Co-operative Compliance: A Framework

FROM ENHANCED RELATIONSHIP TO CO-OPERATIVE COMPLIANCE

OECD

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OECD
BETTER POLICIES FOR BETTER LIVES

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Foreword

Purpose

This report has been prepared to take stock of developments in the application of the concept of co-operative compliance and the changes that have taken place in the business and economic environment five years on from the publication of the Forum on Tax Administration study "Study into the Role of Tax Intermediaries". This report addresses past and current experiences and it is dedicated to evaluating the co-operative compliance approach and how revenue bodies assess its contribution to the delivery of compliance outcomes.

Background to the Forum on Tax Administration

The Forum on Tax Administration (FTA) was created by the Committee on Fiscal Affairs in July 2002. Since then the FTA has grown to become a unique forum on tax administration for the heads of revenue bodies and their teams. The work programme of the Forum is overseen by a Bureau comprised of commissioners.

In 2009 participating countries developed the FTA vision setting out that

"The FTA vision is to create a forum through which tax administrators can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world."

This vision is underpinned by the FTA's key aim which is to improve taxpayer services and tax compliance – by helping revenue bodies increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance.

The FTA is supported by a number of specialist sub-groups and networks, including the Large Business Network. Twenty six countries participate in the network (Australia, Austria, Brazil, Canada, Chile, Denmark, Finland, France, Hungary, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, People's Republic of China, Portugal, the Russian Federation, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States) and it contributed extensively to the preparation of this report.

Caveats

National revenue bodies face a varied environment within which to administer their taxation system. Jurisdictions differ in respect of their policy and legislative environment and their administrative practices and culture. As such, a standard approach to tax administration may be neither practical nor desirable in a particular instance.

The documents forming the OECD tax guidance series need to be interpreted with this in mind. Care should always be taken when considering a country's practices to fully appreciate the complex factors that have shaped a particular approach.

Inquiries and further information

Inquiries concerning this study should be directed to the International Co-operation and Tax Administration Division at the OECD Centre for Tax Policy and Administration.

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Abbreviations and acronyms

ACA - Annual Compliance Arrangement (Australia)

ADR - Alternative Dispute Resolution

ATO - Australian Tax Office

APA - Advance Pricing Agreement

BIAC - Business and Industry Advisory Committee

CAP - Compliance Assurance Process (United States)

CIAT - Inter American Center of Tax Administrations

COSO - Committee of Sponsoring Organisations of the Treadway Commission

CRA - Canada Revenue Agency

CRM - Compliance Risk Management (United Kingdom)

DOTAS - Disclosure of Tax Avoidance Schemes

DURS - Davčna Uprava Republike Slovenije (Tax Administration of the Republic of Slovenia

ER - Enhanced Relationship

ETRP - Enhanced Taxpayers Relationship Program (Singapore)

FTA - Forum on Tax Administration

HM - Horizontal Monitoring (the Netherlands)

HMRC - Her Majesty's Revenue and Customs (United Kingdom)

HRCP - High Risk Corporates Programme

IBFD - International Bureau of Fiscal Documentation

ICS - Internal Control Statement

IOTA - Inter-European Organisation of Tax Administrations

IRAS - Inland Revenue Authority of Singapore

IRS - Internal Revenue Service (United States)

LB - Large Business

LBN - Large Business Network

LTU - Large Taxpayers' Directorate (Hungary)

MAP - Mutual Agreement Procedure

MNE - Multi National Enterprises

MoU - Memorandum of Understanding

NAO - National Audit Office (United Kingdom)

NTCA - The Netherlands Tax and Customs Administration

OECD - Organisation for Economic Co-operation and Development

SARS - South African Revenue Service

SAO - Senior Accounting Officer (United Kingdom)

SME - Small and Medium Enterprises

SOX - Sarbanes-Oxley Legislation

TCF - Tax Control Framework

UK - United Kingdom

USA - United States of America

UTP - Uncertain tax position

Preface

This report is published at a time when tax compliance by large business is the subject of intense scrutiny. The OECD report *Addressing Base Erosion and Profit Shifting* calls on tax administrations to take immediate action to improve tax compliance.

There is a need to restore trust and confidence in the relationship between business and tax administrations. Drawing on the experiences of 24 countries, this report sets out how a co-operative compliance model can help to do that. Since the Forum on Tax Administration (FTA) first discussed the concept of the "enhanced relationship" in the 2008 Study, many more countries have developed approaches based on the principle that businesses that are prepared to be fully transparent can expect certainty about their tax position in return. This report distils these experiences into a model of co-operative compliance. This builds on the original thinking but spells out more clearly how the model delivers better compliance, effectiveness and efficiency. It examines more thoroughly what is required of business and how these programmes should be governed internally. The term "co-operative compliance" also makes it clearer that the underlying purpose of the model is to improve compliance.

I believe this report will serve as a valuable source of reference for tax administrations and a basis for future work for the FTA. I also believe it will help to restore confidence in our relationship with business.

I would like to thank the Large Business Network, the FTA Member Countries and the Business and Industry Advisory Committee who provided the study team with contributions and support.

Peter Veld
Commissioner of the Netherlands Tax and Customs Administration
Sponsoring Commissioner

Executive summary

In 2008 the Forum on Tax Administration published a *Study into the Role of Tax Intermediaries* (the 2008 Study) which encouraged revenue bodies to establish a relationship with large business taxpayers based on trust and co-operation; the so-called "enhanced relationship". This report is based on a detailed study of the practical experiences of countries that have developed co-operative compliance programmes and the views of the business community. The report thoroughly reviews and updates the FTA's thinking about the relationship between revenue bodies and large business taxpayers in the light of these findings.

Overall the report concludes that the value of the co-operative compliance approaches has been established and it is notable how many countries have developed a programme of this kind in the past five years. The main pillars of the relationship identified in the 2008 Study remain valid but subsequent experience has shown that some additional features are also of central importance. The report sets out a revised framework for co-operative compliance.

The report discusses why the original terminology of an "enhanced relationship" is no longer an entirely accurate description of the approach. The report adopts the term "co-operative compliance". This makes it clear that the approach is based on co-operation but with the purposes of assuring compliance, which is to say payment of the right amount of tax at the right time.

The report is based on a survey of 21 FTA members and consultations with the Business and Industry Advisory Committee (BIAC). The results of the survey and additional input provided by countries during the preparation of this report shows that since 2008, collaborative and trust based relationships have been widely established between large corporate taxpayers and revenue bodies; the report lists 24 countries and the numbers are growing. This survey revealed a wealth of experience gained by revenue bodies and that is reflected in the report. The importance of high level commitment and staff training in the implementation of cooperative compliance is clearly demonstrated. Co-operative compliance is fully integrated into the coherent compliance risk management strategies that more and more revenue bodies have adopted, and reflects an increasing focus on the need to understand and influence taxpayer compliance behaviour.

