



DETECTION OF TAX FRAUD BY INDIVIDUALS

Methods undoubtedly modernised, but results still
inadequate

Public thematic report
Executive Summary

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The topic of detecting tax fraud by individuals was selected as part of the citizen consultation launched by the Court of Accounts in 2022 to contribute to the work programme of the financial jurisdictions.

Meanwhile, in June 2023, the government published a national plan to combat tax fraud, structured around 35 measures. Apart from the fact that these measures are aimed more at businesses than individuals, the plan does not specifically refer to the detection of fraud, although the four measures designed to equip the tax authorities for the digital world are partly covered.

However, detecting tax anomalies and irregularities is the first link in the overall policy to combat fraud. It precedes - and determines the effectiveness of - the audit phase, at the end of which taxpayers who are found to have committed fraud will have to pay tax arrears and penalties.

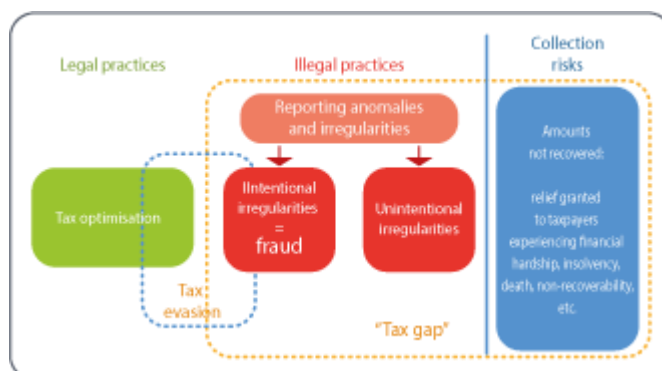
In accordance with the request made to the Court, this report deals only with taxes paid directly by individuals. These taxes accounted for more than €160 billion in 2022, or 30 % of net tax revenues collected on behalf of all public administrations (the State, local and regional authorities and other public bodies). These include income tax (€88.9 billion collected from 18.5 million households), tax on income from transferable securities (€4.0 billion), property wealth tax (€2.4 billion) and inheritance and gift tax (€18.6 billion) in taxes paid to the State, as well as property taxes (€28.3 billion), council tax on second homes (€2.3 billion) and property transfer taxes ("notary fees", €16.1 billion) paid to local authorities.

Major taxes such as value added tax (VAT) or even the generalised social contribution (Contribution Sociale Généralisée, CSG) are legally payable by individuals, but in practice they are assessed and collected without their involvement (by businesses in the case of the former, by employers in the case of the latter), which explains why they have not been included in the scope studied here.

Tax fraud: a phenomenon that is not measured and is often confused with other methods of tax avoidance

The term 'tax fraud' is not always used rigorously, particularly when it is used generically to describe all actions that have the effect of reducing the amount of tax paid. As the diagram below illustrates, several phenomena (tax optimisation, unintentional irregularities, taxpayer insolvency, etc.) have the same result without, however, constituting irregular conduct.

Optimisation, evasion, fraud, unintentional irregularities: the phenomena that reduce tax yields



Source: Court of Accounts

Tax fraud: a phenomenon that has not been quantified and is often confused with other methods of tax avoidance

Tax fraud is defined by Article 1741 of the French General Tax Code (CGI) as a deliberate violation of tax regulations, which implies an intentional omission on the part of the taxpayer in their reporting obligations, a concealment of all or part of the sums subject to tax, the fraudulent organisation of their insolvency or any other act intended to hinder the recovery of tax.

Fraud is a criminal offence punishable by a fine of €500,000 and five years' imprisonment.

Tax fraud, combined with unintentional irregularities and sums claimed by the tax authorities but not recovered, corresponds to the "tax gap", which refers to the difference between the amounts actually collected and those that would result from strict application of tax regulations with no disruption.

A regrettable and persistent lack of estimates of tax evasion, with very broad and imprecise measurement

Unlike many countries, France has no rigorous assessment of tax fraud or even of the tax gap. The amount of each of these two phenomena, even when reduced to a rough approximation, is unknown. The only known amounts are those claimed by the tax authorities after an audit, i.e. a total of €14.61 billion in 2022, divided between €11.95 billion in evaded taxes and €2.66 billion in penalties, around 1/5th of these sums being paid by individuals and 4/5ths by businesses and professionals.

