Combating fiscal fraud by making use of IT

Origin of the project

During the VIth EUROSAI Congress in Bonn, Germany, in May/June 2005, the members of EUROSAI discussed the offer the EUROSAI IT Working Group had made to carry out a project in the area of IT and (international) revenues fraud. They accepted the offer, as it was in line with its own line of thought regarding the audit of public revenues by SAIs –one of the themes of the congress.

The project was staffed by Austria, Germany and the Netherlands (coordinator) – Sweden acted as a sounding board. The project team decided to focus the project on fiscal fraud in order to create a project that was both effective and feasible.

A well-known type of fiscal fraud committed in an international context is the 'VAT carousel' fraud, which causes an estimated annual loss to the European Union as a whole of some € 100 billion. This considerable amount of money and its cross-border nature make it an important area for EUROSAI, as IT is often used in committing the fraud. It is of course the role of the tax administrations to combat fiscal fraud, while the SAI's role is to audit how successful the tax administration are in this respect.

Objectives

During the Congress in Bonn it was noted that fraudsters are ahead of tax administrations in using IT, while tax administrations are in turn ahead of supreme audit institutions (SAIs). The project should aid the EUROSAI-members in making the gaps smaller.

In order to do so we formulated three sub-objectives:

1. Making a first step in detecting best practices and possibilities for improvement regarding the cooperation between different organisations which are involved in combating carousel fraud by making use of IT;
2. Making full use of IT capabilities in analysing vast numbers of data to detect signals that indicate carousel fraud (profiling);
3. Establishing a platform for exchanging good practices and exploring current challenges in the use of IT in combating fiscal fraud.

Survey

The first meeting of the EUROSAI IT Working Group after the Bonn Congress in 2005 was held in Bratislava, Slovenia, in September 2006. During the discussion about this project the members of EUROSAI stressed the importance of taking national differences into account and to make use and liaise with the VAT-working group and OECD who are also performing work in the field of carousel fraud. Because of the complexity it was decided to widen the time horizon (spanning more then one work period) and divide the project into smaller, more manageable projects. As a first project we carried out a survey asking the members of the working group a number of questions regarding combating carousel fraud in their country. We made the questionnaire as neutral as possible regarding national differences.

The questionnaire was send on 11th September 2007 and the respondents were requested to respond before 1st of November 2007. We can inform you that we received nineteen out of the twenty-eight questionnaires that were send. We see this as high response rate, which proofs the interest in the subject of using IT in combating fiscal fraud. The results of the report are in annex I.

We will keep in touch with members of the EU VAT-working group because they possess a great deal of expertise. We believe they can also benefit from the (anonymous) questionnaire results. We expect the results of the project to be also useful for possible future projects of EUROSAI-countries in the field of combating other types of financial fraud and of money laundering practices.

Next work period (2008 -2011)

Included in the proposed Work Plan 2008 – 2011 is the proposal to make a next step by organising three small seminars, inviting tax authorities, customs and statistical bureaus to foster trust between the relevant parties, in order to enhance cooperation. By organising a seminar, we aspire to create a platform for cooperation both nationally between SAIs and their tax authorities and internationally between European countries. We also hope to involve other key players, such as OECD and the EU VAT Working Group. The project team will be staffed by the Netherlands (lead), Austria, Bulgaria, Germany, Lithuania, Russia, Slovenia, Switzerland (q.q.) – Finland will act as a sounding board.

May 2008
Saskia J. Stuiveling,
President of the Netherlands Court of Audit and
resigning Chair of the EUROSAI IT Working Group

# Annex I: Survey results

1 Response

We received nineteen out of the twenty-eight questionnaires that were distributed. We consider this a high response rate and a clear indication of broad interest in the subject of using IT in combating fiscal fraud.

2 Profiling

A major part of the questionnaire addressed profiling – in the broadest sense. Profiling comprises defining a risk profile or a set of risk indicators to analyse the data available to tax administrations. Profiles are used to detect signals of possible fraud cases – carousel fraud in the case of our questionnaire. Success of a risk profile is determined by the level of congruence of its signals with actual carousel fraud cases. Because fraudsters are always trying to find new ways to defraud, tax administrations should put measures in place to keep the risk profile up to date. Cooperation with other tax administrations is assumed to be a key factor in keeping the risk profiles up to date.

