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ECOSYSTEM-BASED DIGITALISATION OF TAXATION

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Ecosystem-based Digitalisation of Taxation

Taxation in time

Taxation is not an independent island, nor does it take place in a bubble - taxation is a part of all of our lives. The probability of fulfilling the obligations related to taxation is strongly dependent on how difficult or easy the obligations related to taxation are perceived to be. A person in a traditional salaried job fulfills his obligations excellently, as long as the processes related to tax rate changes are made easy and when employers take care of their part in terms of withholdings and payments.

As we know, business models and ways of earning are in constant motion. For example, a newly self-employed taxpayer may find the obligations relating to the new position most challenging; there will be many new forms to fill in and new instances to interact with. In an unclear situation, errors may occur in relation to reporting and payment, resulting in the need for subsequent clarification. Many practical issues may also require quite a bit of interpretation e.g., if the legislation is not up to date with regard to the new models of employment. For some, the new and perhaps complicated situation may be an incentive to leave part of the income unreported. As a result of the increasing internationalization and globalization, misreporting and tax evasion practices also travel more widely across national borders. We already have concrete experiences of fraud moving across borders in a situation where controls have been tightened in another country.

It is necessary for the tax administration (henceforth, TA) to stay closely involved in the development of business operations and income generation practices. As a main rule, complying with tax obligations should be made as simple, quick and easy as possible. The TA service solutions must be competitive. It can be argued that practically all other services in the digital world serve as benchmarks for the TA services in terms of the customer experience and the ease of use. Taxation must live in time. Ideally, taxation should be embedded in the daily routines as widely as possible - as it currently is for the large part is for standard salary earners. If tax obligations are met merely as a part of the daily routines of individuals and businesses, compliance becomes a social norm. For the large part that is the case in Finland already. We should make sure that it will continue to be so also with respect to new and constantly developing income streams. If taxation is an automated part of the larger whole, failure to comply becomes marginal over time: circumventing obligations requires active measures and/or opting out of standard solutions altogether.

Vision of the new

The Finnish Tax Administration, alongside with its peers around the world, is heading towards an operating model in which taxation will gradually merge into the daily events of companies and individuals. The amount of administrative work required for tax-related obligations will be significantly reduced or, in part, even completely eliminated. This is achieved by utilizing the information that is generated in people's and companies' daily activities and/or major events in any case. That data is then used as it is for tax purposes and thus, the taxpayer will be relieved from most of the separate reporting obligations. Taxation becomes easy, effortless and - where possible - almost unnoticeable. Tax just happens.

In the traditional model, the taxpayer typically deals with the TA and potential other service providers linked with the same event in separate processes and produces information for each service provider according to the individual requirements set forth by each counterparty. In the envisaged operating model, taxation is integrated with other public and private services that are natural components to the same daily/major event and that utilize the same information/data. The aim is that the data produced for the event in question is utilized by all service providers in the content and form it was produced in the first place. These service providers (and customers) will comprise a seamlessly interoperable ecosystem around the daily/major event.

A good example of such an event would be, for instance, a death in the family; typically, this is a situation where individuals, who are not necessarily accustomed to working with legal issues, will need to address a number of official instances as well as to produce and provide documents to a variety of operators. By standardizing and digitalizing the data content and formats to serve the need for all parties involved as well as standardizing the channels for information flows this can be made significantly less burdening for individuals and less prone to errors and additional work for the instances involved, including the TA. Creation of such an ecosystem is currently underway in Finland.

The information required by differing service providers needs indeed to be carefully defined and standardized. The starting point would be the needs of the customer/taxpayer. The definition work should be a joint effort by the parties of the ecosystem. The key goal is that the production of the jointly standardized data would be required from the customer only once - hence, the concept of "once only" is being cultivated. When the owner of the information (customer) gives the members of the ecosystem (as needed) permission to use the information in their own processes, the customer does not have to deal with each service provider separately. Standardized, digital information can move from the customer to service providers and authorities along standardized channels (interfaces) in real time or whichever pace is decided to serve the purpose.

As mentioned, the administrative work required by taxation (and other public or private services) will be significantly reduced through the standardization of the data and the through the creation of seamlessly working ecosystems. Digitized processes will also improve the quality of information and therefore, there will be a more limited need for ex post investigation to the same extent as is customary today. In particular, the development of the differing compliance by design -solutions, that is, embedding the tax rules into digital tasks and processes will materially enhance the quality (correctness) of the data. This will greatly support a reduction in the need for voluntary compliance through separate tax reporting. Real-time data and interoperable services will also enable the further development of services and processes in ways that are perhaps not even visible to us just yet.