A method as rudimentary as extrapolating to the French situation the tax gap observed abroad (4.5 % in Estonia for the lowest, 16.6 % in the United States for the highest) would only result in an extremely wide range, between €30 and €100 billion for all taxes combined, or between €7 and €27 billion for personal income tax alone, without it being possible to distinguish fraud from involuntary irregularities and unrecovered sums.

This situation makes it impossible to relate the amounts detected or actually claimed to the estimated amounts of fraud or of the tax gap in order to assess the effectiveness of the tools used. The sums claimed as a result of tax audits can be traced and their evolution over

time measured, but it is impossible to state with any certainty the proportion of actual fraud that they help to counter.

Detecting tax anomalies and irregularities, prior to tax audits

The detection of tax anomalies and irregularities refers to all the operations that make it possible to detect them, whether they are the result of first-level checks carried out by tax officials or, as is now mostly the case, automatic controls based on the mass processing of tax data. In addition, there are the various methods of collecting and processing information received by the tax authorities (through whistleblowing, investigations, information provided by other French or foreign authorities, etc.).

This detection phase is likely to lead to a first level of exchanges between taxpayers and the tax authorities and to the correction by the former of their initial declarations. Since the end of the 2010s, it has also been used as the basis for scheduling the formal documentary and on-site audits to be carried out by the specialist services.

Focusing on detection, this report deals only incidentally with the phases of audit and recovery of evaded duties and taxes, which take place after the phase of detection of presumed irregularities.

Marked improvement in detection tools during the 2010s

During the 2010s, new impetus was given to the fight against tax fraud, with the aim of systematically detecting reporting anomalies and irregularities through the use of new technologies.

In this respect, the Directorate General of Public Finances (DGFIP) has developed tools to make massive use of the data held by it or provided by other administrations to identify inconsistencies with the returns filed by individuals. In 2022, this mass cross-referencing of data resulted in 155,000 proposals for audits of individuals, three times more than in 2018.

More generally, the scheduling of tax audits, which was historically based on the highest-value cases - i.e. those involving the largest taxpayers - has changed radically. It is now largely based on risk analyses fed by mass data processing.

In addition to this “technological strategy”, the tax authorities have endeavoured to step up the collection of information that will enable them to identify both sophisticated cases of fraud, for which no declaration appears to be inconsistent in itself, and new cases of fraud that have not yet been the subject of a significant risk.

This dual approach has been made possible by the acceleration of international cooperation, by the continuous increase in the data available to the tax authorities (DGFIP) and by the improvement in the processing capacity of the latter.

A consequence of the expansion and automation of detection techniques: a system that better protects individual rights and freedoms

The technologies used to detect tax irregularities in individuals are potentially intrusive. As a result, new provisions have been introduced by the legislature and the courts to protect taxpayers' rights.

The Constitutional Council has long recognised that the fight against tax fraud is an objective of constitutional value, in respect of which the legislature is free to make adjustments to individual rights and freedoms. However, in view of the challenges posed by technological

developments, it has been necessary to tighten the framework for the powers of the tax authorities from the outset of the audit phase.

Today, the resources deployed by the tax authorities must comply with the principle of proportionality, which ensures that the infringement of citizens' rights and freedoms is not disproportionate to the aims pursued, and with the personal data protection regime.

For example, mass data cross-referencing methods may only be used as tools to assist with audits and may under no circumstances lead to the automatic identification of fraud. The exercise of the right of communication for general detection purposes (for example through the use of detailed records of calls made by private individuals, known colloquially as "fadettes") has been restricted. Finally, the automatic extraction and processing of the content of certain social networks has been limited to pages made public by Internet users in order to respect the right to privacy and freedom of communication.

Fraud detection methods whose effectiveness is difficult to assess due to lack of quantification

In the absence of statistical estimates of tax fraud, it is impossible to establish what proportion of it is detected, and whether this proportion has increased in recent years with the implementation of more powerful tools. This is a major shortcoming that must be remedied: it is the first of the priorities proposed by the Court below.

It is also difficult to assess the impact of the new detection tools on the effectiveness of tax audits, and in particular on the relevance of the scheduling of audits.

The DGFIP's activity indicators and benchmarks relate to the audits carried out and do not establish a link between the reasons for scheduling these audits and their results. The main IT systems used by the DGFIP (ALPAGE and ILIAD), which ensure the traceability of control actions, were designed with a priority focus on monitoring the amounts to be adjusted following audits, rather than monitoring their relevance. The reasons for audits are not sufficiently detailed and are not linked to the breaches detected, hindering a rigorous assessment of the effectiveness of the entire process (detection, audit, adjustment, recovery) related to tax evasion. However, this gap is now being filled by the development of new IT systems that should enable this link to be made.

