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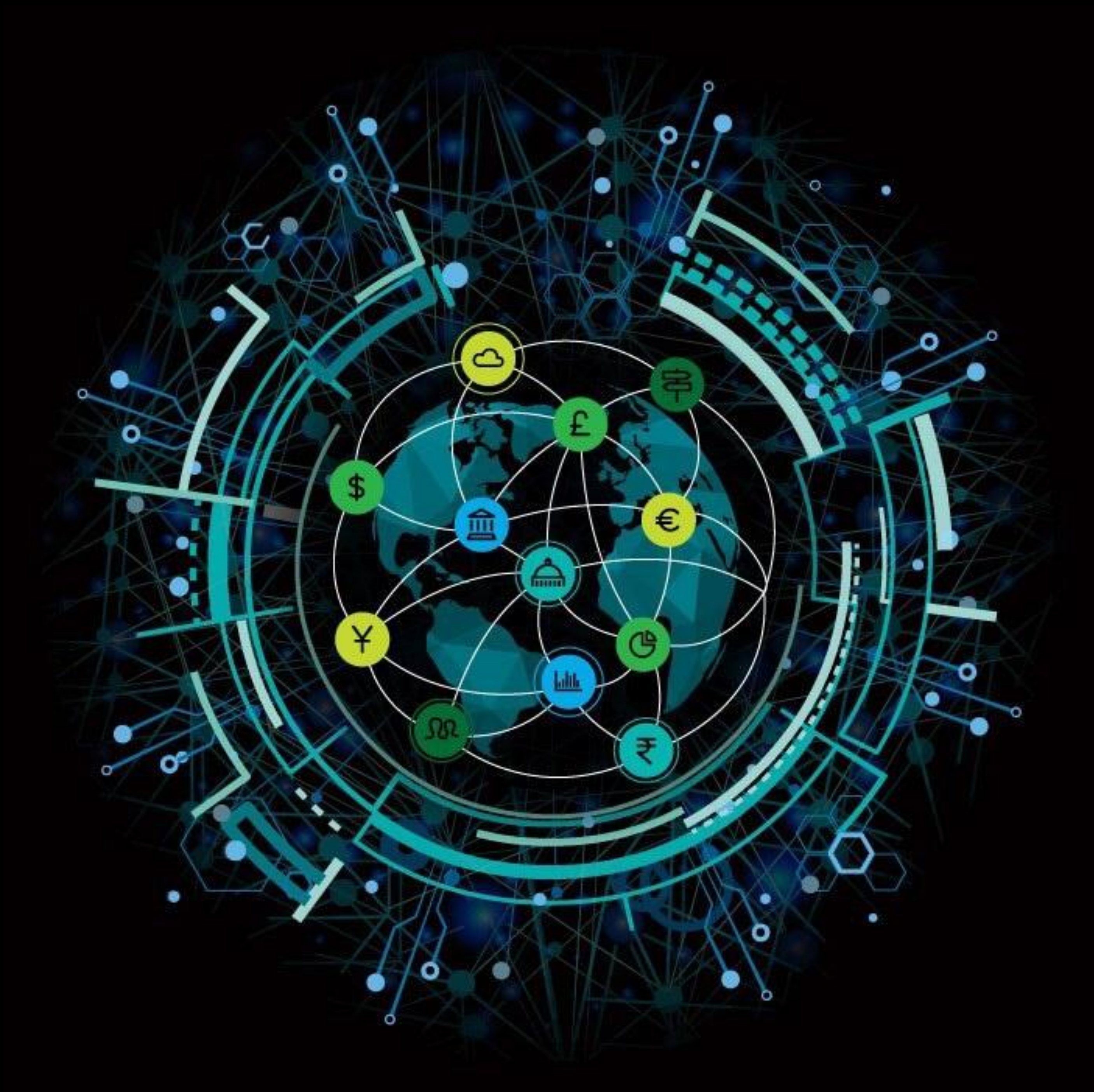

The modern, integrated revenue authority

Lessons from tax and customs integration

Deloitte Center for Fiscal Systems
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Executive summary

Tax authorities have a long history of taking on responsibility for tasks outside the core mission scope of facilitating and enforcing compliance with tax obligations.

One notable expression has been mergers of tax and customs authorities to create unified and sometimes semi-autonomous revenue authorities in more than 75 countries and jurisdictions.

