

# **REPORT OF THE DIRECTOR OF AUDIT**

## **RECOVERY OF VAT ARREARS**

Mauritius Revenue Authority

Performance Audit Report No 3

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## EXECUTIVE SUMMARY

This report examines the collection of VAT arrears at the Mauritius Revenue Authority (MRA). The MRA is responsible for collecting and administering Income Tax, Value Added Tax, Customs and Excise & Gaming Taxes within an integrated organisation structure.

The MRA has known a constant increase in debt arrears during the last three years. Debt has increased by 83% from 2005-06 to 2006-07 and by 108% from 2006-07 to 2007-08. The increase is largely attributed to MRA's effort in tracking defaulters and the increase in number of assessments as shown in the Table 1.

*Table 1 Increase in Debt Arrears during the Last Three Years*

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|                                | <b>2005-06</b> | <b>2006-07</b> | <b>2007-08</b> |
|--------------------------------|----------------|----------------|----------------|
| Assessment Raised (Rs million) | 188.1          | 900.7          | 521.9          |
| Debts collected(Rs million)    | 103.5          | 411.1          | 471.1          |
| Arrears (Rs million)           | 252.3          | 465.2          | 971.5          |

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The Voluntary Disclosure Incentive Scheme (VDIS) scheme also contributed to this increase. At the end of June 2008, tax arrears under VAT amounted to Rs 971.5 million. VAT debt collected in 2007-08 was Rs 411 million (including current and previous years' debt).

Other factors that have contributed to this increase are the inability to pay by businesses due to cash flow problems, death of taxpayers, companies which are in receivership and liquidation and also because of delaying tactics.

### Key Findings

Compared to many countries, the MRA is doing well but more can be done to improve the system through benchmarking both nationally and internationally. The key recommendations highlight areas where there are opportunities to improve.

## **MRA Strategic Management of VAT arrears**

The MRA is already doing a lot of right things such as having strategy on arrears, using modern methods of filing and payments and educating taxpayers.

It is important to understand that there may be other reasons, other than those already known by the MRA, for the increase in debt. It needs to identify and measure the impact of external factors using economist and statistician so that it can focus on what is within its control. Survey can be carried out on taxpayers to determine the reason why they fall into debt.

## **Collection and Enforcement of VAT Arrears**

The MRA is using enforcement action similar to overseas tax authorities. Claims are sent to inform taxpayers of their debts with mention that the MRA may have recourse to enforcement tools as per the VAT Act in case of non-payment. In some cases there are promises to pay and if promise to pay is not fulfilled, taxpayers are reminded by telephone. However, the MRA needs to review whether the existing process is the most effective one in collecting debt.

There is more the MRA could do to collect and enforce VAT arrears more quickly and at lower cost. It can, for example, make comparison with other overseas tax authorities such as UK and New Zealand which are making more frequent and routine use of telephone as an important tool to contact debtors. Moreover, in UK debts which are not paid are referred to the Department's Telephone Centre which attempts to contact debtors to obtain payment. Best practice emphasises on early intervention and outbound calling. The UK Inland Revenue and the Canadian Revenue Agency calculate the numbers and value of debts, revenue from cost of recovery; time to process cases; and recoveries from collection efforts.

## **Incentives and Measures to Ensure Compliance**

The MRA is doing many good things to encourage those with VAT arrears to pay on time and has adopted international best practices. Most of the methods used are similar with other international tax recovery departments we compared. For example MRA has been providing education, customer charters and enforcement tools similar to other tax recovery departments we compared.

However more could be done when it concerns debt recovery e.g. survey could be carried out to determine the reasons why taxpayers get into debt.

## ***Recommendations***

1 Whatever measures the MRA plans to introduce, it should carry out a cost benefit analysis to ensure that what it plans to do is justified.

2. To improve debt collection the MRA could:

- Use telephone at an early stage to contact taxpayers prior to sending claims. If there is no response to claim, the taxpayers are contacted through telephone on a monthly basis. Best practice produced by the Organisation for Economic Co-operation and Development (OECD) emphasized on early intervention and outbound calling. This could yield positive result as early intervention makes it easier for taxpayers to get back on track and improves prospects for business viability.
- Make use of other methods of payment such as direct debit. Direct debit can be used to enable the taxpayer to have his payment automatically deducted from his current or savings account. Debts will be settled early and both the taxpayer and the MRA would benefit; the MRA's debt will not increase and the taxpayer will settle his tax liability on the due date and thus saved from penalties and interest. The MRA is already using the option of payment by installments and Internet banking. In the UK, over 40 per cent of payments are by direct debit. Germany, Japan and the US have made considerable efforts to expand their electronic payment capabilities.
- Payment by credit cards could be considered as in UK and Germany. MRA has already initiated actions in this field but there is the issue of handling costs. The option of passing on the handling costs of credit cards to taxpayers could be considered. Legislation would be needed to allow the authority to pass on these costs.
- Issuing tax clearance certificates to compliant taxpayers where government contracts are sought. This can be considered as conditional requirement by public bodies before awarding contract. Revenue Authorities of USA, Republic of Ireland and Norway issues tax clearance certificates which confirm that tax affairs of companies/organizations are in order. These certificates are needed when a taxpayer seeks a Government contract. This will also encourage tax payers to pay on time.
- Directors to be made liable for those tax debts that are incurred or become due while they are acting as directors. This practice is being adopted by South Africa, Netherlands and Canada. However this may require change in legislation. It would also act as a deterrent and prevent tax debt from building up.