A key feature in creating the ecosystems is cooperation. When ecosystems are formed as part of the everyday life of companies and people, service solutions are not only the development of the authorities' operations, and the authorities cannot craft these solutions based solely on their own judgement. In order to create and maintain a functioning ecosystem which the parties genuinely commit themselves into, close cooperation with authorities, service providers (such as software developers, accounting firms and banks) and customers is needed. Cooperation can take many forms; familiarization with the operating environment of customers and service providers, joint development and joint experiments to ensure functionality and so forth. Large-scale cooperation already exists today, for example, in Finland, the digitalization of the financial administrations is sought to emerge through ongoing work in the "Real-Time Economy" - project.

In addition to making life easier for customers and supporting them to operate correctly, it is crucial for the TA that we are able to ensure smooth, comprehensive and correct access to information even in a changing world. Enhancing the access to information, speeding up the flow of data and improving the quality of information are key factors in terms of ensuring the TA's ability to operate in the future as well: digitalizing economy, the constant development of new business models and payment methods, and changes in earning methods inevitably pose threats to the continuity of tax collection. Staying involved in digitalization development is the best way to make sure that the funding of the Finnish welfare state can be secured in the future in a manner where everyone pays their own share of its funding. In the end, there is a question of justice and equality.

However, the goals described above are still, in many regards, future visions and there is inevitably a lot of work to be done. However, the journey has already begun in many countries and in Finland as well. New measures are also needed. Below, some of the key requirements for an efficient transition are discussed.

Digital by default

In the development of public services, the primary aim must be to utilize digitization so that the need for transactions by the recipient of the service is eliminated or significantly reduced. The part of the public services that will unavoidably require interaction of some sort should be made digital by default.

Many public services require an action (application, notification etc.) by the service recipient. However, it does not have to be this way. Why does the child have to be registered for day care or go to school premises to approve school registration? Why not build the service in a way where the authority makes a proposal about these services automatically (e.g., based on age etc.)? In most cases, the information required for the proposal already exists or can be easily obtained. If the recipient of the service is happy with the proposal, there would not be a need to react in any way - the service would take place as suggested unless objected by the recipient.

There will always be people for whom dealing with the public administration is difficult in general, and for whom even digital services do not help, because they are unable to use them for one reason or another. In terms of essential services, the primary goal should be to build services for these persons relying on human interactions, by phone or in a service point. These encounters should be utilized to the full to address the issues of these individuals as comprehensively as possible at the same time. Such personalized service would undoubtably be somewhat more costly and time consuming. However, comfort should be taken in the assumption that eliminating the need for interaction and improving the quality of the data through digitalisation will bring balancing savings elsewhere.

For others, i.e. those who can and wish to use the digitalized services, do business digitally, digital is made the default mode of operation. Majority of citizens and companies are able to operate digitally when services are implemented taking into account their needs and when the customers are sufficiently supported in the digital transformation.

Cross-governmental ecosystems

Any future service development should not limit itself in the realms of e.g. taxation but would need to commence by analyzing and identifying the other public/private services connected to the daily/major events in the life of the service recipient (the client). Identification of sc. natural ecosystems should be a default setting. The relevant public and private service providers should be brought together to see if they utilize the same/similar data and if that data flow could be made interoperable in order to follow the "once-only" -ideal.

Traditionally, differing sectors of public administration have not been the model students of spontaneous cooperation. This should change at once. The benefits of interoperability, that would allow real time flow of information and cutting the administrative work for all is a no-brainer for everybody. It just requires patience and good spirit in cooperation, a fair amount of new type of thinking and a fair amount of will. And where there is a will, there certainly is a way.

Cross-governmental development projects can of course pose significant challenges in terms of management, coordination and funding. Therefore, there should be a nationally established and generally applicable practice on how to re-arrange the roles and responsibilities, chains of command and financing in a project (and in the later ecosystem) that brings together a variety of government agencies and - typically - private sector operators.

The development project itself as well as the later ongoing operations of the ecosystem should be managed and guided by a party/parties equipped with clearly set decision making powers. This may come across as quite a cultural change for e.g., government agencies accustomed to relatively high level of self-sufficiency and autonomy.

The build-up of a larger ecosystem can surely take time. The span may exceed electoral periods resulting in the need for the political decisionmakers to commit themselves to forward and, also, fund a perhaps material public development plans that have been commenced by the previous government. The political powers should indeed find ways for devoting to a long-term vision for digitalisation, allowing for continuity despite the eventual regime changes.

This applies also to public funding. There is a clear need to arrange the funding of the cross-governmental development projects in ways that would grant the funding as, for instance, a lump sum for the project in general, allowing flexible allocation of the monies to each party of the ecosystem according to need, by the leading party with those sufficient powers. Longer term projects may require also additional funding later on - hence, the need for long term political commitment. If the advancement of the development is left to the mercy of the general funding of differing agencies varying year-on-year, a significant risk of success is evident.