Since the 2008 Study was published some commentators have expressed concerns about the compatibility of the co-operative compliance approach and the principle that taxpayers are entitled to equal treatment before the law. The report addresses that concern directly and sets out why there is no conflict with this fundamental principle.

More recently, greater emphasis has been placed on the importance of compliance with the spirit as well as the letter of the law and this is reflected in the 2011 revision of the OECD Guidelines for Multinational Enterprises. Some concerns have been expressed about the definition of the spirit of the law and whether it affects the rights of taxpayers unduly. This issue is also addressed and the need for taxpayers to be able to take

a different view from the revenue body they are dealing with, even in the context of a co-operative relationship, is recognised.

The report also reflects the business community's experiences of the co-operative compliance approach, highlighting the importance of transparency and disclosure on the part of both parties in a framework of co-operative compliance to reduce uncertainties over companies' tax positions more effectively and efficiently. The importance of good corporate governance systems that support transparency and disclosure has emerged much more clearly over the past five years as an integral part of co-operative compliance. Tax is increasingly more important in the boardroom.

The newly emerged framework therefore not only consists of the seven pillars established in 2008, but also encompasses a systematic approach to tax risk as established in the tax control frameworks of MNEs. The report highlights the central importance of these frameworks in bringing rigour to the co-operative compliance concept, demonstrating that the relationship between the taxpayers concerned and revenue bodies is based on objective criteria and justified trust.

Good governance within the revenue body is also important, particularly in providing assurance to the wider community of stakeholders that the co-operative compliance approach is achieving its primary purpose, which is improved compliance. The report discusses this in some depth and describes a number of governance models and good practices.

As this new framework emerges, so does the question of how to demonstrate the value of co-operative compliance approaches. This report describes tools and experiences of determining costs and benefits for revenue bodies, indicators for measuring effectiveness and their practical application. The study also describes the evaluation of main benefits of co-operative compliance for both revenue bodies and businesses. Co-operative compliance is primarily aimed at ensuring that the correct tax is paid when it is due and consequently does not score well when measured against traditional measures of yield from compliance interventions. The report outlines an approach to the measurement of the success of these programmes that recognises that they provide objectively justified assurances about the reliability of the tax returns submitted by the taxpayers involved. The report also outlines how data about the remaining disputes that do arise could be used to inform more strategic thinking about the tax system.

The report concludes with some thoughts about the future direction of the co-operative compliance concept. It suggests that the concept of the tax control framework could be developed further and that further work on measures of effectiveness may be needed. It also looks forward to the emergence of more multilateral co-operative compliance relationships, involving an MNE and two, or more, revenue bodies.

Chapter 1

Introduction

The Enhanced Relationship concept: Origins, history and conceptual framework

In 2008 the FTA published the *Study into the Role of Tax Intermediaries*. [1] This 2008 Study addressed the topic of aggressive tax planning and analysed the tripartite relationship between revenue bodies, taxpayers and tax intermediaries. The report concluded that there was significant scope to influence the "demand side" of aggressive tax planning arrangements in relation to large corporate taxpayers. These taxpayers and revenue bodies were encouraged to engage in a relationship based on co-operation and trust. The 2008 Study spelt out how more co-operative relationships between taxpayers and revenue bodies could be established. The 2008 Study described a conceptual framework for these relationships, and coined an expression for them: "the enhanced relationship". It also recommended that revenue bodies should look to establish a tax environment in which trust and co-operation can develop so that enhanced relationships with large corporate taxpayers and tax advisers can be established.

The 2008 Study described the following pillars as the basis for enhanced relationships between large corporate taxpayers and revenue bodies:

- in dealings with taxpayers, revenue bodies demonstrating understanding based on commercial awareness, impartiality, proportionality, openness through disclosure and transparency, and responsiveness; and
- in dealings with revenue bodies, taxpayers providing disclosure and transparency.

Following the 2008 Study, the FTA has issued in depth studies about enhanced relationships with banks and with high net worth individuals.

Current context

Revenue bodies in many OECD countries have been set challenging cost reduction targets while being asked to maintain and preferably improve revenues, standards of service to taxpayers and the effectiveness of their compliance efforts.

The FTA has undertaken considerable comparative work in recent years to identify trends and developments in the administration of tax systems and their operational performance and improve collection strategies.[2]

In its recent "Working Smarter"[3] study the FTA identified many examples for working smarter in compliance. That study highlighted as key development the increasing tendency of revenue bodies to adopt co-operative approaches. These are characterised by an engagement with taxpayers or other stakeholders to explore shared interests, including the resolution of material tax risks, early certainty, a level playing field, and reduction of costs.

Project "The Enhanced relationship 5 years on"

The FTA met in Buenos Aires in January 2012 with global business leaders and representatives from the Business and Industry Advisory Committee (BIAC) to discuss how to take the relationship with large business further.

In its subsequent meeting the FTA Bureau discussed the fact that since its 2008 Study the number of FTA countries that have established programmes aimed at establishing an "Enhanced Relationship" with large corporate taxpayers has grown and countries with more mature programmes are taking stock of what has been achieved so far. The FTA Bureau therefore decided that five years on from the publication of the 2008 Study, the time was right to take stock of developments in the application of the concept and the changes that have taken place in the business and economic environment in the meantime.

This report deals with past and current experiences and analyses the enhanced relationship and its future development from different perspectives. An important part of the report is dedicated to the evaluation of the approach and how revenue bodies assess its contribution to the delivery of compliance outcomes. The final chapter of the report contains conclusions and recommendations for revenue bodies based on this analysis and also offers some thoughts about next steps.

From "Enhanced relationship" to "co-operative compliance"

When in 2008 the Study into the Role of Tax Intermediaries defined the collaborative, trust-based relationship based on the pillars listed above, the name "enhanced relationship" was chosen as a term that properly distinguished this approach from an obligation-based basic relationship. Since 2008, many revenue bodies have implemented compliance approaches which are based on the pillars established in the 2008 Study. While the pillars are still valid, major new issues have emerged as these approaches have matured and become more widespread since 2008. One of these is the development of compliance risk management strategies by revenue bodies that focus on effectively influencing and improving taxpayer compliance behaviour. The development of co-operative relationships with large businesses is now embedded in these strategies. In addition tax control frameworks have emerged as a key tool to disclosure and transparency. The term "enhanced relationship" has also raised questions about the nature of the approach and may have given rise to connotations of inequality in tax treatment. In short, large corporate taxpayers and revenue bodies, while they are satisfied that the principles on which the approach is based remain sound, are concerned that the name "enhanced relationship" has given rise to misunderstandings and in some cases suspicion that the concept violates important principles, such as equality before the law. This report addresses the substance of those concerns but the sponsoring commissioner also invited suggestions for a more appropriate name. He received many ideas, but the consensus was that the term "co-operative compliance" describes the concept most accurately as it not only describes the process of co-operation but also demonstrates its goal as part of the revenue body's compliance risk management strategy: compliance leading to payment of the right amount of tax at the right time.[4]

Chapter 2 describes the current state of play, and includes a stock take of country experiences, illustrative examples and common features of co-operative compliance approaches as well as interesting and significant differences.