The case for integration rests on significant overlaps, dependencies and potential synergies. The trend has been driven by the near-universal adoption of VAT/GST, the liberalization of trade, and the need to streamline the administration of direct and indirect taxes.

The experience is mixed with some well-prepared and executed mergers alongside many examples of skin-deep integration with considerable friction between tax and customs functions.

This calls for increased attention to drivers and intended benefits, implications across all layers of the operating model, and stewardship (including change management and benefits tracking) beyond the merger itself.

It is also important to weigh up the case for integration against alternative ways of tackling the same issues and achieving the same benefits.

These lessons are relevant to broader integration and transformation efforts, which are only likely to accelerate, as the response to the pandemic has again demonstrated the power of the tax system as a vehicle for policy implementation.

This paper shares key findings from Deloitte Center for Fiscal Systems research and offers advice for revenue authorities embarking on an integration or transformation journey.

The trend towards policy-driven transformation

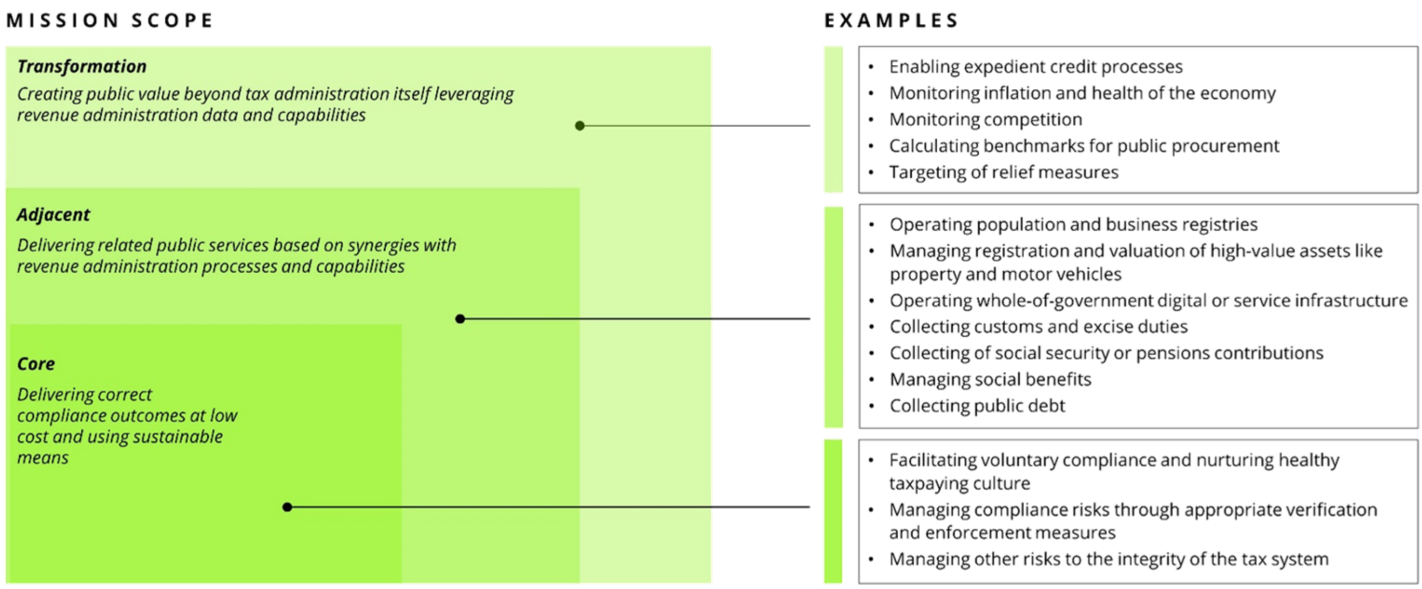
Collaboration across government is critical to tackling complex policy issues and delivering high-quality public services. The past two and a half years have shown the value of effective whole-of-government collaboration in response to the pandemic, which has seen many examples of crisis relief implemented through the tax system and at great pace.

Tax authorities have a long history of taking responsibility for tasks outside the core mission scope of managing tax compliance. It is for instance common to manage population and business registers, collect social security contributions, administer social benefits, collect public debt or operate whole-of-government digital infrastructure.

This trend is explained by synergies with tax administration data and processes, which can underpin effective administration, a seamless service experience and the creation of new forms of public value.

One notable expression of this trend has been mergers of tax and customs authorities to create unified and sometimes semi-autonomous revenue authorities in more than 75 countries and jurisdictions.

