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**THEORY AND PRACTICE OF ECONOMIC PROCESSES
DOCTORATE SCHOOL**

SUBPROGRAM FOR PUBLIC ECONOMICS

**MODELS AND REFORMS OF TAX
ADMINISTRATION –
AN INTERNATIONAL COMPARISON**

THESIS OF DOCTORATE (PhD) DISSERTATION

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1. Research objectives

The main objectives of the research are

- to analyze the systems and reforms of tax administration in international context
- to link the analysis to the principles and practices of the new public management
- to explore the relations between the above fields those seem to be far separated.

Tax administration is one of the remote parts of research by public economists although it is strongly connected to taxation, which is in the focus of public finance. Theoretical and policy questions of tax policy, tax systems, tax planning and optimal taxation have always got more attention in public finance literature. Fewer efforts have been done in analyzing systems and reforms of tax administration despite the fact that tax administration is very labor intensive, the applied information technology costs a lot, and significant amounts are spent to the administration of taxes. At the same time, without efficient operation of tax administration revenues for government budgets would not be generated at the demanded level. Therefore it is crucial what system and what opportunities for modernization are present in tax administration. Tax administration is one of the largest public organizations. It can be considered as a prototype of externally oriented administration that concentrates or can concentrate on services provided for taxpayers.

As far as the functioning of tax administration is concerned, most governments are confronted with the same kind of problems: a steadily growing workload, the complexity of fiscal legislation, the attitude of taxpayers and the degree of non-compliance, the need to improve customer service, the need to reduce costs of tax assessment and collection, and the need for efficient and effective management. These problems raise questions of the efficiency and the effectiveness of tax collection, and the ways in which they could be improved. The analysis of tax administration structure embraces not only the central but the local and regional – if any – governmental levels.

Systems of tax administration from 16 developed countries and from 5 transition countries in Central and Eastern Europe – among them Hungary – are shown and analyzed in the dissertation. The reason of uneven analysis of countries is that the available theoretical and practical information were quite different in depth and content

concerning countries involved in the research. The basic aim has been to develop certain models grouping the countries in order to compare their tax administrations. The foundation of models is the organizational structure but that is more than a simple question of an organization. Economic, legal and social factors are behind organizations influencing opportunities for change. Nevertheless, organizational reforms play a crucial role in moving away from traditional, bureaucratic characteristics of tax administration.

2. Antecedents and methodology

The author has been doing research on tax administration and on public management. He was pioneering in international research team comparing tax administration systems where he had got deep experiments. Then he was the manager of an international research project covering many aspects of tax administration. During the project he was cooperating with academic and professional experts and met many tax officers and managers home and abroad. Recently he has done research for the Hungarian Tax Office in the field of international comparison of tax administrations.

As far as methodology of the research concerns, exploring and analyzing primary sources and information represent the core method. It is complimented by an independent critical treatment and application of the related professional literature. Methodological features are the correct interpretation of terms and categories, the confrontation of principles and real practices, the development and comparison of models.

3. Main findings, assertions and conclusions

1. Several factors influence and determine the environment, role, operation, performance and efficiency of a tax administration. Among them are the size of the public sector, the size and structure of government revenues. The different types of tax revenues can make significant differences in developing tax administration functions and organizational settings. Administrative costs depend on the applied tax forms, as well. The development in economic system contains many elements – for example, transfer-pricing, transaction taxes, and e-commerce – that force tax offices to meet new

and new requirements. The fast progress in information technology affects the operation of tax administration in positive and negative, direct and indirect ways. Tax administration faces important social challenges and demands, out of which fights against corruption, money laundering and tax evasion can be highlighted. One of the features of tax culture in a country is tax compliance. Improving tax compliance belongs to the priorities of any tax administration. The system, institutions, processes and rules of the general public administration in a country are also determining the environment of tax administration. The traditional model of public administration has been weakened by serious reforms including trends of decentralization and even privatization.

2. Having considered taxpayer's rights so crucial many developed countries (Hungary, too) have summarized their strategies in 'Taxpayer's Charter'. Recently less attention has been paid to the charters, but their international influence is still strong. Publishing mission and future is now a common feature. Countries consider similar priorities in their missions and their future plans are also close to each other.