3. To improve management information as an aid to better performance the MRA could:

- Assess the impact of claims and telephones enquiries and this can be done on a pilot basis. The MRA could introduce a new debt management information system on which revenue officers can filter and search the database of debts on many different criteria e.g., age, value, number of recovery action taken and time taken between recovery actions.

Officers and managers will be able to manage the workload and prioritise debts for collection. The system will also allow to measure performance of individual collection officers. This system was adopted by the Austrian Tax Authority in 2001.

- Report on data such as trend for the past three years, the reasons why debt are increasing and the challenges that MRA is facing in managing its debt portfolio and the measures taken to collect debt are reported on a quarterly basis so that corrective actions can be taken without delay.
- Separate the insolvency and liquidation cases from collectible debt. Consequently, target will be more realistic and staff will be incentivised as they will not be assessed on these cases. Outcome of cases under insolvency and liquidation are outside the control of tax officers.
- Analyse the impact of the factors affecting arrears using specialist such as economist and statisticians, so that they can focus on what is within their control and measure progress on that. The expertise of the Operational Services Department, Tax Payers Education and Communication Department and the Research, Policy & Planning department could be helpful.
- Carry out benchmarking on how overseas tax authorities are managing their debts and reports on this on a regular basis. The MRA can adopt the methods that best suit local conditions.

The rate of compliance concerning returns is quite high. On the other hand debt is increasing. Surveys are being done by international tax recovery department to determine the reason why taxpayers are falling into debts. Most overseas debt recovery departments are using different and innovative ways of payments and communications.

4. To provide more help for taxpayers who are in debt, the MRA could:

Carry out a survey to know the reasons why taxpayers fall into debts. The reasons would help to adopt strategies. The MRA has recently surveyed taxpayers on services that it provides and how these can be improved. This laudable initiative by the Research, Policy & Planning department should be encouraged as it provides opportunities to enhance the services provided. Surveys could be done either by sending forms to taxpayers or electronically through mail.

## INTRODUCTION

1. The Mauritius Revenue Authority is a Corporate Body responsible for collecting and administering Income Tax, Value Added Tax (VAT), Customs and Excise and Gaming Taxes within an integrated organisational structure. Taxpayers get into arrears because of financial difficulties or because they are unwilling to pay. At the end of June 2008, tax arrears under VAT amounted to Rs 971.5 million while debt collected during the same year was Rs 411 million (including current and previous years' debt).
2. The main responsibility for debt collection rests with the Debt Management Unit (DMU). However, there are complementary strategies applied by other units of the MRA that also bear on the debt collection task in preventing debt and facilitating payment for example, TECD. The Debt Unit consists of 29 staff with an annual salary of some Rs 12 million in 2007-08. The staffs are responsible for the collection of all different types of taxes. The MRA's debt collection objective is to boost arrears collection. Taxpayers are expected to lodge correct returns and statements by the due date as specified in the VAT Return Form, and to pay their taxation liabilities as and when they fall due for payment. A taxation debt arises when a liability falls due for payment and it remains unpaid.
3. Each staff is given a portfolio of both high value and low value debt. The priorities are to collect high value debt and most recent debt as well as outstanding tax returns. High value debts are those above Rs 500,000. The first action undertaken by the DMU to collect debts is to issue a claim to the taxpayer with mention of enforcement action in cases of non-payment. As long as debt is not settled, penalties continue to accrue automatically.
4. The reasons for non-payment are:
  - The winding up of businesses
  - The death of taxpayers
  - Expatriation and migration
  - Delaying tactics

For the high value debt, where there is a response to claims by the taxpayers, incentives such as arrangement to pay by instalments are made or taxpayers are given a further six months to pay. If promise is not fulfilled, taxpayers are reminded through telephone. In case of non-payment, the MRA takes enforcement actions such as attachment orders, inscriptions, contrainte, objection to departure and distress warrant. Where it is not possible to recover debts using these actions, the MRA might use methods such as the winding up of companies or prosecution. If a debt is not recovered after all enforcement have been taken, the MRA might consider writing off the debt.

For the year ended 30 June 2008, the MRA wrote off debt amounting to Rs 47.8 million.

