

THE SPANISH EXPERIENCE IN THE ADMINISTRATION OF THE PERSONAL INCOME TAX: TAX DATA SENDINGS AND PREFILLED TAX RETURNS*

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INTRODUCTION

A TRADITIONAL PRINCIPLE OF TAXATION IS simplicity, which means that taxes should be easy to understand, to comply with, to administer, and to control. Regulating, applying, collecting, and controlling taxes can be expensive; therefore, it is reasonable that scholars and practitioners have concentrated on this issue. In a first stage, the traditional concern was concentrated mainly on the administrative costs of taxes—that is, the public administration costs of running the tax system. However, there are also the tax compliance costs, or “the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities. They are costs over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax” (Sandford, 1995, p. 1).

The main findings of the research on tax compliance costs (e.g. Sandford, 1995; Slemrod, 2005; Vaillancourt et al., 2008) are probably: a) can be large, taking up substantial resources and offering scope for substantial savings; b) have undesirable distributional effects, falling with disproportionate severity on small firms and low-income individuals; and c) may generate particular resentment, adversely affecting voluntary compliance. These results indicate the significance of tax compliance costs and explain the increasing interest in the subject both by the academic community and by governments. Indeed, in recent years reducing the administrative burden on business and citizens has become a priority item on the political agenda of many countries in the Organization for Economic Co-operation and Development (OECD). Many governments have even set sizeable global targets for reducing the burden of compliance (OECD, 2008). Therefore, reducing tax compliance costs seems to be feasible and prefilled personal tax return systems is one of the means to achieve it.

In Spain, as in many other OECD countries, the system of personal income tax in place requires most taxpayers to file an annual tax return. Taxpay-

ers report all their taxable income and calculate the corresponding tax liability. However, quite often the tax administration already has this information available. All income from employment, most income from capital and business, and certain capital gains are already taxed through withholding taxes, and third parties like employers, banks, and other financial institutions must report this information to the tax administration before taxpayers fill in their annual tax returns. The Spanish tax agency traditionally used the third-party reports to detect unreported income. However, as is taking place in other tax administrations, this traditional approach has changed and, since 1998, the Spanish tax agency has begun to use third-party reports to inform taxpayers. At the beginning, taxpayers only received tax data of their income subject to withholding tax in order to make filing the tax return simpler. However, since 2003, they have started to receive a prefilled tax return where possible.

The aim of this paper is to analyze the Spanish experience with reducing tax compliance costs stemming from personal income tax and, more precisely, with introducing the prefilled tax return system. Nonetheless, this is done in a broader context as the prefilled system is, in fact, the natural consequence of an increasing use of new technologies. This was done first with the more traditional objective of detecting unreported income but later, with the aim of more modern tax administrations, helping and making simpler tax compliance. Before analyzing the administration of the personal income tax, I introduce very briefly the personal income tax in Spain.

THE PERSONAL INCOME TAX IN SPAIN

In Spain, income tax covers all sources of income obtained by natural persons who are normally resident on Spanish territory. Taxpayers must report all sources of income (from employment, from capital, and from business) and capital gains, as well as certain imputed income (mainly

from urban real estate other than the habitual residence). In addition, the regulations fix certain deductions and tax credits, which vary from one taxpayer to another.

The tax has traditionally worked under a self-assessment system: taxpayers must fill in a tax return, reporting all their taxable income, and calculating the tax liability. In practice, however, before submitting tax returns most revenue is already collected at source through a withholding tax, whose amount is credited against the tax liability of the return. Due to the withholding tax, not all taxpayers have to fill in a return; this is compulsory depending on the level and the sources of income.

Since 2007 an important feature of the tax system has been its duality. There are two tax bases, the general and the savings, which are taxed at different rates. Thus, while the general base is taxed according to a progressive schedule (with four brackets and marginal rates from 24 percent to 43 percent), the savings base is subject to a single tax rate (18 percent until 2009 and since 2010 19 percent on the first €6,000 and 21 percent on the rest). The general base mainly includes employment earnings, income from property rentals, and business income. The savings base principally includes interests, dividends, and other capital income, as well as capital gains. Therefore, the current income tax is similar to Nordic dual tax, although rents and business income in Spain are taxed within the general base.

