



The Speaker  
House of Representatives of the  
Dutch States General  
Binnenhof 4  
THE HAGUE

Algemene Rekenkamer  
Lange Voorhout 8  
P.O. Box 20015  
2500 EA The Hague  
The Netherlands  
T 070-342 43 44  
E voorlichting@rekenkamer.nl  
W www.rekenkamer.nl

**DATE** 19 March 2015  
**SUBJECT** Review of the tax system

Dear Ms Van Miltenburg,

The government is planning to review the current Dutch tax system. It won't simply be a question of 'clearing out the attic'.<sup>1</sup> A tax review is an opportunity to align the system more closely with the resources of the tax authorities, i.e. the Tax and Customs Administration, and to gain a better understanding of just how effective the system is.

The Netherlands Court of Audit does not comment on policy decisions, so we will not be making any judgements about the choices made in relation to the review of the tax system. Over the past few years, the Court has frequently audited the performance of the Tax and Customs Administration, as well as the effectiveness of various tax measures. This letter is therefore intended to present the members of the House of Representatives with a number of findings of earlier audits. Where relevant, we relate our findings to those of reports and audits published by other bodies, including the Council of State, the Dutch Advisory Board on Regulatory Burden (Actal) and the National Ombudsman. If you wish, you can include these findings in your discussions about the review of the tax system.

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<sup>1</sup> As announced by the State Secretary for Finance on 14 March 2014 in a letter concerning his policy priorities, House of Representatives, 2013-2014 Session, 33 750 IX, no. 23, and further outlined in his letter of 16 September 2014 headed 'Options for a better tax system', House of Representatives, 2014-2015 Session, 32 140, no. 5.

**YOUR REFERENCE**

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**ENCLOSURES**



This letter focuses on the following topics:

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- the conflicts between the demands of the tax system and the resources of the executive agency;
- gaining a better understanding of effectiveness and ownership;
- the system of tax collection and accountability.

### **The conflict between the demands of the tax system and the resources of the executive agency**

Recent audits have revealed a degree of tension between the current tax system and the ability of the Tax and Customs Administration to enforce it.

A growing number of changes have been made to Dutch tax laws during the past few years. As a result, the Tax and Customs Administration has not always managed to move quickly and forcefully enough to cater for Parliament's new wishes.<sup>2</sup> In an appendix to a document known as the 'Broad Agenda', the State Secretary for Finance cites a number of examples to show that, despite Parliament's desire to reduce the number of taxes, their number has actually risen during the past few years and that they have become more difficult to enforce at the same time.<sup>3</sup> Moreover, the relevant executive agencies themselves – including the Tax and Customs Administration – have seen their own budgets cut during this period.<sup>4</sup> Various examples from our own audits follow below.

#### *Allowances*

In our 2013 Accountability Audit, we pointed out that certain choices made by the States General and ministries have made it difficult for the Tax and Customs Administration to operate the system of tax allowances.<sup>5</sup> The law states that such allowances should be disbursed in the first instance as advances, with the tax authorities then fixing the final amount at the end of the year in question. As a consequence of this system, certain advances have been too high and others have been paid to people who are not in fact entitled to them. The Tax and Customs Administration then has to recover this money.

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<sup>2</sup> Court of Audit (2014), *2013 Accountability Audit*, <http://verantwoordingsonderzoek.rekenkamer.nl/2013/fin/toekomstbestendige-bedrijfsvoering-belastingdienst-vraagt-ruimte-en-realisme>.

<sup>3</sup> House of Representatives, 2013–2014 Session, 31 066, no. 201, appendix.

<sup>4</sup> House of Representatives, 2012–2013 Session, 31 490, no. 104. The Tax and Customs Administration was one of the organisations audited. In our audit report, we urged the government to keep its ambitions and deadlines consistent with budgets, staffing and resources at these organisations and to keep parliament informed.

<sup>5</sup> Court of Audit (2014), *2013 Accountability Audit*, <http://verantwoordingsonderzoek.rekenkamer.nl/2013/fin/bedrijfsvoering/belastingdienst-heeft-verbeteringen-proces-toeslagen-maar-ten-dele-zelf-de#toezicht-op-toeslagen-wordt-belemmerd-door-kwalite>.