The Finnish Real-Time Economy Project

In Finland, a large cross-governmental project "Real Time Economy" was launched in the summer of 2021. The project is a heavy investment on laying the foundations for digitalizing the financial administration of businesses. The aim is to create a seamlessly functioning ecosystem in which the financial administrations of companies, government agencies (Tax Administration, Business Registry, State Treasury, Statistics Finland and the Digital and Population Information Agency) as well as the financial administration service providers (financial institutions and accounting firms supported by software houses) share the financial data of companies in a standardized content and format, using standardized interfaces, as real-time as possible. The project does not create, as such, solutions that have an immediate impact on taxation, but the build-up of the ecosystem paves way for the digitalisation of corporate taxation (direct and indirect taxes).

In line with what has been said above, the digitalisation of the financial administration and the creation of an ecosystem of multiple public and private service providers will enable reducing reporting obligations, increasing the quality of the data and thus, reducing the need for later inquiries, admin work and corrections. The usability of the information enables extensive further development of services in the operations of authorities and service providers.

Real-time availability of accurate financial data allows up-to-date financial controls and planning. In overall, the aim is to increase the profitability and competitiveness of Finnish companies.

The work of project is focused on three main areas. Firstly, the project develops and improves rules and practices with respect to e-invoices, e-receipts, and procurement messages with the intent of increasing the user volumes of these basic business documents. The second area of work is the development of a standard model of financial data for the joint use of the participants of the ecosystem. This requires harmonizing the data content, data format and interfaces for transmission. In addition, the project investigates solutions for the companies to be created and operate in a fully digital form - "born and live digital", as we say. Identifying the most reliable technologies for companies and their financial systems to identify one another and interact with the service providers is a key area for ensuring the creation of a functioning whole, in other words, the ecosystem.

The desired ecosystem will not be completely ready in all regards by the time the duration of the project ends in 2024. For further development work and for the continuity of the ecosystem the roles and responsibilities of the parties of the ecosystem as well as the further financing will require a solid and workable administrative structure to govern the cooperation between authorities and private sector operators.

Need for European and global interoperability

The Real-Time Economy project is a national leg of the project called Nordic Smart Government & Business. Mirroring the goals of the Finnish national project, the key aim on the Nordic level is that structured and standardized business data can be shared automatically and thereby replace burdensome manual handling of data exchange. This involves alignment of digital systems and services as opposed to digital silos and requires collaboration across sectors using the business data. The objective is not to implement a centralised IT-system, but to enable and facilitate a transformation of the Nordic ecosystem and business processes, both nationally and across the Nordic borders.

Given the tight economic relations between the Nordic countries, this is an essential element for the workability of the ecosystem for a large number of companies operating across the northern borders. Obviously, this is not enough. We repeatedly encounter grievances aired by Finnish multinationals who already face a scattered landscape of differing national solutions in this area. This applies, in particular, to VAT reporting practices and standards, for instance, in the form of the continuous transaction controls and alike. In addition to VAT-reporting solutions, some countries apply e.g. the SAF-T format to other areas of taxation, typically with local tweaks. All of the above development, which appear to be gaining speed here and there, results in the multinationals (regardless of their size) facing the necessity of tailoring country-specific financial admin solutions resulting, in turn, mounting ICT-costs and manual labor. In the interest of the effective functioning of the internal market of the European Union, such practical hinderances for cross-border activity and internationalization of businesses appear most ill-advised.

Of course, plenty has been and is being done in the EU and on the international arena. In the OECD, the Tax Administration 3.0 -report and the follow-up work on the road map for the 3.0 vision has been a good start. However, there is a long and winding road ahead from the, as such, great vision to practice. The Commission of the EU has pushed forward a number of initiatives in this area (e.g. the e-IDAS, single digital gateway and the upcoming VAT-package including the e-invoicing). The Commission also provides with assistance on ensuring cross border interoperability (legal, semantic, organizational, technical) by the DG Digit/Reform. However, thus far there has not been an initiative that would guide us towards an EU-wide ecosystem for financial administration. It may well be, that there is no need for that. Hence, it remains to be seen if the current initiatives are enough to remedy the concerns of the multinational and all the actions combined will lower the threshold for entering other markets in this regard. Perhaps the work program of the next commission could seek to compose a more comprehensive and converging initiative that would result in a de minimis list of requirements for national solutions for ensuring compatibility and interoperability - assuming that a EU-wide real time economy - project is unthinkable.

We are convinced that in the interest of international trade, economic growth, and efficiency of the public administration we should do everything in our powers to bring the TAs, other government agencies, financial admin service providers and businesses closer to one another and prevent the fragmentation of the digitalisation development through incompatible national solutions. The digitalisation of financial administration and taxation is, no doubt, the way of the future. With respect to our domain we, as tax administrators, should suppress the virus of polarization even if it seems to gain ground in other walks of life.