3. In their strategies tax administrations highlight improving effectiveness, applying voluntary compliance and efficient use of resources. Effectiveness of tax administration can be measured by the tax gap, which is the difference between the statutory tax obligations and the realized tax revenues. Every country seeks for reducing this gap. Voluntary compliance seems to be a desirable strategy but only half of the countries involved use this institution, others apply tax assessment by the tax authority. It is explained by factors of efficiency and of tax culture. Measuring efficiency is made by comparing administrative costs to the net tax revenues. The rate, however, is influenced by many factors not linked to changes in efficiency and effectiveness. Main motive of tax administration reform in many countries is to reduce or eliminate the gap according to the measure.

4. One of the main factors determining the structure of tax administration is the constitutional settings of governance. Basic questions are: what are the status and autonomy of sub-national governments, what is the division of public administration responsibilities, how this division has been evolving in practice. Answers are not simple since many diverse systems and traditions exist. The central public administration is present at sub-national level anyhow that could be linked to the de-concentration and/or

decentralization of public administration. Administering central taxes is really important enough to keep at central level, and even local taxes are administered by central tax office in most cases or shared with lower level government. Therefore, tax administration is organized in hierarchy on two or often three levels. However, this does not mean that the structure of tax administration simply copies the structure of general public administration. Even they are different in most cases. The functions and tasks of the (central) tax administration differ from other public functions, so reforms in tax administration can or should be independent from reforms in other fields of public administration. Tax administration reforms can become pioneers of reforms even.

5. Regional setting of tax administration structure depends partly on existence of regional government. It is evident in federative and “regional” countries. However the structure of tax administration even in these countries does not follow the structure of government. Although the control of taxation is on federal or central level the organizational settings are diverging along the sub-national lines. Interestingly, regional structure exists in many countries where there is no regional government. Where regional setting does not exist the territorial principle is applied along the line of public administration structure (counties, districts).

6. It is of crucial whether administering local taxes is a function of central or sub-national governments. Several methods exist for delegating taxation right to sub-national level. In administering local taxes the central model is more frequently applied but multilevel administration is also feasible in many countries. In balance, central administration of taxes is more advantageous.

7. Another important feature of the structure of tax administration is whether the different government revenues are administered in a unified or in more separate institutions. Despite alterations some trends can be revealed. In many countries the social security contribution represents the largest revenue in the central budget. Countries involved in the research can be divided into two camps. Arguments of efficiency support the system of unified collection of taxes and social security contribution. Some countries have merged administration of taxes and customs into one organization but it seems not be a trend. In case of separate administration of taxes and customs, the administration of excise tax is the responsibility of customs offices.

Central tax administration is responsible for administering property and vehicle taxes in many countries. If not, sub-national government fulfills this task. Most governments have delegated additional tasks in different number and size to the central tax administration.

8. The “autonomy” of tax administration is a relative term reflecting independent decision-making in budgeting, planning, resource-allocation and management. Autonomy is commonly interpreted as the opposite of tax administration operating in a department of ministry of finance. The different institutional settings are mirroring the separation of policy-making and implementation but do not answer the management autonomy.

9. The size of tax administration is influenced by the size of the country, population, size of the labor force, the structure of public administration, tax culture and numerous other factors. Indicators suggest that optimal size of tax administration can not be determined but it varies between certain limits.

10. The structure of a tax administration organization can be analyzed along the following principles: geographic, functional, tax-type (legal) and target-group (client) approaches. These are supplemented by the principle of “front-back office” and risk-assessment. The geographic principle is generally applied following or not following the structure of public administration. Combined application with any of the above mentioned principle is its advantage. The functional approach represents the basis for analyzing activities. Recently the tax-type principle is less frequent, modernization pushes ahead for functional and client-orientation model. Note that the primary principle is applied together with other principles to the “mixed” approach.

11. The functional principle is applied in many countries like France, Spain, Canada, Austria and Norway. All of them except Norway apply regional structure, too. In case of Canada and Austria regional structure stems from the constitutional setting. Spain organizes tax administration regionally along the public administration structure. In France earlier regional directorates were abolished and new interregional offices were set up in 2000. The organization along functional lines provides internal cohesion since every activity – from registration up to enforcement - is in the same organization. Of course, further specialization occurs but controlling the main functions from a single

center is crucial. One can find examples for deeper organizational divisions or concentration some functions into separate units (tax police).

