Preparations for Self Assessment

Country Y

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1 Introduction

1.1 Self Assessment

Self-assessment is where the taxpayer completes a tax return for the period in question, calculates the tax base, calculates the tax due and sends the return along with the payment of the tax to the Tax Administration.

Self-assessment is different than revenue assessment, which is the current system used for income tax returns in Country Y. Under a revenue-assessed system the taxpayer files a return, the Tax Administration receives the return, examines it and raises an assessment with which the taxpayer may or may not agree. Eventually the taxpayer will pay the tax due which will be either the original computation, the revised figure set by the Tax Administration or some other figure, all depending on how the appeal has been settled. The main changes (and advantages) of self-assessment are as follows: -

- The return must include the taxpayer's taxable income for the year and the tax payable on that taxable income;
- The return is treated as though it were an assessment;
- The return is accompanied by payment of the tax; and
- Audit takes place after the filing of the return thus allowing the Tax Administration to audit selectively according to risk.

It can be seen therefore that self-assessment has the advantage of bringing the tax in to the Treasury sooner than would be the case under the present system. Self-assessment is regarded as a positive aid towards investment promotion. It also cuts down drastically on the interactions between the taxpayer and the Tax Administration. Provided the taxpayer has filed an honest return there should be no need for the taxpayer to meet with officials from the Tax Administration.

1.2 Compliance Enhancement

The main problem affecting the Tax Administration in Country Y is poor taxpayer compliance. The proposed introduction of self-assessment should be seen as one part of an overall strategy aimed at encouraging taxpayer compliance. Other elements of this strategy will be developed by the Tax Administration in the medium term.

1.3 Returns

The Tax Administration receives returns from taxpayers as follows: -

- Employee withholding returns, and
- Tax returns in respect of profits earned by companies, sole traders and partnerships (including capital gains).

The first category of returns is essentially a self-assessed category. That is they are returns where the taxpayer makes the calculation of the tax base and the tax and is obliged to send payment of the tax along with the return. The second category of returns is currently a revenue-assessed category.

In order to put all the taxes on the same footing it would be necessary to amend the income tax law to allow for self-assessment to apply.

1.4 Phased introduction of self-assessment

It is suggested that self-assessment could be introduced on a phased basis, beginning with corporate taxpayers and possibly large sole traders and partnerships.

1.5 Adjustments to assessments

As mentioned above the great advantage of self-assessment is that it allows honest taxpayers to file their returns and pay their taxes without having any interactions with the Tax Administration. The advantage for the Tax Administration is that the tax is paid earlier than would be the case under a revenue-assessed system. Another advantage is that with self-assessment in place the Tax Administration would then be free to concentrate its resources on those taxpayers that it believes have not filed honest returns or who indeed have not filed any return. Of course self-assessment must be backed up with a strong system of penalties for non-filing of returns and for under-statement of income. Self-assessment also demands an efficient and effective audit capability.

Under a self-assessment system, all returns should be screened, checked for mathematical accuracy and other basic indicators and compared to a pre-determined set of risk criteria. Those returns showing a high risk should be audited.

It is suggested that the Tax Administration would be allowed up to four years from the date the return is filed to conduct an audit. If the Tax Administration needs to make any adjustments to the return these can be done by means of an additional assessment within that time period. Of course an additional assessment may be made at any time in the case of tax evasion or fraud. There is no time limit on tax evasion or fraud.

To be fair it is also suggested that the taxpayer would be allowed up to four years to file an application with the Tax Administration for an amendment of a self-assessment.

1.6 Rulings

To provide for certainty of law within the system of self-assessment it is suggested that the Tax Administration would introduce a simple ruling system applicable only to self-assessment taxpayers. Under this system a taxpayer that was in any doubt about the tax effects of a particular transaction or transactions would apply, in writing, to the Tax Administration for a ruling on the tax effects of the transaction. Providing the taxpayer has made a full and true disclosure of all aspects of the transaction and the transaction has proceeded accordingly, the ruling shall be binding on the Tax Administration. Of course if the taxpayer has not made a full and true disclosure of all aspects of the transaction or if the transaction did not proceed in all material respects as described in the taxpayer's application, the ruling would not be binding on the Tax Administration.

2 Implementation

2.1 Legislation

Self-Assessment is a substantive administrative provision for which new legislation will need to be developed. It offers a possibility for improving revenue performance in terms of improvements in collection and the enforcement of compliance.

In terms of the proposed legislation to be drafted, it is suggested that only companies will be subject to Self-assessment. There should be an enabling provision which empowers the Commissioner, by notice in the Government Gazette, to extend the application of the Self Assessment provisions to any other class of taxpayers if it is necessary to do so.