Regarding compliance costs of the tax, there are two important issues to be considered. The Spanish Income Tax is a national tax, collected and regulated by the State. However, 50 percent of the revenue accrues to regions (autonomous communities), which also have the right to introduce certain legal changes. Indeed, they can change the regional tax rates of the general tax base and introduce new regional tax credits, under certain conditions, and, since 2010, regulate the general allowance¹. Therefore, the personal income tax plays an important role on the financing system of the autonomous communities. However, there is a single tax return and the tax is only administered by the national tax agency (in Spanish, *Agencia Estatal de la Administración Tributaria* or AEAT).

Taxpayers must assess two different tax liabilities, one for the state and one for the autonomous community, but both in the same tax return. This is automatically done by the AEAT computer program, as taxpayers must fill in their region of residence. In fact, after more than 10 years of the

taxes being decentralized, most taxpayers do not yet know that a substantial part of the total tax liability goes to the regional government (*Área de Sociología Tributaria*, 2008). Therefore, from the perspective of compliance costs, the decentralization of the tax has little impact for taxpayers.

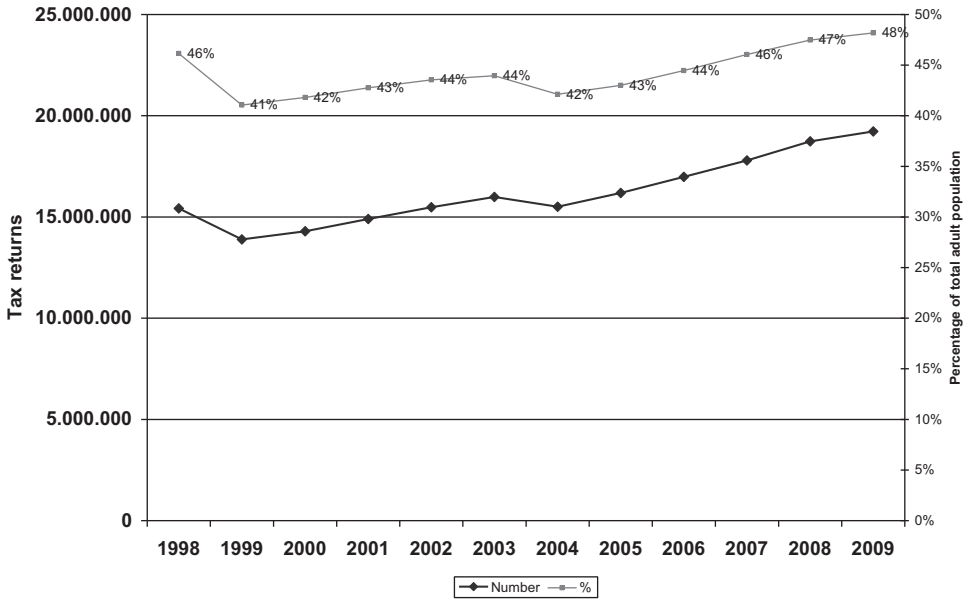
The tax has been substantially reformed over the last years. In fact, there were three major reforms in the last 10 years: in 1999, 2003, and 2007, that is, in each legislative period. It seems that each new government must apply its own income tax! Furthermore, between those years other minor changes have usually been introduced, apart from giving more legal power to the regions.

Changing the regulations very often may be important from a compliance perspective, as they introduce greater compliance costs (at least in the short run) and changes are not always coherent among themselves. For instance, the 1999 reform substantially reduced the number of taxpayers by increasing the threshold, improving the assessment of the withholding tax for employment income, as well as reducing substantially the number of tax credits. However, due to the decentralization of the tax, since 2002 autonomous communities have started introducing an increasing number of regional tax credits, which are not taken into account when calculating the withholding tax (in 2009 there were 120 regional tax credits, or on average eight tax credits per region²). Therefore, taxpayers eligible for regional tax credits may submit a tax return without being required to do so by national norms in order to benefit from the tax credit. Or, they may amend the prefilled tax return sent by the tax administration.

