

Tax and the Taxpayer Who Ya Gonna Call

The focus of this material and talk is voluntary reporting.

The crux of imposing taxes, where the rubber meets the road, is the actual collection of the tax once it is imposed. “Voluntary” reporting is one method of tax collection.

Voluntary reporting is not a regular feature in Tribal tax codes. Tribal taxes will eventually, likely, perhaps, transition to something quite comprehensive and complex, and voluntary reporting can be used by tribal tax administrators for effective and productive tax administration.

Please note, the word “voluntary” is a misnomer. Here the word “voluntary” means self-initiated.

Useful to revisit “What is tax administration”

Tax administration is the management of the day to day processes for registering taxpayers, reporting information, paying taxes, educating taxpayers, auditing, addressing noncompliance, enforcement, and appeals. Tax administration processing involves handling of money, sometimes vast amounts of money.

Even though voluntary reporting relies on and won’t work without the voluntary compliance of taxpayers, tax administrators are key to making the voluntary reporting system *effective* and *productive* by the planning and tactics tax administrators develop and use.

In this context:

- Effective means that the cost to maintain the system is low compared to the amount of money submitted by taxpayers.
- Productive means the tax generates the revenue expected or desired, in other words it is worth the effort.

Pro Tip:

Accounting principles, segregation of duties, and internal controls should be considered at each step of tax administration. Tax administration functions should dovetail with budgeting, with the work of the tribal CFO, and with the legal department.

There are two basic systems used to establish tax obligations:

(1) Voluntary reporting, which is information submitted by the taxpayer upon which the taxpayer bases its voluntary payments.

Note: the word voluntary is misleading and describes the process, and not the ultimate liabilities.

Taxes like business taxes, sales taxes, leasehold taxes, or income taxes fall into the “voluntary” bucket.

(2) Assessments, which is information developed by a tax administrator and sent to the taxpayer in a bill or invoice.

Real property taxes fall into the “assessment” bucket.

Each system has unique tax administration approaches. Your tax code will be designed depending on whether you have a voluntary system, an assessment system, or a little of both.

The premise of the “voluntary” reporting system is that taxpayers have a large role in the work flow of taxpayer *reporting* and *paying*.

In this context:

- Reporting means providing information to the tax administrator.
- Paying means self-assessing and/or remitting payments to the tax administrator.

Pro-tip

For Tribal tax administrators, the decision to use a voluntary system or an assessment system might depend on how many taxpayers and how much information the tribe has about activities or assets of the taxpayers. A tax administrator needs to make choices regarding how taxes will be collected, and these choices need to be made prior to the drafting of the tax ordinance. This is because a tax ordinance should contain sections detailing the duties of the taxpayer and the authority of the tax administrator.

Goal of Tax Administration – Revenue Collection

The goal of a tax is revenue collection, and the goal of tax administration program is to administer taxes so that the rate of compliance and the recovery of tax dollars are high, with low expenses. Expenses include litigation and challenges to your practices and policies. (Sometimes the goal of a tax is to impact taxpayer behavior – for instance cigarette taxes or carbon taxes. Generally, the goal of taxation is revenue collection.)

Test your tax system against these principles:

1. Filing is easy
2. Paying is convenient
3. Tax obligations are understandable
4. Systems are in place to detect and respond to noncompliance
5. Assistance is available

Pro Tip:

The government needs to be mindful of not setting tax rates so high that taxpayers decide to not pay and risk the consequences of noncompliance. A taxpayer’s cooperation requires a belief that the system is fair and requires a system in place that is simple and easy to use.

Fairness, simplicity, and accountability in combination create the backdrop for a tax system that will work. Voluntary reporting is also influenced by reasonable consequences (penalties, fines, interest, etc.) for non-compliance.

So, why are we talking about this?

Not all tax systems work the same way and understanding their differences will steer the processes to put in place.

Today many Tribal governments, perhaps the large majority, impose taxes. For the most part these taxes are collected by tribal businesses, such as food service in casinos, gift shops in resorts, convenience stores at fuel stops, moorage taxes at marinas, and so forth. In these examples the tribal government relies on the known entities that it licenses or creates to act as its tax collector.

As tribal taxes transition and more generally applicable taxes are put in place within the reservation boundaries and throughout Indian Country, tribes will turn to “voluntary reporting” as the tax collection method.

Pro Tip:

Voluntary reporting puts the burden on the taxpayer to know their obligations and report and pay taxes. Since taxpayers are responsible to know the law, Tribes should consider publication of their tax codes, both to increase compliance and for fairness.

Key to Voluntary Reporting - Taxpayer self identifies

There is a chicken and egg thing for voluntary reporting. Yes, the taxpayer does a ton of the work, and yes, the tax administrator must urge the taxpayer to comply with the law.

The million-dollar question is how will taxpayers know they are the taxpayer and understand their obligations to report and pay? For some taxes you will have nearly complete knowledge of who is in the taxpayer pool, such as persons harvesting under a tribal permit. In this situation you might provide tax information with the granting of the permit, and then follow up with persons who do not report. In other circumstances you will need additional information to identify the taxpayers and will rely on the taxpayer to identify themselves. The Tribe might decide to tax all the vendors delivering goods and services to its tenants on trust land. This could include janitors, landscapers, wholesalers, utilities, telecommunications, and accountants. Some Tribes require permits or licenses from all persons doing business on trust land for example. The list of permittees would be a natural source of information and a starting place for who you expect to register.