5. There has been an increase of 108% in arrears from fiscal year 2006-07 to 2007-08 due to an increase in volume and amount of assessment raised and to the introduction of the VDIS.
6. This report focuses on VAT and examines:
  - The reasons for increase in debts (Chapter One)
  - The MRA's strategic management of VAT arrears (Chapter Two)
  - Whether the MRA could collect and enforce VAT arrears more quickly and at lower cost (Chapter Three)
  - Whether the MRA could do more to encourage those with VAT arrears to pay on time (Chapter Four)

The MRA has made significant improvements in recent years as to the way they collect and enforce debts. However, there are opportunities to improve performance further by providing more information, advice and support to taxpayers so as to help them comply, by making it easier for them to settle debts, and by improving the effectiveness of the Unit's collection methods to recover debts more quickly.

## CHAPTER ONE

### REASONS FOR INCREASE IN DEBTS RELATING TO VAT

This chapter of the report examines what are the causes of the increase in debt over the past three fiscal years.

#### 1.1 Arrears of Revenue

The MRA has known a constant increase in debt arrears during the past three fiscal years. Debt has increased by 83% from 2005-06 to 2006-07 and by 108% from 2006-07 to 2007-08. At 30 June 2008 the debts amounted to some Rs 971.5 million. Table 2 refers.

*Table 2 Arrears of Revenue*

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| <b>Fiscal Years</b> | <b>VAT Arrears (Rs million)</b> | <b>% increase</b> |
|---------------------|---------------------------------|-------------------|
| 2005-06             | 253.2                           | -                 |
| 2006-07             | 465.2                           | 83                |
| 2007-08             | 971.5                           | 108               |

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#### 1.2 Reasons for Increase in Debts

This increase is mainly attributed to factors like the inability to pay by businesses due to cash flow problems, death of taxpayers, companies which are in receivership and liquidation, expatriation and migration and also because of delaying tactics.

The following has also contributed to the increase in debt:

Prior to 2006-07 a person should register for VAT if the turnover was Rs 3 million and above. Amendments were brought to the VAT Act as from July 2007, thereby reducing the prescribed limit for VAT registration from Rs 3 million to Rs 2 million. This resulted in an increase in number of taxpayers. The number of taxpayers as at 30 June 2007 was 11,754 and as at 30 June 2008 it was 13,336, an increase of 1582 taxpayers.

Arrears are increasing mainly due to the efforts put in by MRA in tracking down tax evaders by bringing them within the tax net and raising assessments on undeclared income.

Assessment raised during the year 2007-08 was almost five times the amount raised during the preceding year, thus resulting in higher outstanding arrears at the end of the year.

In 2007-08 there was the introduction of the VDIS. Taxpayers who did not submit return previously was allowed to do so in 2007-08 whereby penalties and interest were waived under the VDIS. The scheme allowed those taxpayers to pay in four annual installments which explain the increase in debt in 2007-08. The VAT debt as at 30 June 2008 under VDIS is some Rs 349.3 million.

Another reason why debt has increased is due to inflation. An increase in selling price would result in more VAT outstanding. The rate of inflation for the last three fiscal years ending 2007-08 was 5.1%, 10.7% and 8.8 % respectively.

Performance of staff of the DMU is based on the amount of debt collected during a particular fiscal year. Each year there are debts which remain unattended due to shortage of time. The main reason is that staff will concentrate on debt cases whose values are high so that a greater amount could be collected. The cases involve debts with high value such as above Rs 500,000 and also debt cases between Rs 20,000 and Rs 500,000. Debts of value less than Rs 20,000 remain unattended. As long as debt is not settled, penalties continue to accrue automatically.

### **1.3 Strategies Adopted**

Strategies, objectives and Key Performance Indicators (KPIs) are set to deal with the increase in debts and the debt unit of the MRA has improved/strengthened objectives and KPI as from July 2009 to better cope with the increasing debts. There are still opportunities to improve performance further by providing more information, advice and support to taxpayers to help them comply, by making it easier for taxpayers to settle debts, and by improving the effectiveness of the Unit's collection methods to recover debts more quickly. MRA implemented the Tax Arrears Payment Incentive Scheme (TAPIS) to help debtors settle their liability. TAPIS which was in operation from July to December 2007 has allowed the MRA to recover some Rs 46.1 million of arrears relating to VAT.

## CHAPTER TWO

### EFFECTIVENESS OF MRA'S STRATEGIC MANAGEMENT OF VAT ARREARS

This Chapter of the report examines:

- The objectives, indicators and targets of the Debt Management Unit(DMU)
- Timely collection and analysis of performance data
- Quality information for decision making
- Strategies to deal with increasing debts

#### 2.1 Structure of DMU

The DMU consists of 29 staff with an annual salary of some Rs 12 million in 2007-08. The DMU falls under the Operational Services Department which is responsible for key shared services of registration, service delivery, processing and e-filing and debt management. The MRA has well defined appropriate indicators and targets that support its objectives. However, there can be improvement in the indicators compared with other international organisation and overseas tax departments. We also noticed that the MRA does not have all the necessary information to make decisions compared to other revenue departments.