For the time being, only a small percentage of taxpayers can enjoy regional tax credits as they are very specifically tailored (Durán-Cabré, forthcoming). But the potential impact on the prefilled tax return system should be considered in the longer run. In conclusion, for the purpose of the paper, I consider the Spanish income tax as a single tax, since there is a single tax return and it is only administered by a national agency.

To conclude this brief explanation of the Spanish income tax, I show in figure 1 the total number of tax returns that increases over the period from 1998 to 2009. The number of returns as a percentage of adult population falls in 1999 due to the above mentioned tax reform but then increases steadily and, in 2009, reached 48 percent of the adult population. It is important to bear in mind that the

Figure 1: Tax Returns, Number and Percentage of Total Adult Population, 1998-2009



Note: population over 18 years. Navarra and Basque Country are not included.
 Source: AEAT, *Memoria de la Agencia Tributaria*, 2008, 2009, 2010; Instituto Nacional de Estadística, 2010; author’s calculation.

Spanish economy has grown over the period, which causes an increase in the number of taxpayers as a percentage of the population.

ADMINISTRATION OF THE PERSONAL INCOME TAX IN SPAIN

The Spanish tax agency came into being in 1992 and is responsible for the effective application of the tax system. The tax agency’s primary objective is “to encourage the voluntary compliance of citizens with their tax obligations” (AEAT, 2008, p. 8). To achieve this, it performs two types of action: on the one hand, the provision of information and assistance services to taxpayers; on the other, the detection and correction of tax defaults through control actions. In this paper, I consider only the first type, whose purpose is to minimize the indirect expenses associated with meeting tax obligations—the compliance costs. More particularly, I concentrate on the personal income tax, probably the most important tax of the tax system because of its large effect on different grounds: efficiency, equity, simplicity, and revenue.

With the aim of assisting taxpayers in complying with the personal income tax, the Spanish tax administration provides different help services that have changed over the last years. As a consequence of the technological developments (e.g., more powerful computer systems, the Internet, and other communication systems), the help services have been enhanced and widened: new services can be provided because of the new technological opportunities. To some extent, the introduction of the prefilled tax returns system can be considered as the natural result of an increasing use of the new technologies by the tax administration. A first step was designing a help computer program to file the income tax returns. The following step was the remittance by mail of tax data to taxpayers, the closest precedent of the prefilled system.

Help Computer Program—The PADRE Program

The Personal Income Tax Return Help Program (PADRE) is designed to help taxpayers file their income tax returns. The PADRE program was first introduced in the mid-1980s as a computer program for the tax administration offices. Taxpayers ask-

ing for the service had to go to the administration premises where the tax return was filed for them. Thus, the use of the program avoided arithmetical errors. In 1986, when the program was first made generally available to the public, it was employed by 211,563 taxpayers and, in 1987, by 289,814 taxpayers. This accounted for 2.7 percent and 3.6 percent of all returns.

In 1990, the computer program was made available on computer diskettes so taxpayers, and tax practitioners, could use the program in their own computers. The diskettes were sold along with official documents at very reasonable prices. The number of returns prepared with the PADRE program was 893,704 in 1990, or eight percent of all filed returns. As the use of personal computers spread, the number of returns prepared using the PADRE program soared. In the mid-1990s, the returns made with the PADRE program already accounted for about 50 percent of all returns filed. In 2009 (for the 2008 income tax), almost 99 percent of all returns filed were prepared with the computer program. As we later will see, the use of the computer program allows offering other important services with the aim of reducing tax compliance costs. Nowadays, the program can also be downloaded from the web site of the agency.

The Remittance Of Tax Data

Whenever a worker receives his salary, the employer must withhold a percentage of the earnings as an advance payment of the worker's income tax. The employer keeps the withheld money until it is paid to the tax administration, every month or every quarter depending on the size of the employer. Furthermore, once the year finishes, employers must fill in a report with detailed information on all withholdings. In particular, for each worker they have to report fiscal identification number, name and surnames, gross earnings, and withheld amount.