The lessons from tax and customs integration are relevant to broader integration and transformation efforts, which are only likely to accelerate, as the response to the pandemic has demonstrated the power of the tax system as a vehicle for policy implementation.



Our research on tax and customs integration

The Deloitte Center for Fiscal Systems has undertaken comprehensive research on the integration of tax and customs in order to better understand drivers and experience, offer advice for successful integration and extract lessons of broader relevance.

Our research looks for the first time at more than 200 countries and jurisdictions to capture the full extent of tax and customs integration globally and correlate with other insights and data points, including characteristics of the tax system and its administration; administrative tradition and reform history; and geography, economy and trade.

More than 75 countries and jurisdictions have merged tax and customs, but a closer look reveals that the experience has been mixed and that actual integration is often only skin-deep.

This has important implications for both those countries and jurisdictions that have pursued mergers and those that have kept tax and customs separate.

Unified tax and customs authorities can often benefit from revisiting the original value proposition to make sure that intended benefits are harvested and assumptions hold true.

Separate tax and customs authorities on the other hand are well advised to consider what can be done to manage the issues and harvest the benefits that have given rise to integration elsewhere, as different institutional arrangements will not eliminate the need for collaboration.

Our research also underscores how integration is not about the simple execution of a merger to arrive at a new organizational diagram or make systems speak to each other. It requires a fundamental look at how people, processes and technology interact for optimal outcomes. This will necessarily be a prolonged effort with significant reengineering and change management involved.

Our research builds on **three main sources** of information:

- Deloitte's global expertise and experience combined with interviews with external experts, including present and former senior tax and customs officials.
- Publicly available material from the OECD, IMF, WCO, WTO, EU, donors, academia and governments reflecting trends, experience and institutional advice.
- Data drawn from various sources to build the most comprehensive, accurate and up-to-date dataset available on tax and customs integration.

The case for tax and customs integration

Tax authorities have historically tended to be responsible for income taxes and domestic indirect taxes –hence the oft-used term "inland revenue"– while customs authorities have been responsible for tariffs, excise duties and consumption taxes with international features.

The case for integration rests on significant overlaps, dependencies and potential synergies in revenue collection and the management of fiscal risks across all these taxes. This in turn has a bearing on administrative burdens and the taxpaying experience.

The latter argument was brought out very clearly in Gordon Brown's foreword to the 2004 O'Donnell Review preceding the 2005 tax and customs merger in the United Kingdom: "At present, the UK effectively has two separate business tax systems. I am convinced that by removing departmental barriers and focusing on the customer, the departments can make a step change in performance and efficiency."

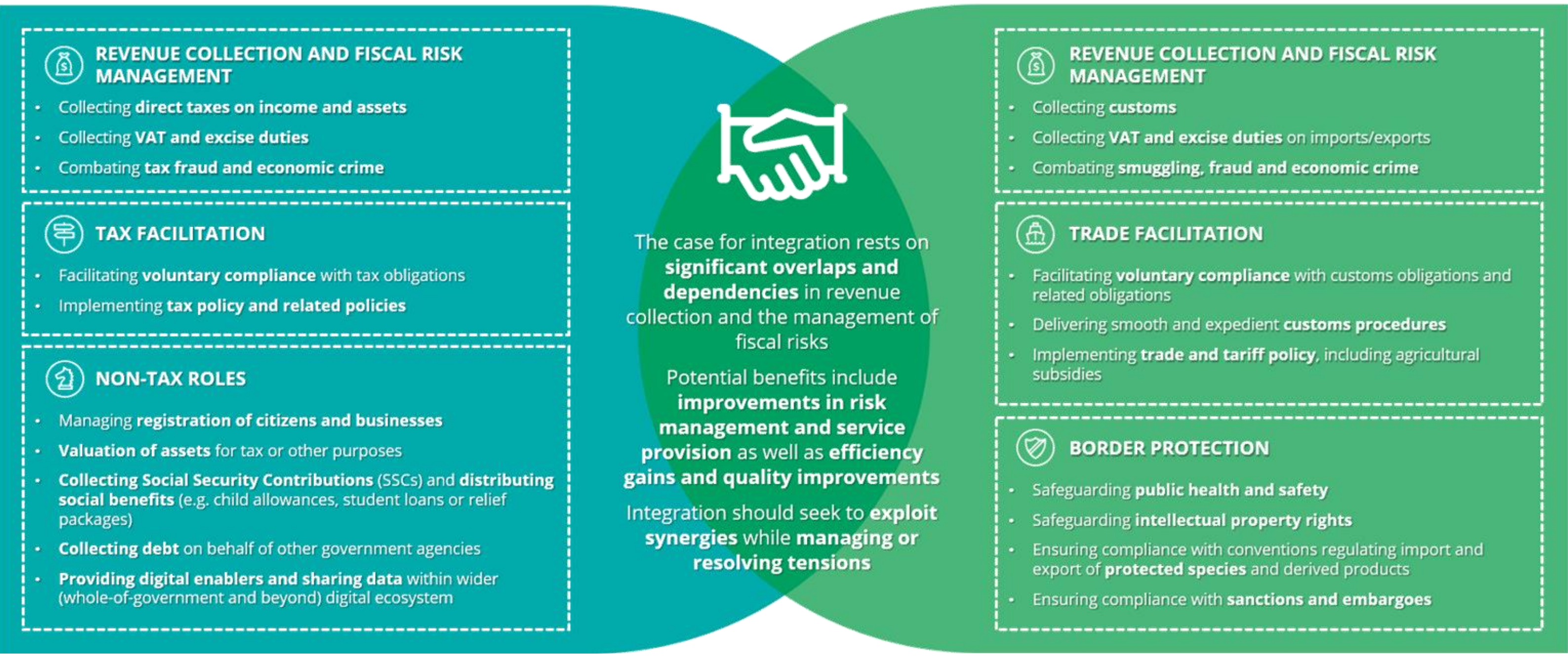
This still vibrant quote serves to illustrate how the integration of tax and customs is frequently seen as a lever for wider reform aspirations.