#### 2.2 Objectives, indicators and targets.

The MRA's debt collection objective is to boost arrears collection. The Key Performance Indicators (KPIs) at the beginning of each financial year in line with the MRA's objectives and targets for the DMU are as follows:

- The amount of debt to be collected as a percentage of total collectible debt
- The number of old debt entries to be written off

Collectible debts are debts where taxpayers have agreed to pay and /or the Assessment Review Committee (ARC) has already deliberated on cases, which were previously objected by the taxpayers. The ARC deals with cases where taxpayers have objected to the MRA's assessment of debt. However, a better KPI may be set, based on all debts i.e. collectible and unenforceable debts (cases at the ARC) while the old debt entries to be written off as an indicator would not show performance achieved in collecting debt.

The DMU is considering the above points and is adopting new objectives and targets as from 2009-2010 to better manage its debt.

### 2.3 MRA's Achievements

The DMU is responsible for the collection of all types of debt i.e. Income Tax, Corporate Tax, Value Added Tax, Hotel and Restaurant Tax and Gaming Tax. The nature and complexity of these taxes is different, yet targets and KPI set are the same for all taxes. The actual performance of the unit, as calculated by this office, in respect to VAT for the two KPIs set by the MRA is as shown in Table 3.

*Table 3 KPI for the Last Three Years*

| KPI  | 2005-06 | 2006-07 | 2007-08 |
|--|---------|---------|---------|
| The amount of debt to be collected as a percentage of total collectible debt | 51.1%   | 40.8%   | 79%     |
| The number of old debt entries to be written off                             | 0       | 0       | 54      |

No variances can be calculated as there is no specific target for VAT. However it can be seen that there is an improvement in the first KPI in 2007-08.

### 2.4 Collection and Analysis of Performance Data

Based on actual objectives and targets, performance reports are well laid out and provide the results on targets and objectives at the right time, on a monthly basis to Senior Management. The DMU prepare monthly progress reports which are submitted to the Research, Policy and Planning Unit for review. The data provided are analyzed in line with set targets and objectives. Where large variances are noted, the Director of the DMU is requested by the Director General to take remedial actions.

### 2.5 Arrears of Revenue

*Table 4 Increase in Arrears*

| Year                     | 2005-06 | 2006-07 | 2007-08 |
|--------------------------|---------|---------|---------|
| VAT Arrears (Rs million) | 253.2   | 465.2   | 971.5   |

Debt has increased by 83% from 2005-06 to 2006-07 and by 108% from 2006-07 to 2007-08 as shown in Table 4.

An increase in tax arrears was noted as from July 2007 as the MRA have been more effective on controlling tax evasion and also more assessments have been raised. The VDIS which was introduced in 2007-08 has also contributed to the increase in arrears.

There may be other reasons for increase in arrears which might be beyond the control of the MRA such as economic decline, taxpayers considering their tax due as secondary compared to other creditors or tax payers who are in financial difficulties.

VAT arrears in 2008-09 amounted to some Rs 776.8 million which represents a decrease in arrears by some 20% compared to 2007-08. The reduction in arrears in 2008-09 resulted mainly from write off of debts and payments being effected under VDIS agreement.

## **2.6 Quality Information for Decision Making**

In its annual report, the MRA provides information such as trend analysis over the past three years, the reasons for debts increase, the challenges that it is facing in managing its debt portfolio and the measures taken to collect debt. However these data are not shown in the monthly report. Management needs this information on a quarterly basis so that corrective actions can be taken without delay. The following have been noted during the audit:

- Insolvency and liquidation cases are included in the target. Instead they should be separated from the existing target set. This will help management to better assess performance as these cases are beyond the control of the MRA and at the same time staff will be more motivated and incentivised. Staff time will be directed to collectible debt and collection will improve.
- The MRA is already using information such as trends in arrears and age analysis that help it to ensure that its objectives are being met. However the additional information below would be useful to the MRA to make decisions and to improve its debt collection process.
- Measuring how reliable the different methods of recovery such as claims, reminders and telephone calls are. Consequently the MRA could decide which activities could be streamlined and hence save time and cost. The UK Inland Revenue and the Canadian Revenue Agency do assess how much debt is recovered from their collection efforts. MRA could adopt a pilot project initially and build up from the results obtained.
- Finding the volume and value of unattended debt. This information will help the MRA to assess the risk that the debt becomes a significant amount, which will then be justifying deployment of resources to collect it. The MRA can report on the unattended debts on a quarterly basis.
- The Austrian Tax Authority has a debt management system on which all taxes are managed. The system is flexible and allows revenue officers and managers to filter and search the database of debts on many different criteria e.g. age, value, number of

recovery actions taken and time taken between recovery actions. The results of searches are available immediately. The system allows officers and managers to manage the workload and prioritise debts for collection. It also allows to measure performance of individual collection officers.