According to the Van Dijkhuizen Committee, the idea for paying these advances at short notice was basically a politically motivated decision taken when the system of allowances was first introduced. The Committee concluded in 2013 that the practice of making quick advance payments without performing any checks made the system highly susceptible to fraud.<sup>6</sup> In 2012, we made clear that the Tax and Customs Administration was not solely to blame for the problems with the allowances (commonly referred to in the media as the 'Bulgarian fraud'), as they were mainly the consequence of legislation that was open to abuse.<sup>7</sup>

In our 2013 Accountability Audit, we also ascertained that the laws on allowances contained certain conditions that were difficult to check,<sup>8</sup> as well as a large number of exceptions.<sup>9</sup> This made it virtually impossible to obtain reliable counter-information from external sources such as the Residents Database.<sup>10</sup> An example of this is the wide range of definitions for the term 'household'. There is no single definition of a 'household' that can be taken straight from the Residents Database and then used to determine both a person's entitlement to an allowance and the size of the allowance in question. This is one of the factors that makes the policy on allowances so complex to enforce.

As well as encountering this implementation problem, we also found that the way in which the legislation on various taxes is prepared produces difficulties and confusion when the Tax and Customs Administration enforces the laws in question. This in turn often raises the administrative burden placed on households and businesses. As a result, the Tax and Customs Administration receives questions and letters of objection, thus further increasing the enforcement burden for the Tax and Customs Administration. Here are some examples of complex legislation leading to enforcement problems:

#### *Expense Allowance Scheme*

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<sup>6</sup> Income Tax and Allowance Committee (2013), *Naar een activerender belastingstelsel. Eindrapport ('Moving towards a more activated tax system. Final report')*, p. 8.

<sup>7</sup> Court of Audit (2014), *2013 Accountability Audit*, <http://verantwoordingsonderzoek.rekenkamer.nl/2013/fin/bedrijfsvoering/belastingdienst-heeft-verbeteringen-proces-toeslagen-maar-ten-dele-zelf-de>.

<sup>8</sup> For example, the maximum number of childcare hours that can be claimed, which is related to the actual number of hours that the parents or guardians work.

<sup>9</sup> The country of residence factor is an example: this is the ratio of care costs incurred abroad to the costs that would have been incurred in the Netherlands. This factor affects people who live abroad, but not in the EU, Iceland, Norway, Liechtenstein or Switzerland.

<sup>10</sup> Court of Audit (2014), *2013 Accountability Audit*, <http://verantwoordingsonderzoek.rekenkamer.nl/2013/fin/bedrijfsvoering/belastingdienst-heeft-verbeteringen-proces-toeslagen-maar-ten-dele-zelf-de>. For more information about the Residents Database, see: Court of Audit (2014), *Basisregistraties vanuit het perspectief van de burger, fraudebestrijding en governance ('General registers from the citizen's perspective, fraud control and governance')*, 28 October, 2014. House of Representatives, 2014-2015 Session, 29 362, no. 238.



The Expense Allowance Scheme was devised in 2009 to make it easier to provide certain services and products tax-free and hence to lighten the administrative burden.<sup>11</sup> Since then, a number of amendments and exceptions have been introduced. The amendments were made in response to requests from the public (i.e. private-sector businesses and educational institutions) and the House of Representatives. The amendments have made the scheme more complicated, thus raising the enforcement workload placed on the Tax and Customs Administration. One of the decisions taken was to introduce a transition period in which employers could choose to use either the old or the new expense allowance scheme. The decision to offer employers a choice meant that, up to the end of 2014, the Tax and Customs Administration still had to carry out checks in accordance with the old rules. It has also led to higher costs, such as the cost of maintaining two versions of the Payroll Tax Guide, carrying out double collective agreement reviews and running a system of twin-track staff training.

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#### *Crisis Tax*

The pseudo-tax on high salaries (known as the 'Crisis Tax') was a temporary measure under which employers had to pay an extra 16% tax in 2013 on salaries of over €150,000 paid in 2012. The idea was to temporarily tax higher incomes during an economic recession. It was intended to raise an extra €500 million in 2013. In 2012, the Tax and Customs Administration warned in an internal document that there was a risk that the tax would be incompatible with the principles of equality and legal security. The Tax and Customs Administration suggested that these problems might result in some 10,000 objections, plus all the extra administrative work involved. These risks started to materialise at the beginning of 2014 just as the Tax and Customs Administration had said they would (with 9,763 objections received by January 2014).

