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IMPROVING THE EFFECTIVENESS OF TAX COLLECTION: \$30 IN ADDITIONAL REVENUE FOR EVERY \$1 SPENT?

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An analysis of OECD countries' expenditure on tax-collection effectiveness suggests high returns on investment.

Improving tax-collection processes and cracking down on tax evasion are among the few ways governments can raise more revenue without prompting a vocal outcry from at least some parts of the electorate.

Fortunately, it is becoming easier for governments to pursue these objectives. The trend toward cashless, digital transactions, coupled with the emergence of powerful data and analytics tools (new algorithms, visualization technologies, and data-management approaches, for instance) is helping tax authorities significantly reduce revenue leakages.¹ At the same time, increasing automation of tax-collection tasks is helping governments reduce processing times, costs, errors, and fraud.

These developments are clearly visible in global statistics.

Estimated tax evasion between 2005 and 2015 declined in 34 of 44 countries analyzed in a study commissioned by the McKinsey Center for Government (MCG).² Across all 44 countries, there was an average decrease in estimated tax evasion of 0.1 percent of country GDP.³ During that same ten-year period, more than 50 percent of the 32 countries for which we also have cost data managed to reduce their overall expenditure on tax administration per capita by about 20 percent, on average, according to the Organisation for Economic Co-operation and Development (OECD) tax-administration database.

As highlighted in MCG's recent global benchmarking study, Denmark, the Netherlands, and the United Kingdom reduced their expenditure on tax administration by around 20 percent, 10 percent, and 30 percent, respectively, between 2005 and 2010. In the same period, the tax gap in the United Kingdom—the difference between actual tax collected and the theoretical

¹ Susan Cunningham, Jonathan Davis, and Tom Dohrmann, "The trillion-dollar prize: Plugging government revenue leaks with advanced analytics," January 2018, McKinsey.com.

² Tax evasion is estimated based on the size of the shadow economy. The shadow economy comprises activities that are not currently registered with or declared to tax authorities but are required by tax law to be registered or declared.

³ Friedrich Schneider, "Size and development of tax evasion for 44 mostly highly developed countries over the period 2000 to 2015," July 2017.

Governments can use digitization, automation, and advanced analytics to improve tax-collection processes, thwart tax evasion, and work more efficiently.

amount that should have been collected—dropped from 7.9 percent to 6.7 percent.⁴ Estimated tax evasion in Denmark and the Netherlands decreased by 0.5 percent and 0.3 percent of their GDPs, respectively.⁵ Common to all these jurisdictions was the increasing use of prefilled and third-party information in tax forms.

Even the countries in our benchmarking study that increased their expenditure on tax administration ended up with net gains: the increases were counterbalanced by significant reductions in estimated tax evasion. For every additional dollar these countries spent, they saw a gain, on average, of around \$30 in tax revenues, or \$45 billion in total (exhibit).⁶

Turkey provides a case in point. Overarching tax reform is still a work in progress for the country; in the meantime, it has sought to improve the effectiveness of its tax collection. Starting in 2004, Turkey reorganized its tax administration, simplified its tax code, introduced digital technologies, and implemented mandatory e-filing.⁷ Citizens' use of e-filing for income taxes rose from 30 percent in 2004 to 99 percent in 2009; in that same period, use of e-filing for corporate taxes increased from 72 percent to 99 percent, and use of e-filing for value-added taxes rose from 70 percent to 99 percent, according to OECD data.

Turkey's tax-collection upgrades resulted in improved accountability, transparency, and information cross-checking among agencies, among other benefits. The country experienced a reduction in estimated tax evasion of 1.1 percent of GDP from 2005 to 2010—which translated into approximately \$13 billion in tax revenue that otherwise would have been lost. Turkey achieved these gains with only a modest increase in funding: spending rose by just over \$230 million, or around \$2 per citizen. In the end, each additional dollar spent on tax collection yielded almost \$60 of additional tax that would otherwise have remained unpaid.

⁴ "Measuring tax gaps 2012," HM Revenue & Customs, October 2012, gov.uk.