Chapter 3 discusses four key issues concerning co-operative compliance: how co-operative compliance fits within the overall structure of compliance strategy, the issue of equality before the law, the issue of the spirit of law and dispute resolution in the context of co-operative compliance.

Chapter 4 addresses large corporate taxpayers' tax governance, describing both the principles deriving from the MNE guidelines as well as the practical application and assessment of internal tax control frameworks.

Chapter 5 looks at the internal governance structures of revenue bodies, describing models as well as essential principles concerning governance in revenue bodies.

Chapter 6 focuses on the evaluation, describing the business case for co-operative compliance approaches- and listing indicators for measuring effectiveness.

Chapter 7 contains conclusions and recommendations, including a summary of important lessons learnt, as well as (possible) next steps.

The annexes to this report contain some helpful background information:

- Annex A contains an overview of websites and links to public information about co-operative compliance
- Annex B is a summary of the report of the Netherlands Government Committee on Horizontal Monitoring
- Annex C consists of diagrams that illustrate features of the overall compliance environment that are likely to encourage an adversarial relationship between revenue bodies and large taxpayers and that would encourage a co-operative relationship: (*www.oecd.org/site/ctpfta/mindmaps.pdf*)
- Annex D is an extract from the "FTA Information Note: Tax Compliance and Tax Accounting Systems" to illustrate the coherence between the concepts of Internal Control and Tax Control
- Annex E provides some background Information on COSO
- Annex F is an overview of lessons learnt

Method

The study was carried out by a project team from and sponsored by the Netherlands Tax and Customs Administration and supported by the OECD Centre for Tax Policy and Tax Administration, working in close co-operation with the members of the FTA Large Business Network (LBN). The study was carried out as follows:

For the purposes of the study, a survey instrument was designed by the staff from the Netherlands and the OECD. A questionnaire was sent to all LBN members in May 2012. A total of 21 countries responded to the questions, providing a wealth of information about all aspects of co-operative compliance in the large business sector. An additional five countries provided descriptions of their approach to co-operative compliance while this report was being prepared.

In June 2012 a workshop of experts of the LBN was held in Paris. An important part of the meeting was dedicated to analysing countries' experience; representatives from BIAC and experts from many revenue bodies presented their experiences and contributed to an in depth discussion about all aspects of co-operative compliance. This workshop

resulted in the outline for the study and a clear view of the topics to be covered by the report.

The project team and Secretariat finalised the content of the report with the assistance of experts from the LBN and in the light of further input from BIAC and representatives of the international tax intermediary community. As sponsor, the Netherlands has also worked with CIAT and discussed the theme with business leaders at CIAT's Technical Conference 2012. The draft of the project report has been discussed with the Secretariats of CIAT and IOTA.

Notes

1. Hereafter referred to as the 2008 Study.
2. For example, see OECD (2013), *Tax Administration 2013: Comparative Information on OECD and Other Advanced and Emerging Economies*, OECD Publishing, (doi: *10.1787/9789264200814-en)* which contains a large array of descriptive information on administrative setups and quantitative data related to the costs and performance of revenue bodies in OECD and some non-OECD countries.
3. *"Working Smarter in Structuring the Administration, in Compliance and Through Legislation"* (OECD, 2012).
4. However, it is noteworthy that France announced the establishment of its own pilot programme in November 2012 and used the term "relation de confiance" to describe it: *www.gouvernement.fr/premier-ministre/pacte-national-pour-la-croissance-la-competitivite-et-l-emploi-un-nouveau-modele-fr*. This is a useful alternative to the term co-operative compliance but this report generally refers to "co-operative compliance" or "co-operative compliance approaches".

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doi: *10.1787/9789264200814-en*

Chapter 2

The current state of play

The key pillars of the 2008 Study

The 2008 Study identified seven pillars as central to the establishment of a more co-operative relationship between taxpayers and revenue bodies. These are understandings based on commercial awareness, impartiality, proportionality, openness through disclosure and transparency and responsiveness by revenue bodies and disclosure and transparency by taxpayers in their dealings with revenue bodies. Countries that have initiated co-operative compliance programmes have found these pillars to be valid and that it is particularly important that the revenue body demonstrates impartiality and responsiveness.

The 2008 Study explained why it is important that the revenue body has a good understanding of the commercial drivers behind the transactions and activities undertaken by large corporate taxpayers. Without that understanding, it is easy for revenue bodies to misunderstand the broader context of an activity or transaction and to respond in a way that results in avoidable and potentially costly disputes and uncertainty. Many countries have recognised the importance of this commercial awareness and have adopted different approaches for developing that awareness within their own revenue bodies. For example, the Irish Revenue's Large Cases Division is organised on a sectoral basis, which encourages the build-up of expertise and greater knowledge of the industry issues that drive certain tax behaviour. In Singapore regular engagements with taxpayers to achieve an in-depth understanding of their business operations and inherent tax risks is one of the objectives of the Enhanced Taxpayer Relationship Program (ETRP). Her Majesty's Revenue and Customs (HMRC) in the UK is committed to taking the business perspective into consideration in implementing policy decisions and designing systems and processes, through more consistent consultation. Staff have to be equipped with the range of skills, competencies and support needed to understand the perspective of large business and to deal confidently with complex commercial matters of relevance to large business in a rapidly changing environment.

The principle of *impartiality* recognises that revenue bodies are required to approach the task of issue resolution with a high level of consistency and objectivity. The importance of this aspect of the co-operative compliance model is generally recognised but it does raise some important further questions. For example how is equality before the law secured if only some taxpayers are party to a co-operative relationship with the revenue body? And how are disputes managed within a co-operative relationship?

The 2008 Study also discussed alternative dispute resolution techniques as a mechanism that can assist an 'impartial approach' to the resolution of disputes. This form of dispute resolution is generally aimed at encouraging a resolution of issues without having to resort to litigation. Reaching a mutually acceptable solution will usually provide a better basis upon which the parties can continue their relationship. But it can give rise to questions about the rigour of the settlement process. In the UK settled large

tax disputes have been the subject of external evaluation on behalf of the UK Parliament's Public Accounts Committee so that they could receive an assurance that the settlements were appropriate and that the arrangements are operating effectively[1]. The issue of governance of co-operative compliance arrangements is something we consider in more detail in Chapter 4.