Conflicts between legislation and enforcement may also be seen in relation to the new legislation on gambling. Taxpayers regard the 2008 Betting and Gaming Tax Act (which empowers the government to tax gambling directly) as complex and unjust; this has led to a large number of objection procedures. On 11 July 2014, the government accepted a bill for a new Remote Gambling Act, allowing both domestic and foreign providers to offer on-line gambling and introducing a differentiated set of tariffs.<sup>12</sup> The Dutch Advisory Board on Regulatory Burden (Actal) and the Council of State both criticised the bill, including the system of tariff differentiation, the administrative burden represented

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<sup>11</sup> House of Representatives, 2009–2010 Session, 32 130, no. 3.

<sup>12</sup> A 20% tariff for on-line remote gambling and 29% for 'land-based' gambling in the Netherlands.



by the new law, and the problems that are likely to arise in enforcing the Act.<sup>13 14</sup> In his response, the State Secretary for Security and Justice said that the government felt that the policy objectives were more important than the potential disadvantages of tariff differentiation and that it did not consider there were grounds for withdrawing the bill.

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### *IT systems*

The maintenance and management of IT applications has become increasingly complex with the passing of time, as IT systems age and become more reliant on each other.<sup>15</sup> Besides this, the proliferation of and changes in tax laws have affected the organisation of the Tax and Customs Administration. Computer systems often have to be adjusted accordingly. For a number of years, our audits of allowances have revealed (major) problems with the Tax and Customs Administration's computer systems, suggesting a structural form of incompatibility between the demands of the tax system and the executive agency's resources.<sup>16</sup>

Every year since 2005 we have reported on computer problems at the Tax and Customs Administration – for example, the late delivery of computer systems and the small amount of time available to the Tax and Customs Administration for designing automated processes. In our 2008 report entitled *IT project for housing and care allowances*, we expressed concerns about the conflict between political pressure and the time frame, and between the working methods used by the project team and the technical complexity of the project.<sup>17</sup> The political pressure to deliver the computer system quickly played a role in the problems we discovered at the Tax and Customs Administration. The Tax and Customs Administration adopted the new system in 2009. Our audit revealed an inconsistency between the desired quality of the new system and the need to adopt it in a controlled manner.<sup>18</sup> We concluded that more time was needed to ensure that the system was up to the requisite standard. In 2010, the new allowance system was still not being used because it contained too many errors that could inconvenience members of the public.

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<sup>13</sup> Actal (2013), Recommendations on the Remote Gambling Bill, JtH/RvZ/JT/HS/2013/210. Actal recommended not enacting the bill if their advice was not heeded.

<sup>14</sup> House of Representatives, 2013-2014 Session, 33 996, no. 4. The Council of State urged the government to assess which was worse: the solution (i.e. the proposed method of regulation) or the problem (i.e. a ban on on-line gambling with limited opportunities for enforcement).

<sup>15</sup> Court of Audit (2014), *2013 Accountability Audit*, <http://verantwoordingsonderzoek.rekenkamer.nl/2013/fin>.

<sup>16</sup> Court of Audit (2005-2013). Annual accountability audits, available at [www.rekenkamer.nl](http://www.rekenkamer.nl) and at <http://verantwoordingsonderzoek.rekenkamer.nl/>.

<sup>17</sup> House of Representatives, 2007-2008 Session, 31 333 no. 2.

<sup>18</sup> House of Representatives, 2009-2010 Session, 32 360 IXB, no. 2.



We again expressed our concerns about IT systems in our last accountability audit (i.e. for 2013), in which we again pointed to the conflict between the demands of the Tax and Customs Administration, the States General and the ministries on the one hand and the continuity of the current processes on the other.<sup>19</sup>

In his letter of 19 March 2014 on the Broad Agenda, the State Secretary for Finance himself discussed the weakness of computer-supported operating processes. The State Secretary stressed the urgency of the situation: 'things can and must improve'.<sup>20</sup>

As part our Accountability Audit for 2014 (published in May 2015), we are currently auditing the improvement programme set out in the Broad Agenda, and the IT governance structure at the Tax and Customs Administration.