### ***2.6.1 Low Value Debt***

Low value debts are left unattended due to time constraint and shortage of staff. The amount of debt below Rs 20,000 stood at some Rs 10 million as at May 2009. The value is quite significant and requires actions to collect the debt.

There are other low value unattended debts in the range of Rs 20,000 to Rs 50,000. MRA does not readily keep full record of these low value debts.

The growth in the amount of low value debt could be a significant risk if left unattended. The MRA needs to regularly report, say on a quarterly basis the full value of unattended debt in order to assess the risk and to take measures to collect the debt e.g request of additional staff. In Australia, for example, the collection of low value debt is being outsourced.

## **2.7 The Way Forward to Deal with Increasing Debt**

The MRA is aware of the increasing trends in tax arrears and they are adopting strategies to deal with the increasing trends in debt cases and amount. For example, the following strategies are being adopted by the MRA: educations, tax payer charter, incentives, write off consideration. Also the MRA is adopting new objectives and KPIs to deal with the increasing debts as from July 2009.

The reasons for increasing debt are the winding up of businesses, the death of taxpayers, expatriation and migration and delaying tactics. Statistics of the number of cases for each reason would help MRA to adopt strategy and allocates its resources accordingly.

There may be other factors for the increase in debts and MRA needs to be able to analyse the impact of these factors, using the expertise of economists and statisticians, in order to identify what is within its control. Controllability will help to determine more realistic targets and at the same time staff will be more motivated. Economists will be able to predict, for example, the inflation rate and its consequences on the activities of the MRA, whereas statisticians can measure, interpret and forecast trends.

New technologies can be used in contacting taxpayers and additional payment methods can be used. The process of recording management information is improved so that information is more readily available for decision making.

## CHAPTER THREE

### ENFORCEMENT AND COLLECTION

This chapter of the report examines:

- Approach to collecting debts by the DMU
- Methods used by the DMU for enforcing the recovery of debt
- Lessons to be learnt from other Tax Authorities

The MRA is doing a lot to collect revenue. However it does not have enough information as demonstrated in chapter one, which could be used to make better decisions. There are opportunities for the MRA to improve further e.g. by using alternative ways of reminding customers of their debt.

#### **3.1 Review of Existing Process of Collecting and Enforcing Arrears**

The MRA needs to review whether it could collect and enforce arrears more quickly and at lower cost. Benchmarking on what other countries have been doing in the identification and collection of arrears, we found that some countries are calculating the cost of collection, using alternative ways of reminding customers of their debt, determining the effectiveness of enforcement actions and penalties.

#### **3.2 Could MRA Collect and Enforce VAT Arrears More Quickly and at Lower Cost.**

The taxpayers are expected to lodge correct returns and statements by the due date as specified in the VAT Return Form, and to pay their taxation liabilities as and when they fall due for payment. A taxation debt arises when a liability falls due for payment and it remains unpaid.

The first action undertaken by the DMU to collect debts was to issue a final claim to the taxpayer with mention of enforcement actions. Selection of cases from the campaign pool was primarily based on the size of debt balances. In administering debt collection, the MRA distinguishes between new and escalating debts. When a new tax debt has been established, a debt case is created at the DMU. Officers' performance was based on the value of debt they would recover for the financial year. As such, they would give priority in recovering high value debts. As a result, low value debts were not dealt with, thereby becoming old debts and subject to penalties.

The MRA has standard work procedures for collecting and enforcing debt. The most common enforcement tool to recover debt is attachment orders. Another useful method which the MRA often has recourse to is the distress warrant and inscription. From a process mapping we carried out for debt collection and enforcement, we found that the MRA could collect and enforce debt more quickly and at lower cost by comparing its processes with other overseas tax authorities.

### **3.3 Lessons to be Learnt from other Tax Authorities**

The MRA can still improve its process by comparing it with what other countries have been doing.