Proportionality is all about the choices revenue bodies make in allocating resources, deciding which taxpayers, which tax returns and which tax issues to prioritise bearing in mind the overall revenue consequences. Risk management is an essential tool for revenue bodies that want to ensure an efficient allocation of resources.

In New Zealand a proportional approach is supported by the appointment of experienced commercially aware personnel as compliance managers. Co-operative compliance arrangements have a materiality clause whereby the New Zealand Inland Revenue will only raise material issues with the taxpayer. The meaning of material issues varies depending on size and nature of the taxpayer. Taxpayers are expected to have strong tax governance, but the Inland Revenue does work with taxpayers to collaboratively enhance their tax compliance systems.

Speaking at the June 2012 meeting of the LBN, a Global Head of Tax of a large MNE said that his aim was that there were "no surprises" with regard to tax. Fewer surprises should result from greater openness and responsiveness on the part of revenue bodies. Accounting standards generally require taxpayers to make provisions for uncertain tax positions that may give rise to additional liabilities. Clearly, the scale of these provisions will reflect the tax strategy adopted by the taxpayer but it will also be affected by the attitude of the revenue body. If the revenue body is reluctant to engage with taxpayers to resolve issues in a timely fashion and if tax disputes tend to be drawn out and difficult to resolve, this will tend to drive up the level of tax provisions that taxpayers carry on their balance sheet. On the other hand, where revenue bodies are ready to discuss the tax treatment of transactions in advance of the tax return being filed, or before the transaction is actually entered into and also operate a system of binding rulings, the levels of tax provisions will tend to be smaller.

Openness and responsiveness, coupled with real time working, create an interaction which should lead towards early certainty. In the Netherlands the resolution of pending tax issues is an important and indispensable step that should be taken when moving towards co-operative compliance. The resolution of pending tax issues clears the way for working in real time. The compliance agreement describes this as "Parties have found solutions for or agreed on issues relating to fiscal and other relevant matters from the past presently known to [X] and/or the Tax Administration in accordance with legislation and regulations, or have agreed on procedural arrangements.'[2] In Norway co-operative compliance has been started in a pilot in which openness and responsiveness are an important aspect of working under a strategy known as: "one step ahead". In Singapore the Enhanced Taxpayers Relationship Program provides a platform for large corporate taxpayers and the Inland Revenue Authority of Singapore (IRAS) to discuss significant current events which have tax impact so as to reduce downstream difficulties in assessments and objections.

The final pillar of co-operative compliance identified in the 2008 Study is disclosure and transparency by taxpayers. In practice this is one of the more challenging pillars to define with precision. Initially it proved difficult to formulate an objective standard of what to expect from a taxpayer in terms of disclosure and transparency. Mandatory disclosure rules are impartial but, like most rules, can be circumvented. Voluntary

disclosure rules can complement mandatory disclosure regimes, but raise different issues. They clearly require the taxpayer to agree to go beyond compliance with their statutory reporting obligations, but this is something that the 2008 Study explicitly anticipated. However, some commentators have been concerned about the subject matter of the disclosure and the view that has emerged since the 2008 Study was published that co-operative compliance should also entail a willingness to comply with the "spirit of the law". That specific concern is explored and discussed in more detail in part three of Chapter 3.

Since the 2008 Study was published, practical experience of co-operative compliance programmes has clarified the essential components of disclosure and transparency by taxpayers. These are firstly the existence of a tax control framework that is robust enough to give the revenue body assurance that the results disclosed in a tax return may be relied upon and that the taxpayer will know what tax positions it has taken that are uncertain or controversial and secondly, as we have just discussed, the willingness to disclose those positions voluntarily. For example, in Australia Annual Compliance Arrangements (ACA) are built on two key concepts: the large business having sound tax risk management processes and a willingness to operate in an open and transparent relationship by making full and true disclosure of major tax risks in a real time environment. In the Netherlands there is a principle of trust in dealings with large businesses but taxpayers have to demonstrate their readiness to be transparent. Accordingly, one of the commitments the taxpayer makes is to put in place a system of internal control, internal audit and external audit aimed at preparing and filing acceptable tax returns.

In the next part of this chapter we review the growing number of co-operative compliance models and we list a number of countries that have adopted a co-operative compliance strategy. Even where countries have not implemented a formal co-operative compliance model or a collaborative and trust based relationship, it is often the case that some form of process has been put in place to improve the relationship with large corporate taxpayers that follows many of the principles set out in the 2008 Study. In some cases they are explicit co-operative compliance models. For example, the Netherlands has developed a model known as "Horizontal Monitoring" (HM) and other countries have adopted explicit models too. We provide an overview of those models and look at two examples of these compliance strategies in greater depth, to illustrate their similarities, some of the differences, the expectations about the benefits, the challenges and the principle finding of review and evaluations. In this chapter input from the BIAC is also included.

The growing number of co-operative compliance models and their implementation

The 2008 Study drew specifically on the experiences of Ireland, the Netherlands and the USA.[3] At that time Australia,[4] South Africa and the UK had also incorporated a co-operative compliance model in their compliance risk management strategy.

Five years on from the publication of the 2008 Study, the number of countries that have established a collaborative and trust based relationship with their large corporate taxpayers and tax advisers has grown. The different approaches countries have adopted are discussed at greater length in part five of this chapter but, in general, it has not required new legislation. Where programmes have been formalised it is usually through the publication of explicit frameworks setting out how the arrangement works and individual agreements between taxpayers and revenue bodies.

In response to the survey sent out to the LBN members the following countries replied that they have developed and/or implemented a co-operative compliance model that align with the principles that were set out in the 2008 Study (see Annex A for an overview of websites and links to public information about co-operative compliance):

Table 2.1 Co-operative compliance models

Country	Co-operative compliance model
Australia	Formal co-operative compliance model as of 2001. The premium product in the current model is the Annual Compliance Arrangement (ACA), which sets out expectations regarding disclosure and service between the large business and the Commissioner.
Austria	Pilot project 'Horizontal Monitoring' with more than ten (big) businesses started in 2011 and will be evaluated continuously until 2014. External stakeholders (chamber of tax advisers, chamber of commerce and chamber of industries) are also involved in this project to develop this approach further.
Canada	In 2010, Canada launched a New Approach to Large Business Compliance that relies heavily on closer and more collaborative relationship with taxpayers and tax intermediaries and is the foundation upon which a co-operative compliance approach is being based.
Denmark	Formal co-operative compliance model as of 2012. Started as a pilot project in 2008.
Finland	A pilot project with six LBs started beginning of 2013 and will last two years.
France	Until recently, France had no formal co-operative compliance model. However, there were innovative compliance approaches and programmes in place to assist large taxpayers to meet their obligations and to comply with the tax rules. These were designed to offer a greater degree of responsiveness and openness. In November 2012, France announced the establishment of its own pilot "relation de confiance" programme, commencing in March 2013.
Germany	No formal co-operative compliance model. However Federal States (Länder) have taken a variety of measures with the aim to improve compliance. For instance, in 2012 Lower Saxony introduced a co-operative approach for large businesses in case of tax audits.
Hong Kong	No formal co-operative compliance model. Initiatives are undertaken to achieve some of the major objectives of a co-operative compliance model *e.g.* dialogue with tax and business community and a risk based approach.