In terms of the proposed Self-assessment provisions, the Commissioner shall not be required to issue an assessment; the taxpayer's return of income will be treated as a notice of assessment served on the taxpayer by the Commissioner. However, the Commissioner should have powers to raise an assessment in any case in which it is considered necessary.

2.2 Implementation Plan

The Tax Administration will need to put in place an implementation plan and an implementation team to design, co-ordinate and closely monitor the implementation of the Self -assessment Programme.

2.3 Public Awareness And Educational Programme

The Tax Administration will need to design and implement both public awareness and educational programmes. The programmes should be designed to raise awareness on Self-assessment by the use of information leaflets and the media. The educational programme should form the core of support for Self-assessment. It should be selective and targeted to specific groups that will be specifically affected by Self-assessment. These will be the Accountants, Auditors, agents and public officers of companies. This should be an on-going programme.

2.4 Staff Training

The training of staff within the Tax Administration so as to ensure that they have the necessary skills and competence to effect the system is vital. An effective audit capability is an essential ingredient for successful implementation of self-assessment. The Tax Administration needs a well-trained and effective Audit

Section capable of conducting simple and complex audits. Currently, there is a lack of sufficiently well trained staff for this type of work.

The Tax Administration should give high priority to putting in place an effective and capable Audit Section.

Self-assessment would ease filing of returns and for staff to be released to do more productive audit and investigation work, thus effectively enforcing compliance by allowing the Tax Administration to focus on persons not complying with the law.

The Tax Administration must also audit withholding agents to ensure that they are complying with their obligations.

2.5 Forms and Practice Notes

The forms and work practices currently in use in the Tax Administration will need to be revised so as to be compatible with the requirements of self -assessment.

2.6 Computerisation Expansion

The Tax Administration will need to embark on an expansion of the current system and also introduce new functionality for self-assessment. With improved computerisation a more efficient system of locating defaulting taxpayers could be possible. In addition, computers may be used with regard to:-

- The computerisation of the Desk Instructions.
- The investigation of the possibility of a help system that will provide on screen assistance for self -assessment.
- The introduction of automatic levying of penalties.

2.7 Compliance Strategy

The Department's compliance strategy should be centred around: -

- encouraging compliance
- detecting and correcting non-compliance

The new more user-friendly and clearer rules will make it easier for taxpayers to comply with return-filing obligations. Compliance work would be geared towards assisting taxpayers to self assess correctly. The Department's main task is to encourage compliance through the provision of service initiatives.

2.7.1 Interest

Under Self Assessment interest must run from the date the tax should have been paid, rather than a due date linked to the date of an assessment.

2.7.2 Keeping Of Business Records

Taxpayers are required to retain records for 7 years in respect of the information included in their returns.

Business records should comprise at least the following –

- receipts and expenses
- sales and purchases records
- other supporting documents relevant to the transactions of the business.

2.7.3 Auditing

There should be a reasonable time frame for conclusion of enquiries opened by the Tax Administration where the taxpayer has furnished all the relevant information under self-assessment. The Commissioner should be free to test the accuracy of any return.

The auditing strategy should be twofold:

- selective auditing; and
- random auditing

Concentrating on the areas where there is a high risk of error and evasion, the majority of returns selected for audit should be chosen on the basis of risk assessment. A risk assessment system based on the prevailing conditions in Country Y should be developed by the Tax Administration.

2.7.4 Computer Compliance Risk Assessment

Random Cases

The Tax Administration must focus on those cases where the risk is regarded as greatest. But a small number of cases could be randomly selected by computer for mandatory auditing in order to: -

- Deter evasion;
- Monitor levels of compliance; and
- Produce management information about risk areas so as to improve effectiveness of risk based selection techniques.

A number of cases could be on mandatory review. These could be permanent review cases or cases which have a particular feature -

- Cases where a ruling has been given;
- Cases where there has been a change of accounting date;
- Cases where there are estimates, and so on.

For compliance work to be cost effective and efficient, auditing has to be carried out on a selective basis but ensuring that the Tax Administration manages risks in all the segments of the taxpaying population. This could be achieved by development of risk management strategies for the different segments of the taxpayer population.

2.7.5 Taxpayer Identification Number

There should be a unique Taxpayer Identification Numbering system (TIN) whereby each taxpayer has a unique identification number used for all taxes. The purposes of developing a unique TIN are: -

- to ensure that all taxpayers may be uniquely identified so as to prevent duplication or confusion in maintaining records and accounts concerning such persons,
- To facilitate and ease the filing of returns, and
- To track information on taxpayers between tax agencies and from other agencies.

3 Conclusion

Self-assessment has advantages for taxpayers and tax administrators alike. It is suggested that large taxpayers filing income tax returns would move to self-assessment. Introducing self-assessment for income tax returns submitted by large taxpayers would bring consistency of assessment to the Tax Administration. It would also mean a significant modernisation of the tax system as it relates to large taxpayers.