- Overseas tax department such as in UK and New Zealand are making more frequent and routine use of telephone as an important tool to contact debtors. Consequently, debt cases could be recovered by making a first direct personal contact through telephone instead of sending claims. Contacting taxpayers early in the collection cycle enables the taxpayer to better manage the debt before it begins to escalate. This also improves the prospects for the ongoing viability of the taxpayer's business.
- The New Zealand Inland Revenue's case allocation processes rely on a risk-modeling system. The risk model uses a range of information about a taxpayer. The information is used to assign a score to the debt case. The greater the score, the more likely it is that a case will be assigned to a debt officer. Cases with lower-risk scores are less likely to be assigned to debt officers. However, the Inland Revenue does not ignore cases with low scores. A taxpayer will continue to receive statements showing the total debt including penalties and interest. This alone can be enough to encourage some taxpayers to resolve the debt. Also, because the risk score grows as debt grows, the probability of a case being assigned to a debt officer increases with time.
- In Singapore, the common actions are calling taxpayers, sending warning letters, appointment of agency and field visits. In order to recover the debt from delinquent taxpayers, the Inland Revenue Authority may decide to take tougher actions such as imposing additional 2% late payment penalties and instituting legal proceedings.
- In Australia, in instances where the tax appears to have been improperly or incompletely remitted, the Australian Tax Office (ATO) employs a number of strategies in order to collect the outstanding tax. Initially this involves making contact with the taxpayer to seek an explanation or classification regarding their outstanding tax obligation or apparent inconsistencies in taxpayer reporting. Beyond this, the ATO employs other intervention and treatment options
- The experience of the UK Department, and other organisations that collect debt, suggests that older debts are harder and more expensive to collect. To deal with its high caseload, the Department established a separate unit for small debts.

- In UK, risk profiling allows the Department to identify more vulnerable taxpayers. For example, the Department could tailor its initial correspondence to the needs of particular taxpayers and could contact taxpayers with relatively small debts but who would need support in paying and discuss payment options at an early stage. This could avoid smaller debts building up to sums that the taxpayer would have no hope of paying.
  
- After hours calling initiative was trialed by the ATO on taxpayers who had not responded to the ATO's previous attempts to engage with them regarding their debt problems. The initiative involved contacting debtors outside normal working hours (contact time 5.00 pm to 8.30 pm), in order to increase debtor coverage. During the six week pilot (31 January to 15 March 2006), the ATO personally contacted or left a message for some 5 000 taxpayers, resulting in payments in full or promises to pay by installments totaling \$52 million. The salary overtime cost of the pilot amounted to \$150 000. On the basis of cost/ potential return, the initiative is a very positive one. Although the initiative attracted press and Parliamentary comment reflecting sensitivities to the potential impact on taxpayers' domestic arrangements and quality of life.
  
- The Collector-General's Office of the Republic of Ireland operates an Active Intervention Management computer system which deals with taxpayers' cases across different tax streams. Managers prioritise the taxpayer cases that staff should pursue mainly by the total owed across all tax streams. The caseworker contacts the taxpayer, only after looking at total liability, and examining their filing and payment history to determine their risk and ability to pay. This enables the caseworker to make a targeted approach to each taxpayer, geared to securing the best outcome from the call. The advantages for the taxpayer are that there is one point of contact with the Office and any refunds due to the taxpayer on one tax stream are automatically set against liabilities on others. In the last 6/7 years since its introduction, there have been dramatic improvements to debt collection during which the outstanding debt has reduced from 15 per cent of the VAT collected in 1997 to three per cent in 2003.

## CHAPTER FOUR

### PRACTICES FOR ENCOURAGING PAYMENT AND PREVENTION OF DEBTS

This chapter of the report examines:

- Whether the MRA could do more to encourage those with VAT arrears to pay on time;
- What more the MRA could do to assist traders to avoid getting into arrears;
- What more the MRA could do to assist traders who have got into arrears;
- Lessons to be learnt from other Tax Authorities.

#### 4.1 Encouraging those with VAT Arrears to Pay on Time

The MRA have systems for collecting taxes which match those used by other tax authorities but more could be done when it concerns debt recovery. Most of the methods used for example claims; enforcement tools and education are similar with other international tax recovery departments we compared.

The rate of compliance concerning returns is quite high. However on the other hand debt is increasing. Surveys are being done by international tax recovery departments to determine the reason why taxpayers are falling into debts.

Internationally most debt recovery departments are using different and innovative ways of payments and communications.

##### 4.1.1 MRA's Current Process

The Authority has 13 departments which reports to the Director General. Amongst these departments, the Taxpayer Education and Communication department (TECD) has as its mandate to provide taxpayer education.

The TECD is a support and facilitation department within the MRA which is a very important part of the chain in providing quality services to taxpayers as it provides the following:

- Educating and assisting all taxpayers in understanding the current rules and processes of revenue collection
- Giving information and advice on the rights and obligations of all taxpayers
- Communication with taxpayers e.g on Collection and filing of tax returns, payments and use of information systems on all transactions

The MRA has a taxpayer charter which sets out the way the MRA is committed when dealing with taxpayers and also outlines the taxpayer's rights and obligations. The department also

issues leaflets and information booklets to guide taxpayers. The MRA has also introduced an E-corner information kiosk so as to encourage taxpayers to submit e-returns and pay their dues on time by instructing their banks.

The MRA also regularly issues information packs to taxpayers, frequently visits organisations for awareness and sensitisation campaigns and frequently updates its website.

#### **4.2 Measures to Avoid Taxpayers Getting into Arrears**

The main responsibility of the TECD is to educate taxpayers on their rights and obligations. The department has carried out a survey on taxpayers to obtain their feedback on its current way of operation and services it offers to determine their satisfactions, but not on the reasons as to why they got into debt.