Tax audit data show that the proportion of fraud cases or cases subject to reassessment within the total number of cases audited has remained at around 55 % since 2018, which prevents us from concluding that there has been a marked qualitative leap in the audit strategy.

With regard more specifically to the detection of tax irregularities in individuals through the cross-referencing of mass data, 27 % of the audits carried out will result from this in 2022. Carried out by a team of seven agents, the productivity gains associated with the cross-referencing of mass data are likely, although they cannot be quantified, due to the lack of precise data on the jobs allocated to detection over the period 2017-2021.

Finally, the increased use of "tax intelligence", which consists of using information communicated by third parties, is showing clear results. This is particularly true of tax informants, the term used to describe people who report potential fraud to the DGFIP in return for remuneration. They have made it possible to recover €110 million in four years since 2018, compared with the €1.8 million paid out to them in compensation.

A formalised and better-structured strategy for detecting tax irregularities among private individuals, to be implemented around six priority areas

Steps in risk management

The national anti-fraud plan presented by the French government in June 2023 is based on 35 operational measures covering a range of issues. However, this ambitious plan does not deal with the detection of tax irregularities as such. Nor does it clarify the principles and resources mobilised by the tax authorities, since it returns to the forefront a number of practices (targeting the largest taxpayers) or concerns (the number of tax audit staff) that the strategy of the 2010s had replaced with other, more relevant matters.

This plan, provided that it is further defined and extended, is nevertheless an opportunity to structure and formalise a genuine strategy for detecting tax irregularities, serving as the basis for and initial phase in the policy of combating tax fraud. This strategy must be comprehensive and structured, and must remedy the piecemeal progress and opportunities that have characterised recent years. It could be based on six priorities, which are reflected in the six recommendations made by the Court of Accounts.

Transparent presentation of tax audit choices and practices, ensuring equal treatment of taxpayers

There are several possible approaches to detecting tax irregularities. It may target major taxpayers, taking the view that they account for the majority of the budgetary implications, even if their numbers are small; this was the approach that prevailed in the past, with the systematic three-yearly audit of so-called “high or very high stakes” cases. Alternatively, it may be based on risk analysis to maximise the yield from tax audits; this is the approach that has prevailed with the mass cross-referencing of data since the middle of the 2010s. Lastly, the audit strategy may leave room for random selection, which would reflect a form of equal probability of being audited; this is not currently the case, as the tax authorities believe that such a rationale would mean devoting resources to files that are predominantly compliant, at the cost of reducing the audit yield.

Formalising a strategy for detecting tax irregularities would make it possible to clarify the place reserved for each of these approaches and to allocate the resources assigned to the audit according to transparent, clearly formulated and stated objectives. It would also be the vehicle through which the tax authorities would present the conditions for the deployment and use of their technological tools throughout the country, in particular by eliminating the exceptions that persist today (for example in Corsica and the overseas territories with regard to the detection of undeclared buildings using aerial views).

A need for statistical estimates of tax evasion

The tax authorities must catch up with many of their foreign counterparts by estimating the amount of tax evasion, or the tax gap, for each of the major taxes.

The DGFIP plans to complete such estimates by 2027, using rigorous modelling based on the VAT experiment that was successfully completed in 2021 and 2022. The complexity of personal taxation must not lead to delays in these estimates.

More cross-functional IT systems to improve data flow within the administration

The siloed design of the IT systems used by the tax authorities, specialised by tax or by function (management of returns, audit, collection, etc.), is a weakness that has been identified for several years. The tax administration is working hard to remedy this, with several projects to modernise or overhaul its major applications due to be completed in the short to medium term.

In this regard, the Court's recommendations focus on two aspects: ensuring the traceability of the administration's actions, from the receipt of taxpayers' returns (which is the responsibility of the tax management departments) to the tax audit and its follow-up, in order to monitor and evaluate the relevance and effectiveness of these actions on an ongoing basis; and introducing more cross-functionality into the applications to facilitate an overall understanding of the past and present situation of taxpayers, which is currently still broken down by tax or territory.

Expand the tax intelligence policy

Effective detection also requires better gathering and processing of tax intelligence (reports from judicial or police departments, whistleblowing, information from foreign administrations, etc.) to identify fraud schemes as early as possible. However, the involvement of these services and the procedures and tools for sharing intelligence within the tax authorities appear to be inadequate. The anti-fraud plan presented in 2023 makes general provision for increased use of tax intelligence, mainly from an international perspective, without specifying how this is to be achieved.

