then help them to improve their process. At another level we use sophisticated fraud detection systems that build on the expertise of tax inspectors and

give them the tools and methods they need to make the whole process of tax collection cost-effective and efficient depending on government priorities.

Our innovative and effective techniques are built into tailored solutions that typically consist of:

- **Avoidance and Error Assessment** – a three to six-week assessment of existing technology and processes around detection and prevention to identify the key areas for improvement and what the priorities are;

- **Solution Design** – a design phase of approximately three months to produce the blueprint for a holistic fraud management approach underpinned by best-of-breed technology. This is usually combined with a small pilot to demonstrate the value of the solution to the stakeholder;

- **Solution Implementation** – a more dedicated proof of value, followed by the design and build of a larger-scale fraud management system with options for fraud management as an IT managed service or as Business Process Outsourcing.

Our proposal is based on the following factors:

- **Business priorities that are defined with the head of fiscal control** to primarily focus on the easiest cases to sanction;
- **Tackling fraud that can be quickly identified** without tying up too much time or resource, whether on cost or human resources
- **Integrating upstream processes into the strategy** to make the existing analytical system more efficient in the medium or long term.

Capgemini is successfully delivering projects for tax offices globally: Australia, Sweden, France, UK, India, US, Brazil, Netherlands, and Slovakia.

For more information or to request a meeting please contact:  
[publicsector.global@capgemini.com](mailto:publicsector.global@capgemini.com)

### Contact our experts:

**Ian Pretty**

ian.pretty@capgemini.com

**Alexandre Negadi**

alexandre.negadi@capgemini.com

**People matter, results count.**



### About Capgemini

With more than 120,000 people in 40 countries, Capgemini is one of the world's foremost providers of consulting, technology and outsourcing services. The Group reported 2011 global revenues of EUR 9.7 billion. Together with its clients, Capgemini creates and delivers business and technology solutions that fit their needs and drive the results they want. A deeply

multicultural organization, Capgemini has developed its own way of working, the Collaborative Business Experience™, and draws on Rightshore®, its worldwide delivery model.

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