MRA also issues a range of leaflets, pamphlets, and brochures providing information to taxpayers on how to pay, on the collection and enforcement actions the authority will take in case of non-payment. The MRA also issued a taxpayer charter in December 2006 and is considering revising it this year. It conducts seminars, workshops, and talk forums in schools and work sites and also to the general public. Print and media campaigns (including television spots reminding taxpayers of their obligations and the benefits of paying in time) were introduced to raise the level of awareness. There was a reduction in the rate of penalty and surcharge as from July 2007.

MRA is already doing good things similar to other tax authorities. But, we are of the opinion that to better encourage those with tax arrears to pay on time, the reason why they get into debt should be known.

#### **4.3 Measures to Assist Traders who have got into Arrears**

In some cases there is personal contact with taxpayers leading to:

- Agreement between the MRA and taxpayer to make payment by instalments.
- Agreement to defer tax payments by a maximum of 6 months when the taxpayer is in financial difficulty.

The MRA implemented the Tax Arrears Payment Incentive Scheme (TAPIS) to help debtors settle their liability. TAPIS which was in operation from July to December 2007 has allowed the MRA to recover some Rs 46.1 million of arrears relating to Value Added Tax. (Annual Report 2007/08). Taxpayers facing cash flow problems are also granted payment facilities to settle their outstanding tax liabilities on an installment basis.

Presently, the available payment options offered to taxpayers consist of:

- Payment by cash,
- Cheques
- And also e-payments through instructions to banks (for those who make e-returns).

The MRA is already using the option of payment by instalments. However we are of the opinion that additional improvements could be made such as using alternative ways of payment and communication tools.

#### **4.4 Overseas Practices**

The MRA does compare their system with other international tax agencies. No specific comparison was made for tax arrears by the MRA. We carried out some comparisons of what international organisations are doing.

##### ***4.4.1 Incentives***

Legislation in New Zealand requires Inland Revenue to charge interest on a taxpayer's outstanding debt, but under certain circumstances Inland Revenue can remit interest and penalties. These circumstances include serious hardship, if the maximum amount of debt has been recovered, or it is inefficient for Inland Revenue to continue chasing the debt. External organisations consulted have pointed out that the compounding nature of interest and penalties can act as a disincentive to pay current and future taxes if the tax debtor believes that they cannot ever catch up. Inland Revenue is aware of this issue and is planning to better understand the point at which penalties and interest influence compliance.

##### ***4.4.2 Reasons why Taxpayers get into Debt***

The UK NAO office commissioned a specialised firm to interview current or former tax debtors to better understand attitudes to debt and why people get into tax debt. The 26 interviews, together with research undertaken by the Department, showed that there are various reasons why taxpayers do not pay tax on time. Small businesses may have difficulties in managing their cash flow, particularly where they need to pay tax in a lump sum or if monthly payments are due before they receive payment from customers. Taxpayers may also miss payments because they are not aware of deadlines; have difficulty keeping records to calculate what they owe or if other debts take priority over tax. Businesses which have become insolvent may also owe tax. Debt also arises because of unexpected circumstances in people's lives such as serious illness or family breakdown. Some people do not pay their tax

on time in the hope that they will not be pursued further. This group may repeatedly dispute the amount they owe or avoid contact with the Department. Some do not pay on time as a way of actively managing cash flow because they view tax payments as less important than paying suppliers. Others do not see being in tax debt as undesirable.

New Zealand Inland Revenue is devising new ways to detect taxpayers who are not complying with their obligations. It is also looking at practices in overseas agencies, as a way of refining its own debt collection techniques.

The Canada Revenue Agency has set up a team dedicated to conducting debt management research.

#### ***4.4.3 Alternative Methods of Communication***

In UK, leading debt collection organisations are expanding the ways in which they contact customers. Many organisations are using SMS text messaging. A large energy company is trialing interactive voice recognition software<sup>18</sup> and SMS text messaging with customers who do not respond to other types of contact. It is said contact rates for SMS were around 12 per cent compared with two per cent for voice recognition software. At around 5p per text, more than 10,000 messages can be sent instantly for approximately £500 (against, for example, £2,300 on postage for 10,000 letters). Other organisations use automated telephone messaging to remind customers that payments are due and to encourage debtors to contact them. For example, a large utility company we consulted said that 20 to 25 per cent of debtors called back after text or voicemail with a payment rate of eight to ten per cent. A debt collection agency said that over 70 per cent of its telephone collection activity involves leaving automated messages. In October 2008, the UK Inland Revenue began piloting voicemail for a small sample of low value debts and was also considering exploring how it could use text messaging.