The cases put forward for tax and customs integration typically include better use of data; improvements in risk management; more streamlined management of direct and indirect taxes; reduced administrative burdens and better service provision; and efficiency gains resulting from synergies and economies of scale.

There are also limits to integration, as customs authorities have significant non-revenue collection tasks (including trade facilitation and border protection) that are not an easy fit with a tax administration operating model.

The case for tax and customs integration thus rests on exploiting synergies while managing or resolving the tensions arising from these non-revenue tasks. This has in some cases been achieved by carving out border protection responsibilities and assigning these to a different agency.

There is no perfect solution, as what is appropriate and feasible will differ from one context to another. What is critical, however, is that any institutional reform is based on proper preparation starting with clarity of purpose and deep expertise in affected domains.



The trend towards integration

Tax and customs integration picked up in the late 1980s and has steadily continued ever since with only a small number of mergers failing or being rolled back. The first wave of mergers can be attributed to a period of intense public sector reform in many Western countries.

The tragic events of 11 September 2001 put renewed emphasis on border security, which slowed the pace of integration and even led to reversals or the creation of specialized border protection agencies in some cases.

The trend towards integration has nevertheless continued with more than 40 mergers over the past two decades and at least another three countries preparing or considering mergers as of late 2022.

The rise in integration can be attributed in large part to three interconnected drivers: most countries and jurisdictions developing broadly aligned VAT/GST systems, the liberalization and growth of international trade, and new compliance risks arising from the management of cross-border aspects of VAT/GST.

These factors have combined to call for intensified collaboration and strengthen the case for integration.