### **Gaining a better understanding of effectiveness and ownership**

#### *Information on effectiveness*

A revision of the tax system is also a good opportunity to gain a better understanding of its effectiveness. This applies both to the effectiveness of tax collection and to the effectiveness of tax policy measures.

We have been reporting since 1999 on the relatively limited amount of information available on the effectiveness of various fiscal instruments.<sup>21</sup> One of the findings of the audit we are publishing today, for example (entitled *Tax Expenditure and Environmental Impacts*<sup>22</sup>) is that no evaluation has been performed to date of 32 of the 86 forms of tax expenditure.<sup>23</sup> Moreover, 13 of the 54 evaluations currently available do not contain any judgements about the effectiveness of the tax measure in question. We can gain a better understanding of the effectiveness of tax measures by subjecting them to regular reviews as a matter of routine. The Council of State has already indicated that there is a need for caution in making use of tax measures because they seldom have the intended effect in practice. The Council has also recommended that, where tax relief is adopted as a policy measure, sufficient evidence of its expected effectiveness should be provided *beforehand* and

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<sup>19</sup> Court of Audit (2014), *2013 Accountability Audit*, <http://verantwoordingsonderzoek.rekenkamer.nl/2013/fin/bedrijfsvoering/prioriteiten-en-realisme-nodig-voor-toekomstbestendige-bedrijfsvoering-en>.

<sup>20</sup> House of Representatives, 2013-2014 Session, 31 066, no. 201.

<sup>21</sup> House of Representatives, 1998-1999 Session, 26 452, nos. 1-2.

<sup>22</sup> [www.rekenkamer.nl/belastinguitgaven](http://www.rekenkamer.nl/belastinguitgaven).

<sup>23</sup> Tax expenditures are defined as tax measures adopted to achieve policy goals set in areas such as the economy, employment, the environment, energy and transport. The total value of tax expenditure in 2015 is estimated at €18.5 billion. This is more than three times the value of government grants and subsidies.



that the aims of the measure should be expressed in quantitative terms, so as to enable its effectiveness to be measured.<sup>24</sup>

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With regard to the effectiveness of tax collection in practice, we have previously stated that a tax gap analysis is a useful way of obtaining more information on the effectiveness of tax measures, large-scale measures in particular.<sup>25</sup> The tax gap is the difference between the amount that the government should theoretically receive if everyone pays all their taxes in accordance with the law and the amount actually paid in practice. On 5 March 2015, the State Secretary for Finance promised that he would inform the House, in the next half-yearly report from the Tax and Customs Administration (that was due to be published at the end of March) about a new kind of tax gap analysis that the Administration was developing.<sup>26</sup>

#### *Information on ownership*

The tax reforms could also be used as an opportunity to draw clearer lines of ministerial 'ownership' of the various tax instruments. The inconsistencies between the system and its practical implementation to which we have already referred may indeed increase if it is not clear who exactly 'owns' certain tax instruments, such as allowances and tax expenditures. For example, we pointed out in 2009 that four ministries were obliged to account for the regularity of the spending of four types of allowance, i.e. housing allowance, care allowance, child-related budget and childcare allowance, despite the fact that they had only a limited degree of influence over the way in which the Tax and Customs Administration distributed the allowances.<sup>27</sup> As a further complication, care allowances are not part of the spending framework.<sup>28</sup> This means that the minister responsible for the policy field in question, i.e. the Minister for Health, Welfare and Sport, does not need to find compensation for any budget overshoots (as is the case with expenditure that is part of the spending framework).<sup>29</sup> Instead, any overspending simply leads to a deterioration in the EMU balance (i.e. the difference between annual revenue and expenditure in the entire public sector).<sup>30</sup> This suggests that care allowances have no obvious 'owner'.

Uncertainty about 'ownership' also plays an important role in accounting for tax expenditure. The government reports on tax expenditure in the Budget Memorandum and the appendices to the Budget Memorandum. Most of the

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<sup>24</sup> House of Representatives, 2013-2014 Session, 33 752, no. 4.

<sup>25</sup> House of Representatives, 2014-2015 Session, 34 000 IX, no. 4.