A similar process is followed for most sources of income: all income from employment, most income from capital and business, and certain capital gains. As a consequence, before taxpayers submit their income tax return, the administration already knows most of their earnings from the information provided by third parties. For that reason, in 1998 (for the 1997 income tax) the Spanish tax administration started to offer a new help service: the remittance of tax data to those taxpayers who asked for it. The service was used by 335,946

citizens, which accounted for only two percent of taxpayers. Five years later, in 2002, the total number of such documents sent was 2,601,416, or 17 percent of taxpayers.

According to the Spanish tax agency, the tax data service yielded excellent results in years past, "reaching all its taxpayer assistance goals and preventive objectives" (AEAT, 2004, p. 65). For that reason, the service has been strengthened heavily through advertising campaigns in the media. Furthermore, it has been well received by citizens, who quickly realized that the information provided was very convenient, since on a sole sheet of paper they could find almost all the relevant information for filing their tax return. In addition, the provided information was improved, including, for instance, income from property rentals subject to withholding, contributions to pension plans and funds, capital gains on the sales of investment funds, donations, and real estate information.

The tax data service is offered to all citizens but it is only provided on request. Taxpayers wishing to receive tax data have to ask for it, by telephone, Internet, or in person at the offices of the tax administration. The only information required to obtain the service is the fiscal identification number and the gross tax liability of the previous year's tax return. In order to ensure confidentiality, the information is sent by post mail to the fiscal address of taxpayers, regardless of who requests the service. Since 1999, the information can also be obtained from the website of the agency.

The remittance of tax data to taxpayers is a help service still provided by the Spanish tax agency but to some extent the service was integrated within a new service, the prefilled income tax return, which I turn to now.

Prefilled Tax Returns

With the aim of making compliance easier, the AEAT first introduced in 2003 a pilot program for the 2002 tax year: the "draft tax return," or in other words, the prefilled income tax return. The pilot program consisted of sending a letter to 1,500,000 taxpayers offering the opportunity of asking for the prefilled tax return. Therefore, participation in the pilot program was only by invitation and basically among wage-earners and pensioners, whose sources of income had been subject to a withholding tax. Selected taxpayers had to request the prefilled tax return, which otherwise was not sent. Along with the prefilled tax return, taxpay-

ers received the tax data employed to fill in the return.

The following year (2004, for the 2003 tax year) the program was extended to all taxpayers and was integrated with the sending of tax data. Taxpayers requested a single service, “tax data / prefilled tax return,” and the tax agency decides what it sends, depending on the sources of income taxpayers earn. Generally speaking, the tax administration mails the prefilled tax return when it has enough information about the taxpayer’s income to fill in the return. This is usually the case when the income is subject to withholding or additional information can be obtained from other sources. For instance, the imputed income from estates is available from the cadastral office. Otherwise, the tax administration does not have enough information to assess the tax base and, hence, cannot calculate the tax liability. If so, the tax agency sends the tax data in lieu of the prefilled tax return. Therefore, taxpayers always receive a useful answer to their request, either the prefilled return or the tax data.

To avoid legal problems, the Income Tax Act had to be modified and the prefilled tax return was introduced as another option offered to taxpayers to comply with their income tax obligations. Recall that self-assessment has been the traditional system for collecting the income tax in Spain. As a consequence, since 2004 taxpayers can ask to receive tax data or a prefilled tax return. The tax agency sends a prefilled tax return when possible; otherwise, tax data is mailed. When taxpayers receive the prefilled tax return and they agree with the proposal, they can confirm it and it will be considered their final tax return from a legal perspective. Confirmation can be given by telephone, through the Internet, SMS, or coming in person to the tax administration offices or collaborating entities (mainly banks and savings banks). If taxpayers do not agree with the prefilled return, they can either amend it or hand in a normal self-assessed tax return.

Therefore, the prefilled tax return or tax data are options that have been offered to Spanish taxpayers since 2004. It is voluntary, so citizens have to ask to receive it. The request can be made in the tax return of the previous year or later by telephone, the Internet, or in person. Nonetheless, from a legal perspective, not receiving the prefilled tax return or tax data, even when it has been requested, does not exempt one from the obligation of submitting a tax return.