12. Organization along tax-types is featuring only some countries, despite the fact that this approach has several advantages (homogenous client-groups, supporting legal interpretation and compliance, integrating collection and audit, etc.). At the same time, it costs more because of parallel hierarchies are at tax-types, complicated for the taxpayers, separate processes and services according to tax-types. Italy, Ireland, Greece and Portugal belong to this group.

13. Target-group orientation has brought high expectations in organizational reforms. Although large taxpayers are treated separately in almost every tax administration, only few countries have initiated to apply this principle. The Netherlands, Belgium and the United Kingdom have mostly been inspired so far. In target-group or client orientation tax offices (or some of them) are specialized one or more taxpayer groups or activities. The principle is always the same. Efficiency can be improved if tax administrators should treat similar taxpayers applying less legal rules and procedure or they should concentrate on large taxpayers providing the bulk of tax revenues and representing special risk. Large enterprises represent strategic importance for tax administration. Not only because they pay more taxes but because their performance in the economy requires special attention and legal (tax) safety.

14. In the new reform of 2003 the Dutch tax administration has kept the target-group orientation but got rid off the traditional organizational structure. The five big divisions and related local offices have reorganized. The new organization is the so-called “flat management” structure. The core and supporting activities and processes are under a Management Team responsible for controlling the administration. Information technology is concentrated in the center but implementation is organized in regional structure.

15. One can follow a combined application of principles through organizational changes of the Swedish tax administration. The regional approach has been a dominant factor for many years together with the changing dominance of the functional and the target-group orientation. In the beginning of the 90’s there was a shift in the internal organization

towards taxpayer orientation. It is most visible at local level. Earlier taxpayer had to keep contact with different county and local tax offices in order to arrange their tax affairs. Nowadays in most cases only one contact-point is needed, the local office. The objectives of the integration of taxation processes have been to improve efficiency and tax compliance. However, integration does have limits. The tax law is extremely complex and nobody could know every aspect. Within the service sections there must be certain specialization. The trend of returning functional orientation is visible in the National Tax Board as well.

16. Six countries (Austria, Belgium, Denmark, the Netherlands, Ireland, Canada and Spain) have merged tax and customs administrations into one organization as part of a ministry or as independent agency. Reasons, conditions and motives for integration are different. Motives of mergers were improving effectiveness of collection (the Netherlands) or efficiency (Denmark) or both (Canada).

17. Certain trends in time and in space, certain shifts of applying models are seen in tax organizations. The earlier dominant tax-type approach has been replaced by functional and client-oriented approaches or even a mixed model is used in order to improve effectiveness. From territorial view the regional structure has gained more attention because of cost-efficiency and economy of scale purposes. Every country lays greater emphasis on treating large taxpayers. In most countries a separated organization operates in this field. In organizational settings information technology has got special role.

18. Since the 80's and 90's wider-ranging reforms have been seen than any other period of the twentieth century representing a paradigm shift from the traditional model of public administration, dominant for most of the century, to a new model of public management. Different names are used to indicate this new model of public management: managerial reform, new public management, market based public administration or entrepreneurial government. Preceding the reforms public sector had been attacked and new demands had emerged for cutting government spending. As a result the economic activity of governments has decreased. Methods of governance have also been questioned.

19. Literature on reforms is very wide, treated as a new discipline in developed countries. Reform has become subject of trainings for public administrators and tax administrators. Unfortunately, only few publications about the new public management are available in Hungarian.

20. Tax administration – like other large public organizations – is involved in almost every aspect of new public management. Tax administration is an integrated part of public financial management since it implements the government fiscal policy through collecting revenue. The financial management reform trajectory consists of three important sectors: budgeting, accounting and auditing. Most financial modernization strategy has a common objective that is performance oriented budget and management.

21. In the new public management the contracts represent the institutional basis of public sector. Reforms have led to a choice between two options concerning provision of public goods and services: long-term versus short-term contracts. Long-term contracts are featuring public enterprises while short-term contracts are derived from private sector. The latter can have more forms of application in controlling public sector. In light of new public management contracts determine not only public employment relations but objectives and tasks of public service provision.