A more structured approach needs to be put in place to improve the sharing of tax intelligence, to ensure that it is followed up and to draw conclusions from it. One of the aims of this approach should be to develop cooperation between tax management departments and tax audit departments in order to monitor and exploit the mass of information at their disposal.

A proactive prevention approach aimed at taxpayers

The current fraud prevention approach is primarily aimed at businesses. It takes the form of information and support systems, based on a map of abusive practices and arrangements that is kept up to date and published on the impots.gouv.fr website.

The tax authorities have other opportunities to provide taxpayers, particularly private individuals, with information and prevention messages. As in most OECD countries, the tax authorities are taking advantage of the growing dematerialisation of their dealings with taxpayers, particularly when they file their tax returns online, to develop tools for raising awareness and analysing risks in real time, in the form of pop-up windows. These pop-up windows alert taxpayers to potential inconsistencies or breaches that could give rise to a subsequent audit. Strengthening this approach would increase the number of alerts issued to taxpayers acting in good faith, deter certain minor frauds (e.g. tax reductions and credits) and improve the quality of relations with the public.

Greater recognition of the specific skills and professions involved in combating fraud required in human resources management

The technological strategy deployed in the 2010s was not accompanied by a precise identification of the specific skills required to detect tax irregularities. There is a lack of data to assess training efforts in this area. In addition, the DGFIP's human resources management,

from recruitment to career management, consistently favours cross-functional skills, without clearly indicating the place given to specific skills related to the fight against fraud and, in particular, to detection, for which there is no recognised role within the tax administration.

Implementing a policy of attracting and retaining staff specialised in detecting tax fraud is therefore a major challenge if the strategy that the Court is calling for is to be formalised over the long term.

In the 2010s, the tax authorities took advantage of the possibilities offered by the dematerialisation of tax management to develop powerful tools for detecting anomalies in tax returns and tax irregularities. These tools have profoundly changed the way tax audits are planned, moving away from an approach that targets the largest taxpayers to one based on risks identified by the mass processing of data collected. However, these tools have not been integrated into an explicit fraud detection strategy. This is evidenced by the fact that fraud in the various taxes is still not statistically estimated using tried and tested methods, making it impossible from the outset to decide on the best allocation of resources and the effectiveness of the systems deployed. In fact, this report notes that the relevance of tax audits has improved over the last five years, a sign of more effective upstream detection, but there is a lack of data to support and quantify this progress more precisely.

The national anti-fraud plan presented by the French government in June 2023 is an opportunity to specify and formalise a detection strategy, although none of its 35 measures deals directly with this issue. The Court's insistence on the need to formalise this strategy and make its main aspects public is a response to a public issue that goes beyond questions of efficiency and the appropriate allocation of resources. At a time when public debate sometimes leaves room for suppositions, approximations and even untruths, it is the responsibility of the tax authorities to explain who they are auditing and why, on the basis of what risks, and with what balance between the power of the technological tools at their disposal and the protection of taxpayers' rights. Only then will it be possible to strengthen tax compliance, which is the cornerstone of the Republican Pact.

Recommendations

The Court of Accounts recommends that the ministry of the economy, finance and industrial and digital sovereignty formalise, by the end of 2024, a national strategy for detecting tax irregularities to complement the June 2023 anti-fraud plan, structured around the following six priorities and recommendations:

1. present the strategic choices for scheduling tax audits in a transparent manner and ensure that the tools and methods deployed for this purpose guarantee equality for taxpayers by eliminating unfounded customary exceptions;
2. establish a methodology and schedule for estimating personal income tax fraud by the end of 2024, in partnership with Insee and on the basis of the lessons learned from the estimate made of VAT fraud;
3. ensure that the PILAT project enables a link to be made between suspected, detected and established fraud, and thus assess the relevance of the reasons for scheduling audits;
4. on the basis of experiments and local best practice, create a national IT tool for mobilising internal intelligence that is simple, quick to use and includes systematic feedback to the issuing agent;
5. step up preventive action in the form of real-time alert messages when data provided during online declarations seems inconsistent or missing, warning taxpayers of the checks that could ensue;
6. ensure that recruitment and transfer procedures enable the DGFIP to make the most of the professions and skills specific to the fight against tax fraud.