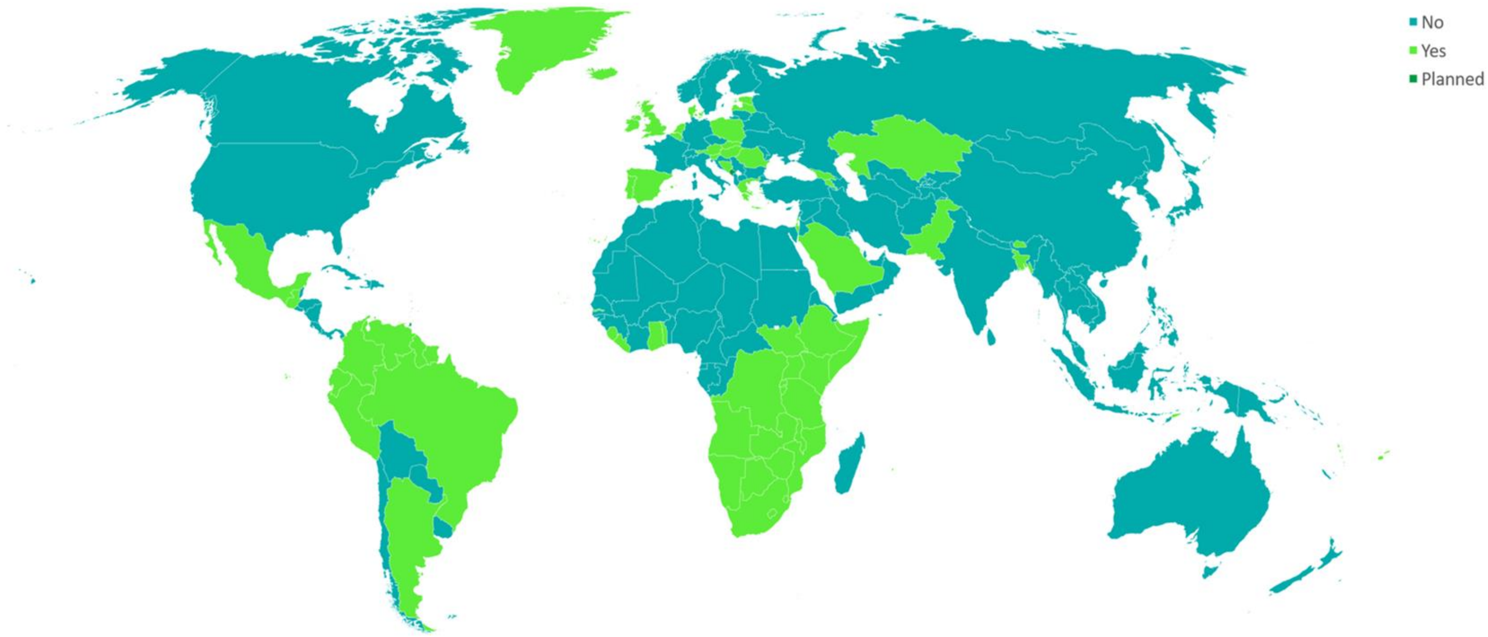
The adoption of a VAT/GST is a strong predictor of tax and customs integration: 39% of jurisdictions with VAT/GST have opted for integration while 93% of jurisdictions with unified tax and customs authorities also have a VAT/GST.

A closer analysis reveals some interesting geographic variation. Tax and customs integration is for instance particularly prevalent in Latin America, the southern cone of Africa and the European Union – all of which are major free trade areas heavily influenced by Western reform traditions.

The trend is notably less pronounced in Francophone North-West Africa, Asia and North America.

There is a strong correlation between tax and customs integration and wider reform trends and initiatives, including good governance, territorial governance, institutional reform, administrative reform, and pro-growth policies.

These findings underscore the importance of tracking changes in the environment and approaching integration as an integral part of wider reform efforts.



Four different institutional models

Tax and customs authorities have traditionally been run as separate departments within their responsible ministry, which will normally be the ministry of finance.

These departments are typically responsible for direct and indirect taxes respectively, although with some variation in how the responsibility for VAT/GST is distributed.

Integration of tax and customs is in many cases accompanied by greater autonomy, which has led to a more diverse landscape with more semi-autonomous and/or integrated revenue agencies.

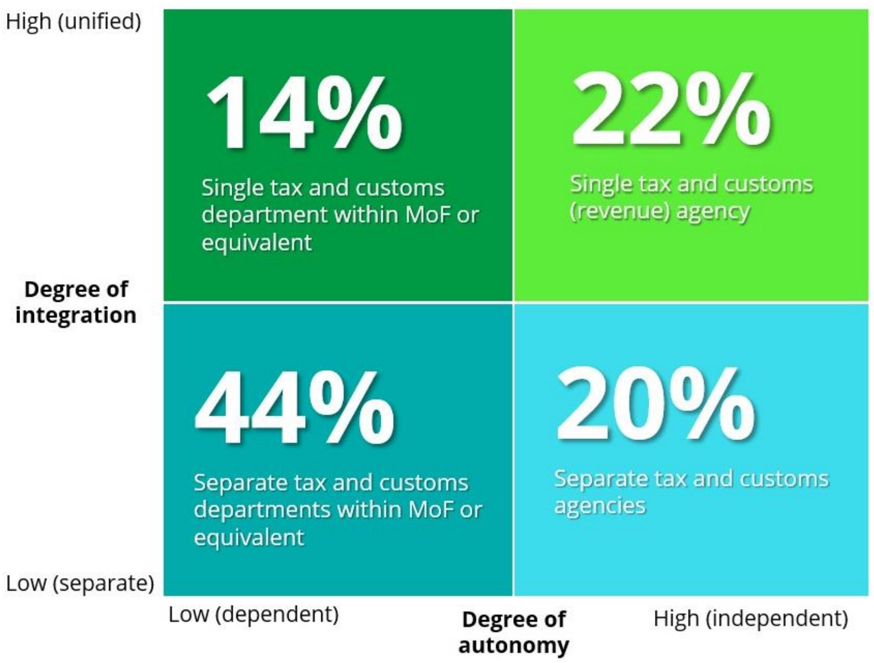
Our research has identified four different institutional models with the degree of integration and autonomy as the differentiating factors.