<sup>26</sup> [http://www.tweedekamer.nl/kamerstukken/plenaire\\_verslagen/detail?vj=2014-2015&nr=60&version=2](http://www.tweedekamer.nl/kamerstukken/plenaire_verslagen/detail?vj=2014-2015&nr=60&version=2).

<sup>27</sup> House of Representatives, 2008-2009 session, 31 924 IXB, no. 2, p. 44.

<sup>28</sup> Under budgetary rule 33, care allowances are part of the revenue framework.

<sup>29</sup> Under budgetary rule 18.

<sup>30</sup> House of Representatives, 2013-2014 Session, 33750 XVI, no. 112.



budgetary consequences of tax expenditure are included as 'memorandum items' in budget articles or policy agendas and are not included in the ministries' annual reports.<sup>31</sup> This means, for example, that responsibility for the policy on tax incentives for fuel-efficient cars lies with both the Minister of Economic Affairs and the Ministry of Infrastructure and the Environment, even though it is the Minister of Finance who is responsible for the tax instruments used in practice.<sup>32</sup> The high 'cost' of the tax policy leads to lower tax revenue, but does not affect the two ministries' budgets.<sup>33</sup> We therefore recommend that, when the tax system is reviewed, action be taken to define which ministry 'owns' which tax measures. This should make clear which minister is responsible for the proceeds of each tax measure and should also make it easier for Parliament to exercise its right to approve and amend the budget.

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### **The system of tax collection and accountability**

In addition to pointing to the above problems with the practical aspects of legislation, we would like to take this opportunity to also address certain issues that are more a matter of principle.

First of all, the current conflicts between the aims of the tax system and the resources of the executive agency responsible for enforcing it may undermine the willingness of taxpayers to pay tax. Complex legislation that is susceptible to fraud and is difficult to enforce may weaken public confidence in both the system and the government.<sup>34</sup> This is illustrated by the action taken to combat social-security fraud, which the National Ombudsman has said involves prioritising the fining of offenders, even though this does not make it any more likely that fraudsters will be caught. The National Ombudsman has claimed that this helps to create an impression that fraudsters go unpunished, whereas any errors, whether intended or not, are heavily penalised.<sup>35</sup> In order to create a tax system that is supported and trusted by the general public, it is absolutely crucial that the underlying legislation is consistent with the enforcement capacity of the Tax and Customs Administration, and vice versa.

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<sup>31</sup> This is our own finding.

<sup>32</sup> Our 2013 Accountability Audit discussed the high level of expenditure on tax incentives for fuel-efficient cars, <http://verantwoordingsonderzoek.rekenkamer.nl/2013/ienm/beleidsinformatie/hoge-prijs-voor-tegenvallende-milieuwinst-zuinige-autos>. We will be discussing the policy of tax incentives for certain types of electric and hybrid cars in our 2014 Accountability Audit, which will be published in May 2015.

<sup>33</sup> Caminada, C.L.J. and A.P. Ros (2012), 'Belastingfaciliteiten' ('Tax Facilities'), and: C.A. de Kam and J.H.M. Donders (ed.), *Jaarboek Overheidsfinanciën* ('Government Finance Year Book'), p. 170.

<sup>34</sup> Income Tax and Allowance Committee (2013), *Naar een activerender belastingstelsel. Eindrapport* ('Towards a more activating tax system. Final report'), p. 6.

<sup>35</sup> Helden, van W.J. e.a. (2014), *Geen fraudeur, toch boete – een onderzoek naar de uitvoering van de Fraudewet* ('Not a fraudster, but still fined – a study of the enforcement of the Fraud Act'), *The National Ombudsman*.





We also wish to point out that taxation is part of a democratic process in which the people's elected representatives are involved in collecting and distributing public funds and accounting for how they are spent. There are four tiers of government in the Netherlands (including the district water boards) that collect and spend public funds, and report on their activities, all of which are subject to democratic control. If the whole cycle were to remain within a single tier of government, all political and democratic debates about the desirability, regularity, efficiency and effectiveness of government action could be pursued at the same level and taxpayers would find it easy to follow the audit trail. In reality, however, the situation is far more complex.