Table 2.1 Co-operative compliance models *(cont.)*

Hungary	No formal co-operative compliance model. However, the recommendations of the 2008 Study have been taken into consideration in their Strategic Plan. As part of this plan the Large Taxpayers' Directorate (LTU) has been operating a client relationship management system with dedicated staff dealing with operational questions from large taxpayers. This ensures mutual co-operation at the tax directorate and the maintenance of flexible daily relations.
Ireland	Formal co-operative compliance model as of 2005 after a process of engagement and consultation with the various stakeholders, both internal and external.
Italy	No formal co-operative compliance model. However Italian Revenue Agency was reorganised in 2009 and a new Large business division was implemented. The 'Risk Management Monitoring' is a main feature of the reorganisation and it is a risk based approach driven by the specific features of the industry sector and by any available information concerning the specific taxpayer and potentially affecting its level of compliance. This ensures that investigations are focused on high risk taxpayers, avoiding or minimising intrusive enquiries for non high risk taxpayers. And it enhances the establishment of relationships based on co-operation and proportionality.
Japan	Formal co-operative compliance model for super-large corporations since 2010. When the Agency examines them, it also checks their corporate governance on tax. It plans a pilot project: if it could confirm proper tax processing of high risk transactions in corporations with good corporate governance on tax, it postpones the next examination of them.
Netherlands	Formal co-operative compliance model 'Horizontal Monitoring' (HM) started in 2005 with two pilot projects. Since then it has been integrated in the broader compliance risk management strategy. Essential elements of the steps taken towards a compliance agreement include Board to Board engagement and commitment ("tone at the top") and resolving legacy issues. The model was evaluated in 2012 by an independent Government Committee.
New Zealand	Formal co-operative compliance model. Started with a pilot project after a project team considered the 2008 Study and made recommendations about how to embrace the findings. A small group of taxpayers were invited to consider entering into the programme. The first agreement was signed in November 2010.
Norway	A pilot co-operative compliance project started in August 2011 and will last until December 31, 2013. The pilot includes six groups of companies in different branches. The pilot is based on the recommendations in the OECD 2008 Study. In addition to the pilot project, the Large Taxpayers Office in general is working based on dialogue, and most of the Large Companies have a Client Relationship Manager.
Portugal	No formal co-operative compliance model. However, in early 2012 a Large Business Unit was established with the aim to enhance the relationship with large business taxpayers.

Table 2.1. Co-operative compliance models *(cont.)*

Russia	A pilot project started late 2012. At the end of 2012 four major Russian large businesses have officially signed Co-operation agreement on "Horizontal Monitoring – Enhanced information exchange". The pilot aims to establish a new format of interaction between the tax authorities and companies based on transparency, trust and co-operation.
Singapore	Formal co-operative compliance model 'Enhanced Taxpayers Relationship Program' started in mid 2008 with a pilot project after consulting the Singapore International Chamber of Commerce, an industry association representing multi-national companies and locally-owned business enterprises, to engage and build relationships with the top large businesses.
Slovenia	Formal co-operative compliance model. Started in May 2010 with a public call for all large taxpayers to inform the Davčna Uprava Republike Slovenije (DURS, Tax Administration of the Republic of Slovenia) about their wish to participate in the pilot project.
South Africa	Formal co-operative compliance model 'Taxpayers Engagement Strategy' of 2004. This strategy includes the project "taking tax to the Boardroom", entering into a Banking Accord, sharing taxpayers risk rating and providing South African Revenue Service (SARS) perception of their compliance and influencing sectors of economy.
Spain	Formal co-operative compliance model: 'Code of Good Tax Practice'. Started in 2009 with the creation of the "Large Companies Forum". The Code of Good Tax Practice was finalised in July 2010.
Sweden	Formal co-operative compliance model. Started in 2006 with "the Dialogue". Companies could get answers in advance of filing returns in relation to certain tax issues. Formally launched in spring 2012 on a small scale by inviting 15 companies to become involved.
UK	In 2006 HMRC introduced a formal co-operative compliance approach for large corporate taxpayers, based on a customer relationship management model and using the 'Tax Compliance Risk Management' framework. In 2009 HMRC signed off its 'Large Business Strategy'.
USA	Compliance Assurance Process (CAP) started in 2005 as a pilot project and became permanent in 2012.

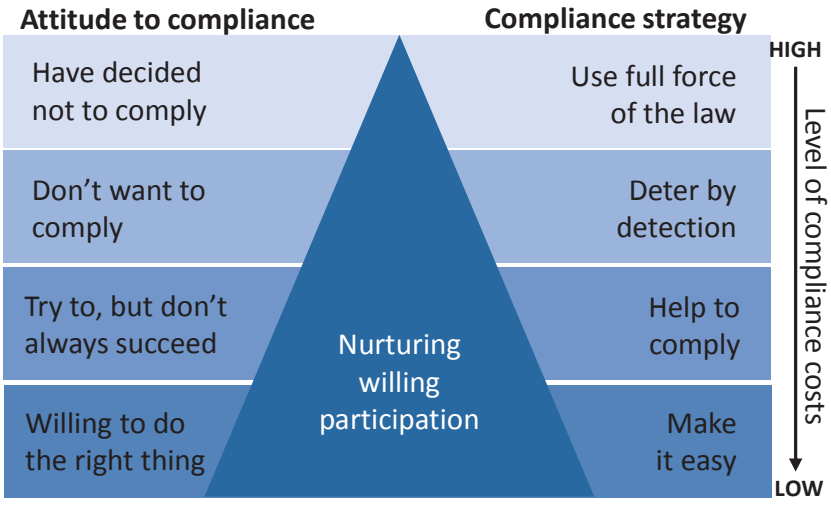
Illustrative examples of co-operative compliance models

Two examples, Australia and Singapore, are described here to illustrate in more detail how the principles have been translated into practice.

Australia

The Australia Taxation Office (ATO) compliance strategy is based on a compliance model that takes into account the factors that influence taxpayers' behaviour. The ATO aims to encourage taxpayers to adopt the attitude that they are "willing to do the right thing" resulting in a low level of compliance cost.