22. The main characteristics of public management reforms are the followings:

- Transformation of systems and organizations of public service aiming at significant increase in efficiency, effectiveness and innovation capacities.
- Involvement of customer – individuals or groups – into service provision.
- Re-organizing institutions in order to ease hierarchical dependencies, to strengthen autonomy of subordinated levels, to simplify organizational control creating responsible bodies and non-specialized local offices.
- Outcome-orientation.
- Customer-orientation in accordance with “value for money”.
- Application of business moments.
- Focus on outputs and outcomes.
- Promoting and motivating performance through changing inputs.
- Downsizing government and bureaucracy through spreading contracting out.
- Introducing contracting in management.

- Changing relations between politicians and bureaucrats, serving public is becoming managing policies.

23. The new public management can be controlled and implemented only in strategic way. It means that not the operations but the conditions are subject to reform. Five ingredients can be distinguished: system objective, motivation, accountability, structure of power and organizational culture.

24. In tax administration the general approaches to reform is basically the same to ones in other institutes in the public sector. Greater attention is given to performance, to effectiveness and to quality of services provided for taxpayers. Managers at lower level of organization enjoy more power but keeping taxation rules and processes untouched. Internal markets are created for supporting services or they are outsourced. In some cases outsourcing is applied to the main information technology.

25. The relation between tax administration and politics was traditionally relied on precisely detailed budgetary allocation, rules and orders. The new managerial approach has shifted this relation towards performance budgeting and contracting. Performance budgeting applies standards that make performance measurable. Timing and spacing are crucial dimensions of evaluating performance. In most tax administration seems to be that objectives and standards are linked to a minimal level of performance. These objectives are set by a ministry or parliament, sometimes consulting with the tax administration. In countries applying contract management, to objectives are formulated in a bargain between the minister and the head of tax administration.

26. Using performance measurement in tax administration is rare, although several countries have initiated its introduction. In many countries allocation of budgetary sources is determined by internal organizational factors in order to avoid unfavorable effects of incrementalism in measuring performance.

27. Reporting of performance requires efficient information system. Most of the data is derived from the accounting system of the tax administration. Unfortunately, it does sometimes not provide adequate and fast information to managers. Therefore several tax

administrations have developed managerial information system to provide special information to decision-makers.

28. There are convincing examples for managerial reforms, like contract-management in the Dutch tax administration, performance orientation in Sweden or customer orientation in France. One should be aware of the limits of managerial reforms. In the Netherlands – for example – contract management does not relate to larger investments and central procurement. The Swedish tax administration is still rule-oriented despite the principles transforming the whole administration. Deregulation has touched upon mainly the management and support functions while core functions are still precisely regulated by tax laws. Effects of deregulation can be seen first of all in managing financial and human services. In France the internal reorganization of tax offices has proved to be too radical and blocked by trade unions and tax officers. Thus decision was made on step-by-step introduction of reforms.

29. In developed countries reform of tax system preceded the reform of tax administration by several years. Moreover the motives for reforming tax administration have been not the tax structure modified but the needs for efficiency and effectiveness. In the ex-socialist countries reforms of tax system and tax administration were accomplished at the same period. Transition countries involved in the research have developed tax system similar to ones in developed countries.

30. At the time of system change transition countries had tax offices (ministry departments) with low level competencies and workloads. It had a great importance to transform the structure of offices from sector and tax-type orientation to functional ones. Timing of transformation was also crucial. Priorities had been given to stabilization objectives, like employing skilled labor, training, developing system of registration and data processing, accounting and introducing standard forms. They had early recognized the need and importance of technological development. Organizational reforms had required longer period, sometimes it was implemented in several steps. Gradual development had also meant that the questions of efficiency, effectiveness and management were put on the reform agenda only after stabilization. It was also expected that reforms would not bring immediate increase of revenue.

31. Comparing five ex-socialist countries (Estonia, Czech Republic, Hungary, Romania and Ukraine) one can state that the bulk of the revenues are collected by the central government, but local governments are also entitled to administer their own taxes and user fees. The latter seems to be a part of strategy for establishing local democracy.

32. Responsibility for taxation relies usually on the Ministry of Finance in these countries. In the Czech Republic and in Romania the ministry takes the responsibility to control the management of intermediate and local tax offices as well. In Estonia, Hungary and Ukraine this responsibility has been delegated to a separate central agency.

33. The management structure of the five tax administrations is different but there are some similarities. Top level can instruct and order subordinated levels and supervise their decisions. Budget allocation is determined from the center and reaching some performance levels are required. A certain performance orientation is present but they operate still in a very bureaucratic environment.