When the tax administration cannot fill in the prefilled return, taxpayers receive their tax data, as happened before the new help service was introduced. However, another substantial improvement has been introduced since the 2003 tax year. Taxpayers, apart from receiving their data by mail, can view the data directly from the AEAT website or can even download it. Taxpayers receive a letter with a reference number that has to be introduced in the corresponding page of the AEAT website for access or to download the information. Tax data downloaded is automatically incorporated into the PADRE program, which undoubtedly makes it much easier and faster to file the income tax return.

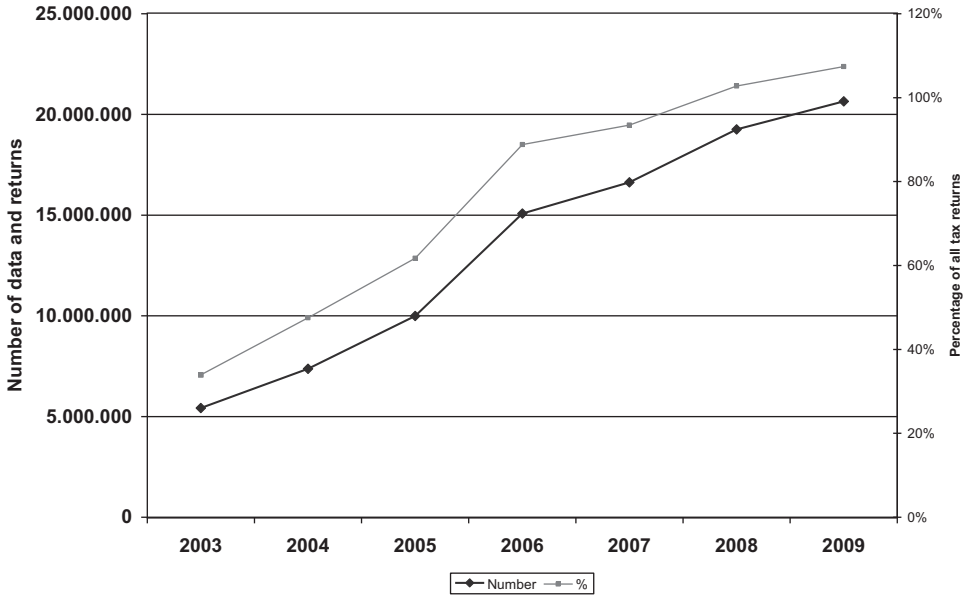
In 2003, when the pilot program for prefilled returns was first introduced, the total number of requests for tax data and prefilled tax returns fulfilled was 5,422,459 (figure 2, principal Y-axis), which accounts for 34 percent of taxpayers (secondary Y-axis). In 2004, when the program was broadened, the number of sendings reached 7,370,757, that is, 48 percent of taxpayers. In the following years, these numbers soared: in 2007, the last year for which definitive data are published, the tax agency sent the service required to 16,627,255 citizens, that is, 93 percent of taxpayers. The provisional information for 2008 and 2009 shows that the number of citizens requesting the service has increased again.

In 2003, the year of the pilot program, the number of prefilled tax returns was 547,431 (figure 3), that is, about three percent of all income tax returns (figure 4). In 2004, when the program was extended, the number was 4,362,853, which accounts for 28 percent of all returns. Subsequently, the total number of prefilled returns soars in 2009 with 13,872,788, that is, 72 percent of all tax returns.

To assess more accurately if the prefilled service is useful for taxpayers, it is also important to know the number of prefilled returns confirmed without emendation. This number has also increased greatly as figure 5 shows. In 2003, only 29 percent of prefilled returns were confirmed. Subsequently, the number of confirmations have increased steadily and, in 2009, accounted for 55 percent of all prefilled returns. Therefore, the quality of the service can be seen to have again improved.