Figure 2.1 Compliance Model[1]

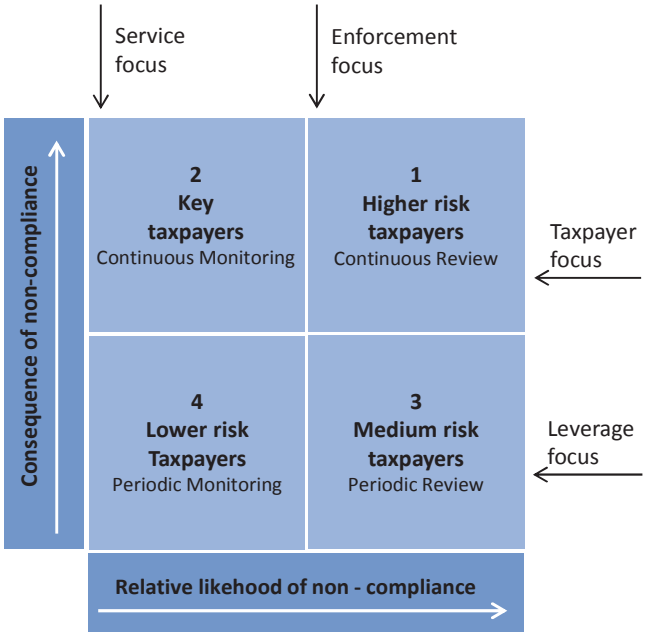


Source: Australian Taxation Office, Example of co-operative compliance model

1. www.ato.gov.au/Tax-professionals/Compliance-for-tax-professionals/In-detail/Compliance-program/Compliance-program-2011-12/?default=&page=5 , accessed in June 2013.

The ATO developed a Risk Differentiation Framework, to support the compliance model, which has a big impact on its compliance strategies.

Figure 2.2 Risk Differentiation Framework[1]



Source: Australian Taxation Office, Risk Differentiation Framework fact sheet

1. www.ato.gov.au/Business/Large-business/In-detail/Risk-Differentiation-Framework/Risk-differentiation-framework-fact-sheet/

The specific compliance strategy adopted is informed by the risk categorisation of the large business being examined. Part of the strategy is that the ATO's Commissioner directly informs the Board of all higher consequence taxpayers (the key taxpayers and the higher risk taxpayers) about their risk categorisation and the reasons why the ATO has adopted that view.

The ATO shifted its compliance strategy for large business from a strong focus on audit, particularly of the top 100 businesses, to a strategy of offering practical certainty to a large business by managing tax risks in real time and directing resources to cases which demand the most attention. For the largest companies in the tax system, the ATO developed an enhanced relationship approach. The premium product for the enhanced relationship for key taxpayers is an Annual Compliance Arrangement. This is a voluntary arrangement between the ATO and the large business covering one or more taxes. The Annual Compliance Arrangement is built on two key concepts: 1) the large business has a good tax governance process and 2) the willingness to operate in an open and transparent relationship by making full and true disclosure of major tax risk in a real time environment.

An Annual Compliance Arrangement provides the following benefits for the taxpayers:

- a speedier resolution of technical issues (in real time);
- administrative solutions to resolve compliance irritants;
- centralised points of contact and ongoing dialogue on technical matters;
- a closure of returns to further ATO review;
- concessional treatments of penalties and interest;
- a plan outlining agreed processes and timelines;
- the possibility of extension of thresholds for correcting GST mistakes for a GST ACA;
- not being subject to post-lodgement risk reviews or audits for periods and income years covered by an ACA;
- not needing to complete the Reportable Tax Position schedule for income years covered by an ACA;
- not being subject to a pre-lodgement compliance review.

The ACA's are tailored to the taxpayers' specific circumstances.

Singapore

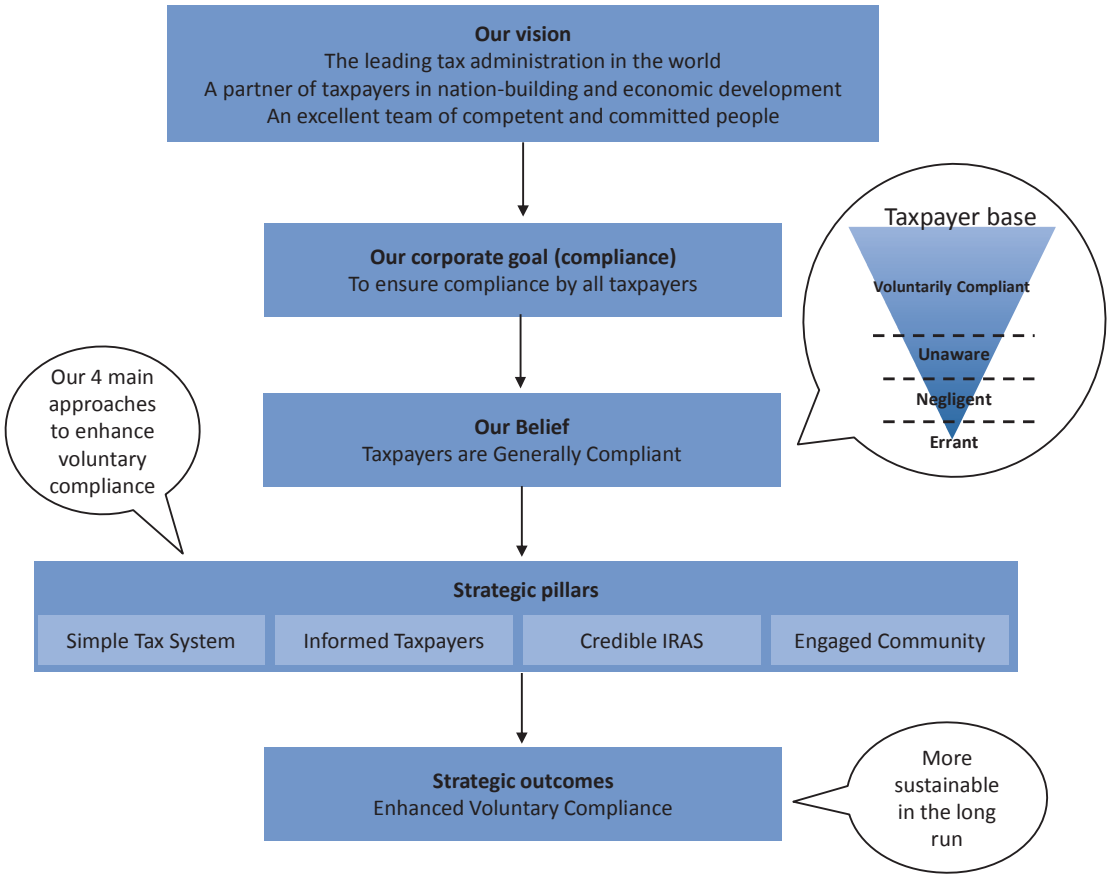
The Strategic Compliance Framework of the IRAS aims to maximise voluntary compliance through its four strategic pillars which are:

- having a simple tax system which makes it easier for taxpayers to comply and reduces scope for taxpayers to cheat the system;
- helping taxpayers to be informed of their tax obligations as those who know their tax obligations and how to comply, are likely able to get their tax matters right;

- building a credible IRAS by taking proactive actions to facilitate compliance and prompt and effective actions against non-compliance;
- creating an engaged community that believes taxpaying is necessary as this will support the revenue body's efforts in ensuring everyone pays a fair share of taxes.