We will give an example of profiling: a tax administration within the European union noticed a sharp rise in imports of mobile phones from a small Gulf state. They actually seized a plane load of mobile phones that had been shipped as part of a carousel fraud scheme. That incident led to an adjustment of the risk profile, in that it came to include large imports from outside the European Union.
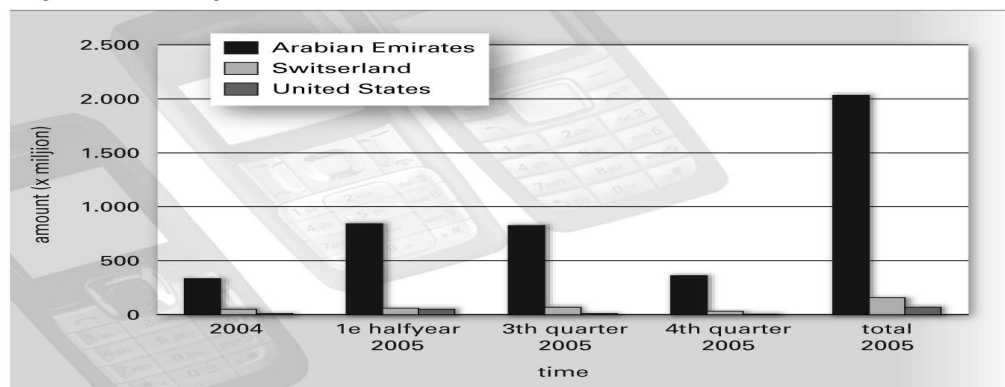
In the process scheme below we describe the process of profiling. Tax administrations use IT in combating fiscal fraud by analysing vast amounts of data.

Profiling
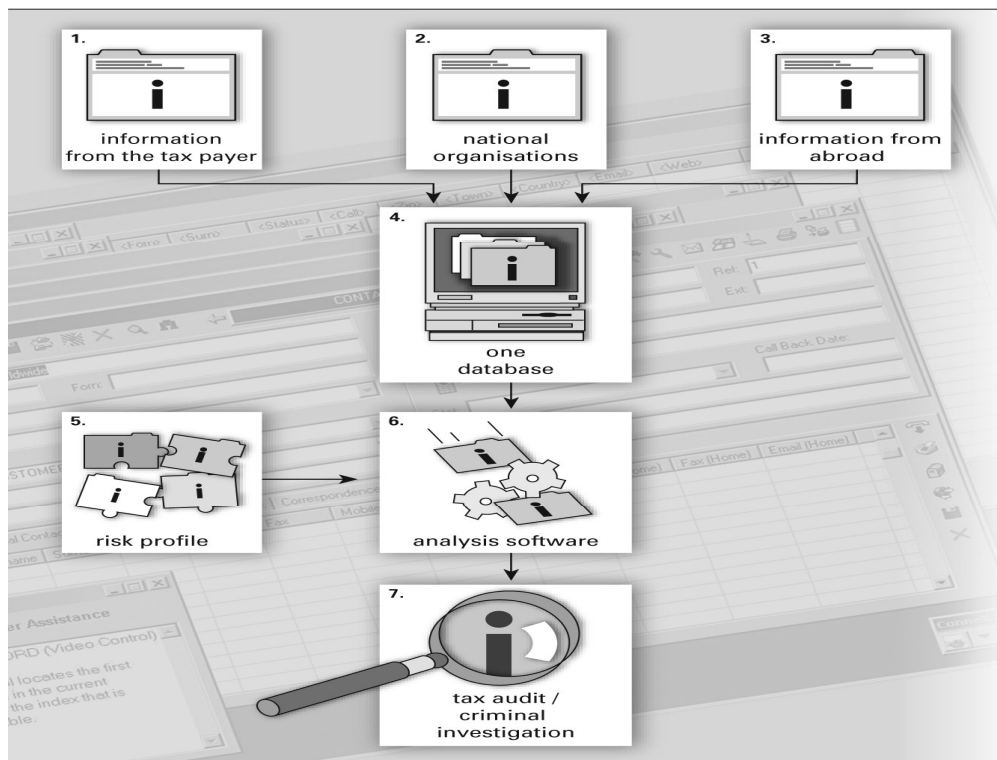
The first step in profiling is gathering these data in such a way that the data can be processed by a computer. There is data originating from tax payers (no 1), data from national organisations (no 2 e.g. banks, chambers of commerce) and international data (no 3) available to tax administrations. There may exist legal obstructions to access to data or lacking means for the administration to be able to use the data, for instance insufficient budget or lack of knowledge. It is practical to gather all data in one database, before analysing the data (no 4). Risk profiles are based on actual fraud cases or on professional judgments of experienced tax officers (no 5). The profiles are used to analyse the data (no 6). The cases that receive red flags, should be audited by tax officers (no 7).