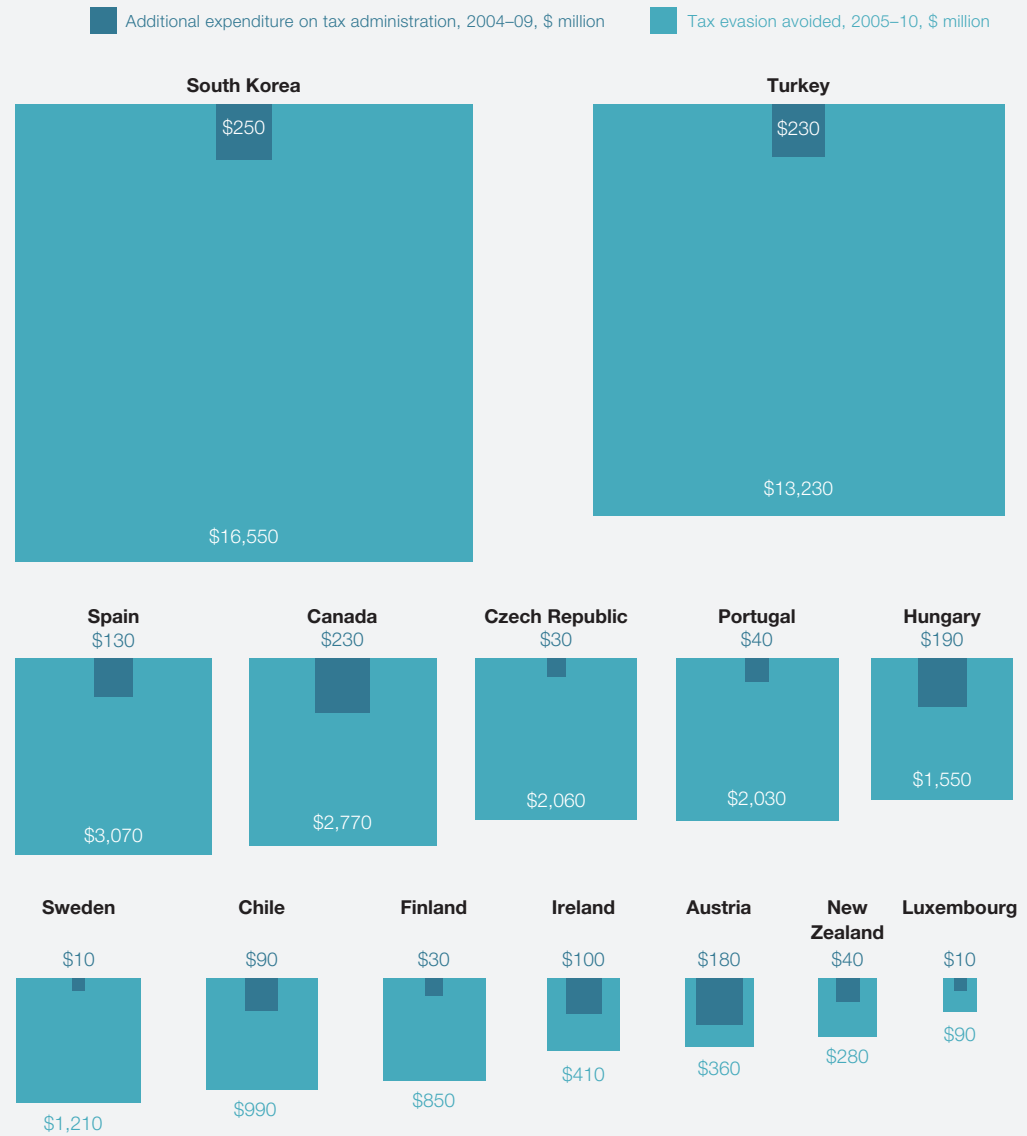
⁵ Andreas Bühn and Friedrich Schneider, "Size and development of tax evasion in 38 OECD countries: What do we (not) know?," CESifo working paper, CESifo Group Munich, series 4004, November 2012, cesifo-group.de.

⁶ To get these figures, we calculated what tax evasion would have been in 2010 had there been no improvement from 2005. We then compared this figure with the actual estimated tax evasion in 2010.

⁷ "Survey of trends and developments in the use of electronic services for taxpayer service delivery," Organisation for Economic Co-operation and Development, March 2010, oecd.org.

Exhibit

Increased spending on tax administration was easily offset by much larger reductions in tax evasion.



Note: This analysis includes only countries that increased their total expenditure on tax administration between 2005 and 2010. Figures are in 2010 dollars at purchasing-power parity and have been rounded.

Source: Bühn and Schneider, "Size and development of tax evasion in 38 OECD countries," CESifo Group Munich, November 2012; Organisation for Economic Co-operation and Development; World Bank; McKinsey Center for Government analysis

In their quest to capture uncollected revenue, most countries could benefit from reforming their tax systems. Such changes can be politically difficult to agree on and implement, of course. The good news is that even within existing tax systems, there are still powerful levers governments can pull—using digitization, automation, and advanced analytics to improve tax-collection processes and work more efficiently. ■

For detailed findings from the McKinsey Center for Government's productivity research, see ["The opportunity in government productivity,"](#) on [McKinsey.com](#)

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