34. In Hungary, the Tax and Financial Control Office (APEH) is responsible for administering central taxes. Beside APEH there are other authorities entitled for collecting government revenues: the Customs Office, the Office of Duties and the local governments. The system is rather fragmented providing different scale of collection and different level of efficiency. For example, the municipal government considers the function of tax authority as questions of democracy, but administering local taxes costs a lot. They produce approximately one fifth of the total tax revenue while employing close to same people than the central tax administration. The idea to extend the operation of central tax administration to local level is being blocked by local government's political interests. They are afraid of loosing their tax base and revenue if central administration takes over the functions.

35. The APEH reorganized its organizational structure along functional lines in 1992. Since then the administration have been operating in a two-tier organization with a headquarters in Budapest and with four capital and 19 county directorates. The office has decentralized all taxation functions to county level. In modernization of organizational structure the separated large taxpayers approach has emerged. Since 1996 the largest companies have been treated by a new office.

36. In the second half of the 90's the integration of tax and customs administration was on the political agenda. No merger but certain cooperation was established between the two institutions. In 1999 in two steps, the administration of social security contribution became responsibility of the central tax office.

37. Recently the strategy of APEH concentrates on the followings:

- to meet the central governments requirements
- to serve taxpayers
- to develop internal organization
- to provide attractive job

38. In the last years the central tax administration in Hungary has face two challenges. One is the developments in information technology the other is joining the European Union. Moreover, one of the priorities of a new policy is reduce cost and size of tax administration. The idea of regional reorganization on the agenda, but this is a question of the near future.

4. Publications in the field

Books (book chapters):

New Trends in Public Administration and Public Law, ed., co-eds. Hugo Van Hassel and György Jenei, *EGPA Yearbook*, Annual Conference, Budapest, 1966

Public Finance in Transition Countries, eds. G. Wright and J. Nemeč, Chapter 4. Principles of Taxation, *NISPAcee*, Bratislava, 1997

Közösségi pénzügyek: elmélet és gyakorlat a közép-európai átmenetben. 4. Fejezet: Adózási elvek, Bp. AULA Kiadó, 2000

Local and Regional Tax Administration in Transition Countries, ed., *Local Government Public Service Reform Initiative*, *Open Society Institute*, Bp., 2000

Articles:

A szemléletváltozás szükségessége a közszolgáltatásban, *Társadalom és Gazdaság*, BKE Aula Kiadó, Bp., 1994/5

Improving efficiency and performance or how these can be interpreted in a post-communist country. The case of the Hungarian Tax Administration, *Society and Economy*, BUES, AULA Publishing House, Bp., 1996/2

Tax Policy and Tax administration in International Comparison, *Society and Economy*, BUES, AULA Publishing House, Bp., 1998/2

Helyi kormányzati fejlesztések finanszírozása – nemzetközi áttekintés, *Magyar Közigazgatás*, 2001. július, LI. Évfolyam 7. szám

Research reports:

The Effectiveness of Tax Administration, co-authors: H. van Hassel, F. Sabbe, *Katholieke Universiteit Leuven*, Belgium, 1995

A hatékonyság és a teljesítmény javítása, avagy hogyan értelmezhető ez egy poszt-szocialista országban. A magyar adóigazgatás példája. In: *Hatékonyság és közszolgáltatás I., Kutatási beszámolók 5.*, 63-85. o. Közszolgálati Tanulmányi Központ, BKE, Bp. 1996

Az új közszolgálati menedzsment és az adóigazgatás. In: *Paradigmaváltás a közszektorban, Kutatási beszámolók 14.*, 150-174. o. Közszolgálati Tanulmányi Központ, BKE, Bp. 1998

Conference papers:

Comparing tax systems in Central-Eastern Europe, *EGPA Conference*, Bad Tatzmansdorf, Austria, 1994

Tax Administration in Hungary, *EGPA Conference*, Rotterdam, the Netherlands, 1995

Tax Policy and Administration, an International Comparison, *Budapest-Oxford Conference*, Budapest, 1997

Tax Administration at Intermediate Level in Hungary, *EGPA Conference*, Paris, France, 1998

Tax Administration in Local Government in Hungary, *EGPA Conference*, Athens, Greece, 1999