Nuts and Bolts – Threat of Detection and Escalation

Taxpayer behavior changes if the taxpayer believes that noncompliance will be discovered. Some tax administrators send questionnaires to addresses, with a requirement that the form be returned within a set time, with specific “fill in the box” regarding vendors, or sales, or business activities. For this approach a common technique is to send a follow up letter to locations that did not reply, with specific content about the increased threat of noncompliance and the financial risk of not complying. This escalation method has proven to increase registration and tax collection.

Another technique, which is used where a taxpayer has been uncooperative, is to allow the tax administrator to register the taxpayer, estimate taxes, and pursue collection based on those estimates. This type of authority would need to be included in your tax code. Some Tribes, such as the Navajo Nation, use this tool to increase compliance.

Pro Tip

The Tribal Tax Code should include authority to gather the necessary information and examine books and records as well as estimate taxes and send invoices.

Nuts and Bolts - Paper returns, smart forms, EFile

This process step is how periodic information is provided from the taxpayer to the tax administrator. Reporting is different from payment of the tax (although it can be simultaneous) because the actual financial information and money is typically handled separately from the data and information. Large organizations use electronic payments, automatic payments, pay pal, credit cards, etc. Most organizations continue to accept checks but some organizations no longer accept cash due to the risk associated with cash handling. This is also a segregation of duties issue and depends on internal controls.

What information is reported and in what format is an important decision. The development of the form is crucial because it has to capture the taxpayer identity and any information necessary for the tax administrator to analyze trends and calculate tax liability. This data is important for reconciliation of amounts owed, billings, and payments. It is used for desk reviews and selection of field audits, for collection, and targeted education.

Nuts and Bolts – Good Data

Having good data is a huge part of risk management and is how work gets prioritized. Taxpayers are the source of much of the data and a tax administrator must balance a perfect world of maximum data with the burden on taxpayers of reporting. A lot of thought needs to go into what a taxpayer needs to report on a routine basis. Because the tax will be a source of reliable income for the Tribe it will be important to do revenue estimating. This raw data and any trends can be integrated into the tribal budgeting system.

Nuts and Bolts - Decision Making for Electronic Systems

Whether to use an electronic filing system (e-file) is an IT decision, a work flow decision, and depends on the scale of the Tribal tax program. According to studies on electronic filing, significant savings are realized only if the electronic process is used by nearly all taxpayers. The reason for this is that when it is not mandatory and not the exclusive system the tax administrator will still be processing paper forms. This will require a document management system, and keying in of information. Tax administrators who do not require electronic filing might segment their population and require it of large taxpayers, or might have other means of converting the information to data or tracking the records, such as optical character reading (OCR) or will use bar codes to help sort and inventory reports.

Nuts and Bolts - Account Review

In addition to the programmed features (software applications) in the tax administration computer to flag underpayments and no payments (known as out-of-balance accounts,) it is important to

have a practice in place for account review. Again, the scale and scope of account review depends on the size of your organization, the sophistication of your processes, and the number of taxpayers. If you have a taxpayer base of 300 tenants, you can develop a simple desk method and an excel spreadsheet to review all filings and payments. If you have thousands of taxpayers you likely will have a computerized method where errors and glaring holes are flagged and reports are automatically generated.

Nuts and Bolts - Audits

The point is to have a method to ascertain whether taxpayers are reporting correctly and a plan on what to do with what you learn. There are basically two types of audit, the desk audit and the field audit. Desk audits take place at the tax organization and use the data that has been reported as well as any additional information the tax administrator may request of the taxpayer. Field audits are more involved and are at the taxpayer's location(s). Field audits look at books and records and analyze business processes. Field audits are very time consuming and expensive. Generally, most taxpayers are not subjected to field audits.

An audit is both an enforcement tool (deterrence and detection) and an education tool. At the conclusion of an audit (either desk or field) the taxpayer will be billed for underpaid tax, will receive a credit or refund, or will be at status quo. Reporting instructions might be provided that highlight areas of concern. Since audits are expensive in terms of staff and time, a tax administrator will want to develop audit selection criteria. Some random audits are usually done and then data is used to select specific taxpayers or industries.

Pro Tip

Create a system that can run reports and compare points in time so that you can address issues as they arise. In a way, a field audit tests your entire system and is a way to evaluate whether your outreach and education has had its intended effect.

Nuts and Bolts - Education - to address gaps learned from reporting

Education will help taxpayers and their advisors understand their obligations and rights (taxpayers cannot comply if they do not understand the tax laws and procedures). Written material should be clear and direct. The risk of not complying should be shared with the taxpayer. Education happens during all tax processes and the tax administrator's interaction with taxpayers needs to be purposeful and aimed at gaining on-going compliance. Specific upfront education about the tax, whether an existing tax or a new tax, should be carefully designed.

Pro Tip:

Education increases the rate of voluntary compliance, which saves the Tribe money.