The model of separate departments within a ministry of finance remains the dominant one: 44% of the 216 countries and jurisdictions covered by our dataset are still organized in this way while 36% have opted for integration, 42% for autonomy, and 22% for both.

The actual degree of integration differs across cases with many examples of integration being only skin-deep.

This may in part be the result of the inherent difficulties of tax and customs integration –which one WCO report has memorably described as “mating a terrier with a retriever”– and a superficial commitment to integration beyond meeting the expectations of political stakeholders for an organizational merger to be carried out.

There are also different degrees of autonomy. Revenue authorities are (for reasons explored below) at most granted semi-autonomous status with the actual degree of autonomy varying with administrative traditions and governance arrangements.



Combining integration with autonomy

Tax and customs integration is often accompanied by governance reforms granting greater autonomy to the newly created revenue authority, which may for instance be insulated from undue interference and equipped with powers to determine its own people policies, organization, strategies and priorities.

The benefits expected from autonomy include greater professionalization and innovation, as management in the new revenue authority is empowered to pursue improvement options and accountable for results, which may be measured in reduced costs and improved outcomes.

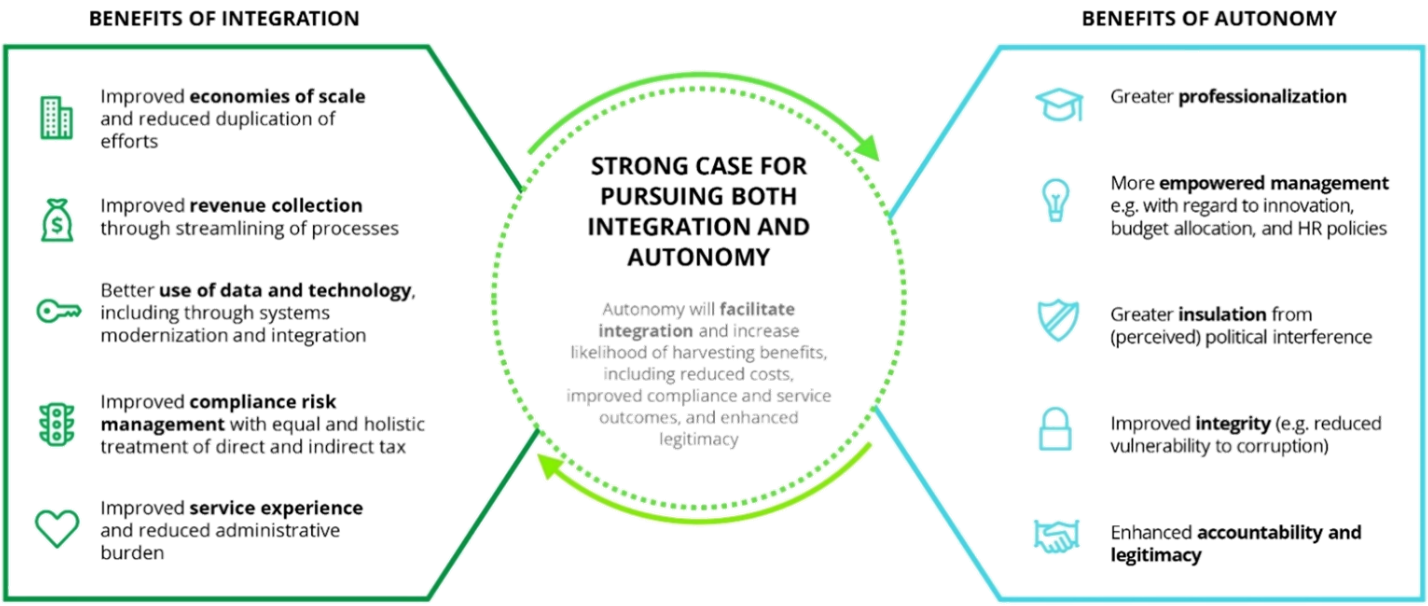
This makes autonomy a good fit with integration, as greater autonomy will imply greater freedom and (with the right governance arrangements) stronger incentives to pursue the benefits of integration.