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We would therefore like to suggest that the wider debate about extending local taxes may have a bearing on public confidence in the tax system. The key question here is whether taxes should be collected by the same tier of government as that which spends them. In 2014, about two thirds of local-government revenue came from central government grants and about ten percent from local taxes. The latter is a very low proportion by international standards.<sup>36</sup> The State Secretary for Finance has indicated that he will be assessing, in collaboration with the Minister of the Interior and Kingdom Relations, whether and how local taxes could be extended and whether there would be broad public support for this.<sup>37</sup> The government has pointed out in this respect that local government has been given more responsibilities following the decentralisation of certain social services.<sup>38</sup>

We join the government in stressing the importance of having a tax system that allows a clear account to be given of how resources have been spent. We went into this point in greater detail in our 2012 and 2013 accountability audits: after all, in a situation in which budgets are fixed and allocated centrally, but are spent and accounted for at a local level, arrangements must be put in place for giving additional information on what results have been achieved at a macro level, how much money is required and hence how much taxation needs to be raised. It is a complex task. The Organisation for Economic Cooperation and Development (OECD) claims that a big tax imbalance between local and central government may lead to moral hazard, i.e. a situation in which local authorities – which depend on external resources provided by the central government – have no real incentive to spend tax revenue efficiently.<sup>39</sup> In 2014, the Netherlands Bureau for Economic Policy Analysis

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<sup>36</sup> Netherlands Bureau for Economic Policy Analysis (2014), *Vervolgrappportage decentralisaties in het sociale domein* ('Follow-up report on decentralisation in the social domain').

<sup>37</sup> House of Representatives, 2014–2015 Session, 32 140, no 5.

<sup>38</sup> House of Representatives, 2014–2015 Session, 34 000 VII, no. 36, pages 7-8.

<sup>39</sup> OECD (2014), *OECD: Territorial Reviews: Netherlands 2014*, OECD Publishing, pp. 288-294.



also pointed out that more local taxes means greater incentives for efficiency.<sup>40</sup> We 10/11  
have regularly reported in our audits that we do not know enough about the effectiveness and efficiency with which local authorities spend the resources allocated to them by higher tiers of government. This applies to EU grants allocated to the Netherlands,<sup>41</sup> for example, but also to the way in which local authorities report on the spending of specific-purpose grants.<sup>42</sup>

Moreover, it is difficult for the general public to work out which representative body they should approach where one tier of government is responsible for collecting and distributing tax revenue, and another tier is responsible for spending the same money and reporting on the way in which it has been spent.

The relationship between the collection and spending of tax revenue is a key prerequisite for a political and financial system that is keen to see tax resources spent efficiently.

## **Conclusion**

We agree with the State Secretary for Finance that the current tax system has now gone beyond the limits of socially acceptable practicality and that a less complex system is therefore no longer a matter of choice, but a necessity.<sup>43</sup>

In the interests of a methodical review of the tax system, it is important for the government not to wait too long before coming up with an outline of the new system. The House of Representatives has to be given enough time to simplify the tax laws in consultation with the government and to devise an enforceable tax system. During the preparations for the previous major overhaul in 2001, the House of Representatives was already shown the initial plans as early as in 1997. It is also vital that the Tax and Customs Administration be given enough time to implement the new system properly. An assessment must be made in good time of the practical requirements that need to be met, so that the tax authorities have enough time and resources to do the job.

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<sup>40</sup> Netherlands Bureau for Economic Policy Analysis (2014), *Vervolgrapportage decentralisaties in het sociale domein* ('Follow-up report on decentralisation in the social domain').

<sup>41</sup> House of Representatives, 2014-2015 Session, 34 150, no. 1, appendix.

<sup>42</sup> Netherlands Court of Audit (2013), *2012 Accountability Audit*, <http://verantwoordingsonderzoek.rekenkamer.nl/2012/bzk/bedrijfsvoering/nog-acties-nodig-bij-verantwoording-en-controle-specifieke-uitkeringen>.

<sup>43</sup> House of Representatives, 2013-2014 Session, 31 066, no. 201, appendix.



We would be happy to answer any queries about the contents of this letter. We are sending a copy to the Minister and State Secretary for Finance and to the Speaker of the Senate. **11/11**

Netherlands Court of Audit

Saskia J. Stuiveling,  
President

Ellen M.A. van Schoten RA,  
Secretary-General