#### ***4.4.4 Timing of Payments***

Taxes which have different statutory payment dates make it complicated for taxpayers to remember deadlines, understand their total tax liability and schedule payments, especially when there is a time lag between money being earned and tax being due. A recent review by the OECD of programmes to reduce the administrative burden of tax regulations suggested that countries could consider aligning VAT and other periodic tax liabilities. Tax authorities in Australia, Denmark and Sweden are integrating business tax obligations to reduce costs and inconvenience of complying with complex tax regulations.

#### ***4.4.5 Alternative Payment Options***

The UK Inland Revenue has introduced further payment options, including payment by credit card and direct debit for paying in instalments. Payment over the internet is increasing; online transactions have increased by 44 per cent in the last year.

Over 40 per cent of payments are by direct debit, the Department's preferred payment method. VAT taxpayers can set up direct debits online. From July 2008, taxpayers have been able to set up direct debits by telephone for other taxes. The Department expects to offer online direct debit services on all taxes from late 2008. In 2008 the Government introduced legislation to accept payment by credit card and to pass on the merchants' handling charge to the taxpayer at the time of payment. The Department expected to introduce payment by credit card over the telephone by the end of 2008 and online in early 2009.

Other revenue bodies in Germany, Japan and the US are working to improve the efficiency of debt collection activities. Examples of initiatives/programs undertaken include, developing new ways of payment e.g. phone banking, internet banking, direct debit payments and the greater use of credit cards.

#### ***4.4.6 Information Provided on Websites***

New Zealand's Inland Revenue website directs individuals who are "having difficulties making a tax payment" to a webpage setting out the options for payment which includes time to pay arrangements and which requests the customer inform them early of any difficulties in making payment. The webpage links to a booklet that draws together information and advice on how to pay, the collection and enforcement measures that may be used and contact helpline numbers available.

The United States of America Internal Revenue Service website has a section for filing and/or paying late and the different methods available to those who cannot pay all they owe by the due date.

The Australian Taxation Office Website directs customers to a webpage "difficulty in paying your tax debt". It provides a contact helpline and email address for customers to contact the Taxation Office if customers cannot pay their tax on time or if payment would cause serious hardship.

## SCOPE AND METHODOLOGY

### Scope of the Study

This performance audit assignment focus on the Mauritius Revenue Authority's management of tax debt. We limited our audit to VAT only. We examined whether the system of collecting debt is efficient, economic and effective. We are of view that the MRA has done a lot since its setting up and is willing to do more to improve further.

### Methodology

Our fieldwork comprised the following methodologies:

- Analysis of MRA's data.
- Interviews and process familiarisation.
- Benchmarking with overseas tax authorities.
- Files and document review at the MRA

### Data Analysis

Our analysis covered debt across VAT based on the following:

- Monthly management reports, which are prepared and analysed by the Research, policy and planning department.
- Financial information from the audit reports, Corporate plan and Annual reports.
- Standard reports taken from the department's debt systems.
- Key performance indicator source data
- Trends in the value and volume of debt.

### Document Review

We scrutinized the internal departmental documents and files relating to debt:

- Strategy documents, including analysis of performance data on a monthly basis.
- Information available to taxpayers from the Department, including the website, hard

copy leaflets and samples of letters to taxpayers.

- The Annual report, Corporate Plan and Audit reports & other internally generated reports prepared by the Research, Policy and Planning Department.
- Taxpayers individual collection sub files.

### **Interviews and Process Familiarisation**

We conducted semi-structured interviews with senior management and staff members involved in debt management and collection, including those in processing and operations. We reviewed around 20 debtor cases files. Our aim was to familiarise ourselves with the processes used by staff to collect debt and to gain an understanding of how taxpayers end up in debt and how debt builds up.

### **Revenue Department Overseas**

For the international benchmarking, we reviewed and analysed performance audit reports on the Internet. We analysed performance audit reports prepared by other audit offices such as UK NAO, Australia NAO, New Zealand audit office and Canada Audit Office

We also reviewed reports on tax administrations and debt by OECD as well as report prepared by the European Union.

We requested five commonwealth tax revenue authorities via the MRA to describe their debt collection processes but unfortunately only two, Australia and Singapore responded.

We also wrote to five overseas audit offices to get an insight of their tax authorities process. Only Australia and New Zealand responded.

**GLOSSARY**

|       |  |
|-------|--|
| ANAO  | Australia National Audit Office                        |
| ARC   | Assessment Review Committee                            |
| ATO   | Australian Tax Office                                  |
| DMU   | Debt Management Unit                                   |
| KPIs  | Key Performance Indicators                             |
| MRA   | Mauritius Revenue Authority                            |
| NAO   | National Audit Office                                  |
| OECD  | Organisation for Economic Co-operation and Development |
| SOPs  | standard operating procedures                          |
| TAPIS | Tax Arrears Payment Incentive Scheme                   |
| TECD  | Taxpayer Education and Communication department        |
| VAT   | Value Added Tax  |
| VDIS  | Voluntary Disclosure Incentive Scheme                  |