A further argument in favor of autonomy is enhanced legitimacy, as autonomy is seen to reduce integrity risks and provide insulation from outside interference, which can be a critical concern in countries with weak governance traditions or a high incidence of corruption.

Autonomy is never absolute. Revenue authorities are not only critical for public finances, but also vested with some of the most intrusive powers of the state. This imposes limits to how much autonomy is feasible and desirable. Thus, revenue authorities are normally at most granted semi-autonomous status subject to appropriate steering and oversight mechanisms.

The degree of autonomy varies across regions. Autonomy is for instance an exception in South-East Asia and Francophone North-West Africa while some degree of autonomy is widespread in the Americas, the Southern cone of Africa, and Europe.

Revenue authorities contemplating integration or other major reforms should consider if there is a case to be made for greater autonomy as a lever to enhance the chances of success.



Implications for revenue authority operating models

Our review of international experience suggests that integration often is only skin deep. This is because integration is frequently seen as a project to simply bring functions together in the same organization.

The approach adopted often involves the customs authority being bolted on to the tax authority as another vertical without meaningful integration beyond the elimination of duplicate functions (e.g. human capital, finance and IT) and possibly some data-sharing arrangements and limited operational coordination.

It is not uncommon for this to result in a situation where the typically smaller customs authority feels swallowed up by the larger tax authority, which can lead to resistance and resentment – particularly if customs officials feel starved of resources or left with a diminished role.

But integration –whether of customs or other responsibilities– should not stop at simply carving out space for one organization inside the other or harvesting the most low-hanging fruits.

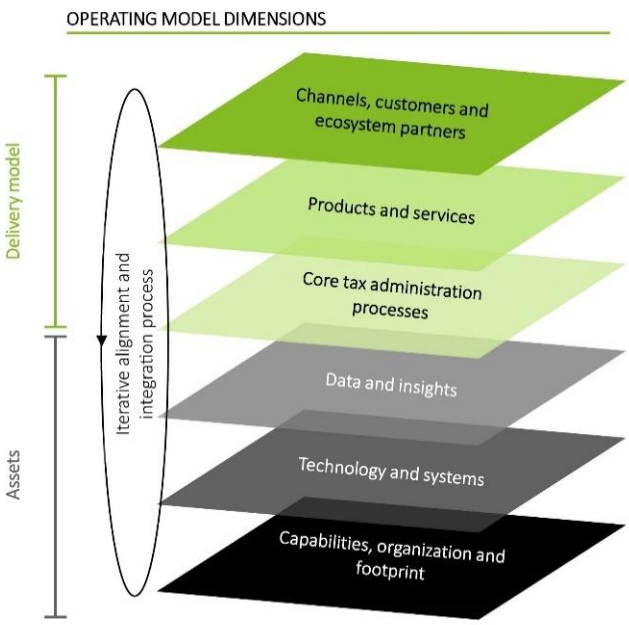
The most successful integrations have started with an understanding that tax and customs integration will have to affect all layers in the operating model to arrive at something greater than the sum of the parts.

This transformation cannot be understood or undertaken separately from wider reform trends and initiatives, including efforts to implement modern tax administration thinking based on principles like taxpayer centricity, lean and digital.

A good starting point can be identifying the current state (as is) and desired future state (to be) across the different layers of the operating model to determine what should be different.

This may include a more streamlined service experience with equal treatment of direct and indirect tax aspects of international trade; reengineered processes leveraging tax and customs data; consolidation of office structure to arrive at greater economies of scale and more viable professional environments; and modernization of core systems to address technical debt and enhance flexibility.

These key shifts will in turn inform a detailed blueprint for the future state operating model and a roadmap for implementation.