Below we present the results of the survey.

3 Information from tax payers and from national organisations

47% of the respondents reported legal restrictions regarding data exchange between tax administrations and national organisations, mainly banks, about criminal information – for instance about money laundering. 63% of tax administrations are authorised to seize IT-equipment from tax payers, only about 30% of respondents answered their tax administration can monitor telephone conversations or e-mail. One country that can seize IT-equipment, doesn't possess the knowledge to access the data.

4 Information from abroad and databases

47% of the respondents reported legal restrictions regarding data exchange with other countries, especially non-European Union (EU) countries. 53% of the respondents met legal restrictions exchanging information with supranational organisations such as the European anti-fraud office OLAF and the international police organisation Interpol.

Most tax administrations (57%) feel their budget is insufficient so that they cannot hire specialized personnel. A large minority (42%) report insufficient budgets for IT-equipment.

Most countries make use of VIES[1] and EUROCANET[2] to exchange information about fiscal fraud. Also, a number of other computer applications were mentioned. Respondents differ in their evaluation of the data quality of VIES and EUROCANET, as the table on the next page shows. The table also suggests that using the two systems in combination might improve results.

	Timely?	Accurate?	Sufficient?
VIES	Yes 35%	Yes 59%	Yes 65%
EUROCANET	Yes 93%	Yes 79%	Yes 57%

5 Risk profile

All countries use risk profiling to select cases for thorough analysis. The answers seem to indicate that not all countries update the risk profiles in a systematic way (8 out of 19 reported they do).

6 Analysis software

Most countries would like to have software to their disposal that diminishes their work load when analysing the total mass of tax data to a level that the tax administration is able to handle. The countries that have analysis software

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[1] VIES: VAT Information Exchange System, an EU system that was established to facilitate the flow of data held across the internal frontiers which:

- enables companies to rapidly obtain confirmation of the VAT numbers of their trading partners;

- enables VAT administrations to monitor and control the flow of intra-Community trade to detect all kinds of irregularities.

[2] European Carousel Network, a project sponsored by the European Commission using data from the police and other organisations.

installed, make use of generic applications such as IDEA, ACL and SPSS. Only a few countries use specialized software like AIS, ZYLAB and RSCASE.

7 Further steps in the context of EUROSAI

Included in the proposed Work Plan 2008 – 2011 of the IT Working Group is the proposal to make a next step by organising three small seminars, inviting tax authorities, customs and statistical bureaus to foster trust between the relevant parties in order to enhance cooperation. By organising a seminar, we aspire to create a platform for cooperation both national between SAIs and their tax authorities and international between European countries. We also hope to involve other key players, such as OECD and the EU VAT Working Group.

As part of the survey we also asked SAIs if they had performed audits of profiling or the use of IT in combating fiscal fraud. 5 out of 19 countries answered that they had done so. From the results of the survey we concluded that SAIs can carry out very specific audits in the field of profiling and of the use of IT in combating fiscal fraud. These audits might be done joined-up with other SAIs.

There may also be opportunities for quick wins. For instance, a small number of countries have so-called web crawlers at their disposal. A web crawler is a computer program that roams the internet for signs of possible taxable activities. Five countries expressed a need for such programs. If our tax administration does not make use of web crawlers, SAIs could inform them of other countries that douse them and that they may be willing to share some of their expertise.