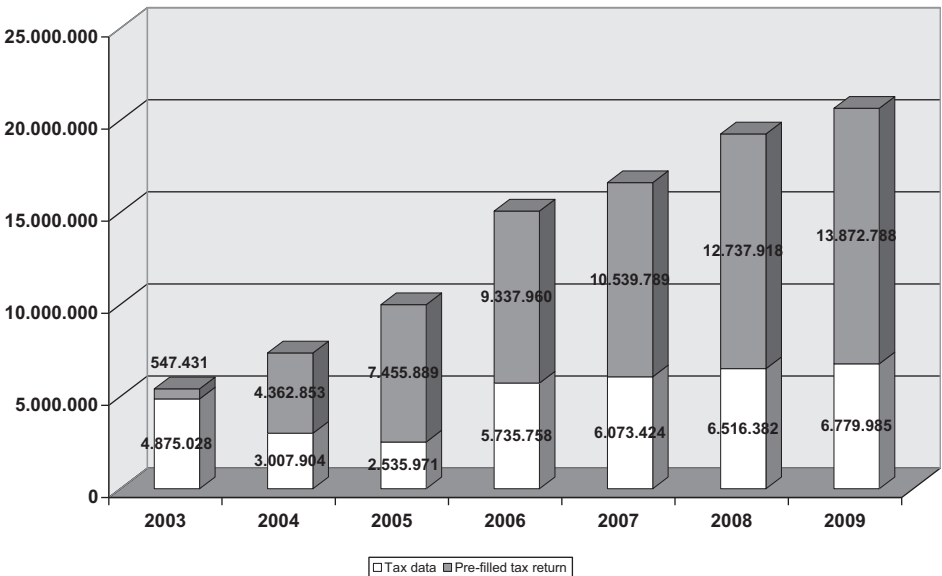
In conclusion, I think it is quite clear that the results of these help services, first the tax data and later the prefilled tax return, are very positive. They are used by the great bulk of taxpayers. Both services make complying with the tax

Figure 2: Tax Data and Prefilled Tax Returns, Number and Percentage of All Tax Returns, 2003-2009



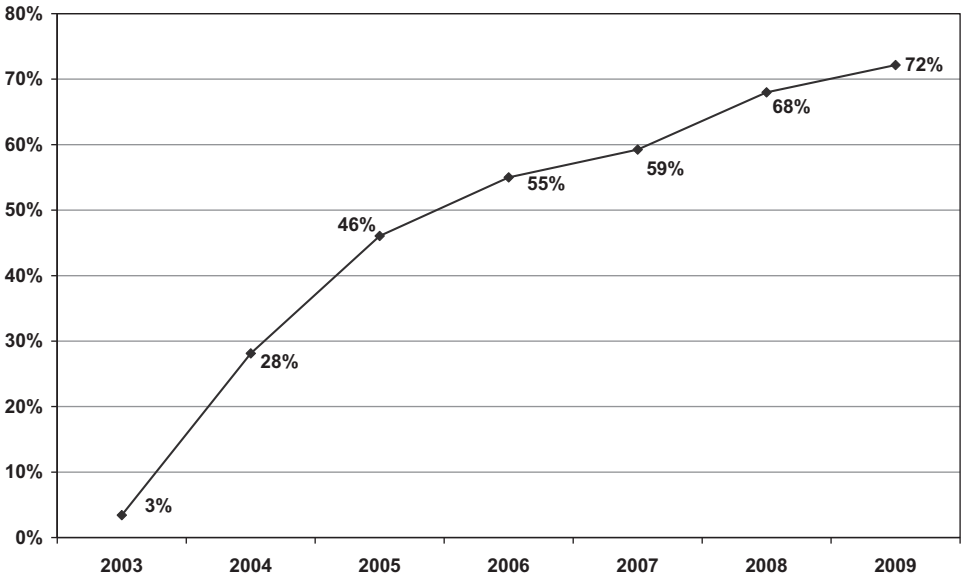
Source: AEAT, 2009; provisional data for 2008 and 2009