The strategic compliance framework depicts how IRAS' focus on compliance is aligned with IRAS' vision and its corporate goal of ensuring compliance.

Figure 2.3 Strategic Compliance Framework

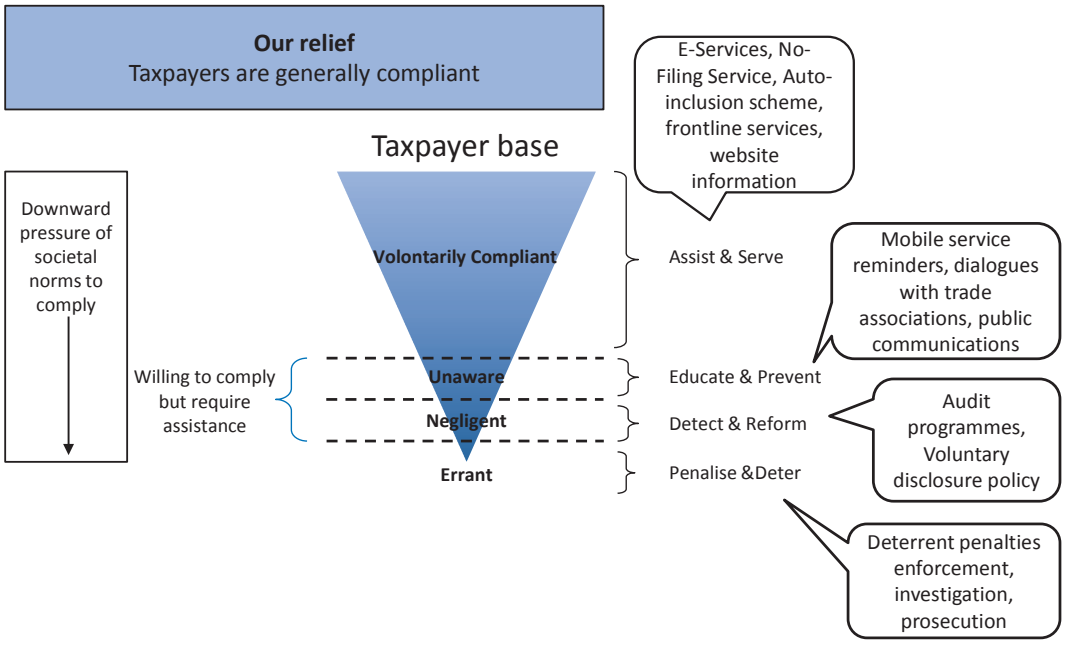


Source: Inland Revenue Authority of Singapore, www.iras.gov.sg/irasHome/page03a.aspx?id=7986

IRAS' compliance actions are anchored in the four strategic pillars and the sustainable outcome of the compliance actions is to enhance voluntary compliance. While IRAS aims to make it easy for taxpayers to comply IRAS will also take strong deterrent measures against taxpayers who do not fulfil their tax obligations.

IRAS adopts a risk-based approach in carrying out its compliance actions. It identifies and prioritises key areas of compliance risks and develops compliance programmes to address these risks. Taxpayers benefit from an enhanced understanding of the compliance risk issues and what IRAS is doing to address the issues. IRAS regularly shares its compliance focus for the year, outlining the areas of its audit focus for each major tax type as well as highlighting common mistakes made by taxpayers.

Figure 2.4 Inland Revenue Authority of Singapore - Customer Relationship Framework



Source: Inland Revenue Authority of Singapore, www.iras.gov.sg/irasHome/page03a.aspx?id=7992

It is also IRAS' belief that excellent service will facilitate voluntary compliance. While taxpayers do not have a choice about paying taxes, IRAS believes that it has a choice in making their experience as easy and pleasant as possible. The Customer Relationship Framework is an important feature in the service strategy of the IRAS as it is a holistic framework that guides IRAS staff in their approach to manage taxpayer relationships with the objective of facilitating tax compliance. IRAS adapts its service approach depending on the taxpayer segment.

In 2008, IRAS started a pilot programme, Enhanced Taxpayers Relationship Program (ETRP), for the top large corporate tax taxpayers with the objective of building a collaborative taxpayer relationship with its strategic taxpayers. These strategic taxpayers can be defined as a small number of large taxpayers that contribute a significant proportion of tax revenue. They generally have more complex business structures and operations which may inevitably lead to more tax issues. There is therefore a need for an increased understanding of the large taxpayers. As the ETRP engagement is premised on a collaborative approach, it enables taxpayers to better understand IRAS' requirements and for IRAS to gain insightful knowledge of their business operations. This helps to create a win-win situation of faster issue resolution, timely finalisation of tax matters and lower compliance costs for taxpayers. Presently, the ETRP is extended to companies by invitation from IRAS.

The (common) features of co-operative compliance models

The survey results show that co-operative compliance models have a number of common features. They are listed below.

Pillars

The principal characteristics set out in the 2008 Study remain valid and are still considered as essential to effective co-operative compliance strategies. Understanding based on commercial awareness and openness (disclosure and transparency) are specifically mentioned by some countries as the most important characteristics. Experience has shown that in many cases higher levels of transparency and disclosure on the part of the taxpayer can be achieved through such relationships than by enforcement alone. Nevertheless, such relationships still need to be underpinned by statutory obligations and safeguards that apply to all taxpayers**.** Co-operative compliance approaches can best be characterised as "Transparency in exchange for certainty".

Context: Compliance Risk Management Strategy

Changing from a "traditional" control approach to a co-operative compliance approach in many cases is the result of the development of a compliance risk management strategy. The rationale for relationships of this kind is to create a joint approach to improving tax risk management and overall tax compliance, with benefits for both parties. In response to the survey almost all countries responded that the co-operative compliance model with large corporate taxpayers is part of a 'wider (compliance) strategy'. The overall conclusion is that co-operative compliance models are firmly rooted in the overall (compliance) strategy of the revenue body. This is demonstrated by the examples from Australia and Singapore in Part 3 of this chapter. In Canada, building on the progress and experience gained as a result of their Audit Protocol initiative, the 'New Approach to Large Business Compliance' relies heavily on an enhanced relationship with taxpayers and intermediaries, and a more comprehensive risk assessment process. Italy implemented "risk management monitoring" in 2009 for managing large business taxpayers. In Slovenia the horizontal monitoring pilot project is a consequence of establishing the strategic business plan for the period 2012-13. After the publication of the 2008 Study, the South African Taxpayer Engagement Strategy increased the engagement with taxpayers, intermediaries, industry bodies and other stakeholders. The UK signed-off its Large Business Strategy in 2009, which is based on HMRC's customer-centric approach.