INITIAL STATE (AS IS)	FUTURE STATE (TO BE)
Fragmented channels, limited understanding of customer needs, and failure to leverage ecosystem partners	Seamless and carefully orchestrated service experience delivered across channels and in concert with trusted ecosystem partners
Inadequate service offering, inconsistent experience across tax types, and failure to integrate with broader ecosystem	Contemporary and carefully orchestrated service offering integrated with natural processes in broader ecosystem
Poorly documented processes with many manual steps and significant variation across tax types	Standardized and streamlined processes with greater degree of uniformity and consistency across tax types
Siloed and ad hoc use of data with limited ability to bring data together in whole of customer view	Insights-driven organization systematically leveraging data to fuel processes and target areas of costs, risks and customer pains
High incidence of legacy systems resulting in significant duplication of functionality, inflexibility and rising maintenance costs	Loosely coupled architecture with greater reliance on standard components and technologies across systems domains
Immature and fragmented capabilities, significant duplication of e.g. support functions, and large footprint	Integrated organization with reformed capabilities, economies of scale in key areas, and reduced footprint

Lessons and advice for successful integration

The integration of critical government functions like tax and customs is a big mouthful for any organization. Like any major reform, it requires the ability to articulate a compelling vision, translate this into a future state blueprint and roadmap, and effectively implement this while managing the many moving parts.

Integration is often preceded by a long ramp-up with the pros and cons being debated for years. Nevertheless, it is not always clear that there has been consensus on the drivers for change and the intended outcomes beyond the first phase of merging the two organizations and harvesting immediate benefits.

There have also been surprisingly few attempts (whether by national audit bodies, donors or academia) at evaluating integration efforts.

Anecdotal experience suggests that integration projects can quickly become political in nature with a strong focus on policy intents (e.g. burden reduction) and legal aspects, including the drafting of enabling legislation.

One particularly contentious issue relates to disparities in employment conditions, career structures and pay scale. This should be resolved at an early stage, as it is otherwise likely to haunt the implementation.

It is important not to underestimate the change management component of integration, which will affect staff, stakeholders and taxpayers in different ways. There are also significant cultural differences between tax and customs functions. This calls for strong stewardship and extensive involvement throughout the integration process, but perhaps especially at the early stage when the future state blueprint is shaped.

Tax and customs integration does not take place in a vacuum. It needs to be treated within a broader modernization and reform narrative to help staff, customers and stakeholders make sense of changes. The timing should also take account of other major reform initiatives to explore momentum while avoiding fatigue or distractions.

Taking account of these lessons and insights from other major reform projects, the Deloitte Center for Fiscal Systems has set out a “cookbook for successful integration” with eight steps to help revenue authorities get a good start on their integration and transformation journeys.

COOKBOOK FOR SUCCESSFUL INTEGRATION

- Establish clarity on **platform for change**, including drivers, desired outcomes and evaluation criteria
- Establish and critically review **alternative options** for achieving desired outcomes
- **Involve staff, stakeholders and taxpayers** from the outset to leverage their insights and perspectives
- Develop **future state blueprint and roadmap** aligned with wider modernization efforts
- Develop compelling **change narrative** and test resonance with staff, customers and stakeholders
- Identify and dismantle **barriers to integration** (e.g. need to enact enabling legislation or resolve disparities in pay scales) up front
- Build adequately staffed and resourced **organization to deliver change** and provide stewardship
- Apply **phased approach** with clear milestones and objectives, leverage agile methodology and adapt as needed

Get in touch

About the Deloitte Center for Fiscal Systems

The Deloitte Center for Fiscal Systems brings together Deloitte's global revenue administration expertise and experience.

The center is dedicated to assisting revenue authorities working hard to deliver on core mission objectives while reimagining the way they operate within complex and constantly evolving fiscal systems.

About the lead author

Ronnie Nielsen is a Revenue Administration Specialist and Thought Leader helping revenue authorities tackle known challenges and explore new opportunities. He has visited or worked with revenue authorities in 30+ countries and contributed to more than a dozen publications on revenue administration reform themes, including behavioral insights, compliance risk management and technology-enabled business transformation.

Ronnie regularly posts on LinkedIn on revenue administration topics. Connect with him at www.linkedin.com/in/ronnieidnielsen

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Contacts

Ben Powell

Partner (United Kingdom)

Deloitte Center for Fiscal Systems and Revenue Administration Community Co-lead

bpowell@deloitte.co.uk

+44 118 322 2815

Atresha Whitmore

Principal (United States)

Deloitte Center for Fiscal Systems and Revenue Administration Community Co-lead

awhitmore@deloitte.com

+1 571 302 6141

Ronnie Nielsen

Senior Manager (Denmark)

Revenue Administration Specialist and Thought Leader

rnielsen@deloitte.dk

+45 2724 2009

Deloitte.