Figure 3: Tax Data and Prefilled Tax Returns Sent, 2003-2009



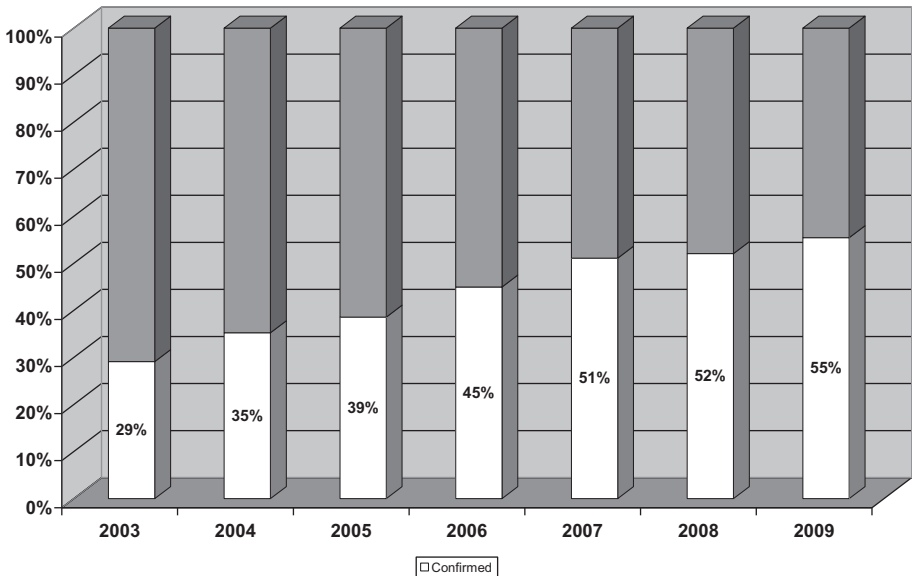
Source: AEAT, 2009

Figure 4: Number of Prefilled Tax Returns as a Percentage of All Returns, 2003-2009



Source: AEAT, 2009

Figure 5: Prefilled Tax Returns Confirmed, 2003-2009



Source: AEAT, 2009

more simple. The greater the experience with the prefilled return service, the greater the number of taxpayers requesting the service and confirming the return. Nonetheless, a prefilled tax return cannot be offered to all taxpayers as the tax agency does not always have enough information to assess the tax base and tax liability. This happens, for instance, with income from property rentals or from personal businesses, where the tax agency cannot know all sources of income or types of expenditures.

In other cases, the tax agency can prepare the prefilled return but it will not be confirmed because some information is missing. For instance, it may be difficult to know if a taxpayer can take advantage of a particular regional tax credit. It depends on the nature of the tax credits—for instance, for nursery expenditures, textbook expenditures, restoration and conservation of regional historical estates—because quite frequently very precise conditions must be met and it is very difficult for the tax administration to have information about them. Consequently, the powerful computing system allows obtaining data from many different sources, which simplifies tax compliance but, at other times, it is the proper regulation of the tax that causes complexity and little can be done by the tax administration to avoid this.

CONCLUSIONS

As far as the prefilled income tax return is concerned, the assessment of the Spanish experience is highly positive. In fact, this new help service can be considered as a two-stage process: first, through the remittance of tax data; and second, through the provision of prefilled tax returns, or only tax data if those are not possible. The increasing number of taxpayers requesting the services and the increasing number of confirmations of the prefilled return demonstrate that it works well. It would be very interesting to have more official information about the costs of the services but it seems quite clear that the overall result is positive.

Another important issue is that the new services are provided using third-party information reports, but this information was already available for the tax administration. Consequently, the prefilled tax return system does not imply increasing compliance costs for these third parties (e.g., employers). In other cases, the information was

already available to other bodies of the public administration and now is also available for the tax administration.

In conclusion, the new service is a clear example that third-party information can be extremely useful both for fighting against tax fraud and for simplifying tax compliance. The improvement and the assessment of the service should be a permanent goal of the tax administration.

Acknowledgments

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Notes

- ¹ See Ruiz Almendral and Vaillancourt (2006) or Durán-Cabré and Esteller-Moré (2006) for further information.
- ² See Durán-Cabré (forthcoming) for more detailed information about the regional tax credits.

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