Several countries that do not have a formal co-operative compliance approach have nonetheless designed or created strategies which aim to enhance the relationship with large business taxpayers. The Hungarian Strategic Plan takes into consideration the recommendations of the 2008 Study and Portugal created the Large Taxpayers Unit with the aim of enhancing the relationship with these taxpayers. Countries which are in the pilot phase of co-operative compliance also mentioned how their pilots fit into a broader context (moves towards contemporary support and supervision, an increasingly complex environment, globalisation, competiveness and the pressure to achieve cost reductions).

As the development of compliance risk management strategies provides important context for co-operative compliance models, these strategies are described more fully in part one of Chapter 3.

Implementation

When designing and implementing co-operative compliance models, countries have to address a number of key issues and challenges. For example, how should the group for which co-operative compliance is appropriate be defined? Legal issues need to be considered, such as the rules governing disclosure and confidentiality, and the ability to offer taxpayers certainty in advance of filing, or even earlier, within the framework of a co-operative compliance relationship. In addition to these legal issues, countries also need to consider the resources needed to support a co-operative compliance model, both in terms of quantity but more particularly capability. In effect, implementing a co-operative compliance strategy entails a change programme.

Most countries that have implemented a co-operative compliance model recognise the importance of a high level of engagement between their staff and the taxpayer. For example in the Netherlands and in Australia, Board to Board contacts ensure commitment to implementation and ongoing development of co-operative compliance. Most countries also find that implementation of a co-operative compliance model requires change in culture and behaviour. This includes a greater emphasis on so-called soft skills that need to complement high levels of technical expertise. Understanding the resource implications and the expected benefits are critical to building the business case for the model.

Most countries started their co-operative compliance programmes with a pilot. The advantage of a pilot programme is that it allows changes to the original approach to be incorporated quite easily and these changes help to improve the co-operative compliance model.

Generally, engagement and consultation with various stakeholders is considered to be a vital part of the development and implementation of co-operative compliance programmes. A few revenue bodies mention developing forms of guidance about co-operative compliance programmes in conjunction with business and their representatives.

Corporate Governance

Since the 2008 Study was published, the importance of good corporate governance systems that support the necessary disclosure and transparency has emerged much more clearly as an integral part of the co-operative compliance concept. The existence of visible and reliable systems of tax governance provides more assurance that the taxpayer is able and willing to meet the required standard of disclosure and transparency. In this respect a (tax) risk management control system or Tax Control Framework (TCF) is an important tool. Given the importance that is now attached to this element of the co-operative compliance model, the topic of governance and tax control frameworks is explored more fully in Chapter 4.

Interesting and significant differences

The survey results demonstrate that revenue bodies have made some different choices in implementing co-operative compliance models. This part describes the most significant differences.

Is the co-operative compliance approach established in regulation?

All co-operative compliance approaches operate within the boundaries of law and regulations but countries formalising the approach have mostly not needed to change existing laws and regulations. Instead, the majority of countries formalise the co-operative compliance in some kind of agreement with taxpayers. For example Australia formalises its approach in an Annual Compliance Arrangement (ACA). In Austria the 'declaration of intention' describes the facts concerning taxes, the legal opinion of the fiscal effect, the obligation to commit according to the described facts and the development and implementation of a Tax Control Framework (TCF). South Africa entrenches their approach in a value proposition to corporate taxpayers. The UK published a clear and detailed framework setting out how the revenue body will assess companies' tax governance, delivery and strategy and the sort of treatment they can expect if they adopt a 'low risk' approach. This framework takes place within the normal statutory framework of HMRC's enforcement powers and of companies' rights and obligations. For banks the UK also introduced a voluntary 'Code of Practice on Taxation'[5]. In the Netherlands taxpayers sign an individual compliance agreement with the revenue body in which the principles of Horizontal Monitoring and the process/way of working are laid down. Co-operative compliance agreements in New Zealand do not have a legal stature and they are non-binding. In Spain the co-operative compliance approach has been laid down in The Code of Good Tax Practice, which was approved by the Large Companies Forum in July 2010. This Forum was created in July 2009 and consists of the Spanish Tax Agency and 27 very large companies working in 15 different economic sectors. This is a kind of Memorandum of Understanding and it is voluntary and open to all businesses (not only to the 27 companies included in the Forum). If accepted and signed by the Board of Directors of a company, some rights and obligations result for both parties (the revenue body and the company) according to the text of the Code.

A few countries mentioned that their co-operative compliance model does not require a formal agreement when entering into a co-operative compliance approach *e.g.* Ireland. However, in Ireland a co-operative compliance document has been published, which outlines the benefits of co-operative compliance to both Revenue and business and outlines how it will work in practice.

Are co-operative compliance approaches open to all taxpayer segments?

In most countries the co-operative compliance approach is offered to a specific class of taxpayers, generally defined by a set of objective criteria, such as size and complexity. As explained earlier, the Australian Annual Compliance Arrangement is focused on their key taxpayers. The Austrian pilot project is only open to businesses with a supervisory body and with a turnover of more than approximately EUR 9 million. Canada is currently contemplating a co-operative compliance arrangement that would be applicable to the entire population of the largest business entities (over 25 000 corporate taxpayers, clustered into just under 1 200 Large Business Entities (LBEs) with annual revenues in excess of CAN 250 million). The co-operative compliance arrangement initiative will be first piloted with some of the largest and most complex entities. Ireland states that only large businesses that are dealt with Revenue's Large Cases Division are asked to enter into a co-operative compliance arrangement. The Italian risk management monitoring covers all taxpayers that qualify as a large business taxpayer, as defined by a legal provision, being those with a total turnover or revenues exceeding EUR 100 million (approximately 3 000 large business taxpayers). Similarly, Sweden's co-operative

compliance programme applies to all large company groups. A large company is defined as those being managed by the Swedish Special Large Taxpayers Region. That means that they either belong to one of the 350 largest groups in Sweden or have an annual payment of salaries exceeding SEK 50 million (approx. EUR 5.8 million). The Netherlands appears to be the only country that has designed and implemented a formal co-operative compliance approach for all companies: large businesses and SME's. However, revenue bodies are increasingly looking for ways to apply the principles of co-operative compliance to SMEs, recognising the very different characteristic of this customer segment. The strategies revenue bodies have developed to engage with and involve SME taxpayers are more fully explored in the separate report on this subject that the FTA has published alongside this report.[6]

Is entry into the co-operative compliance programme upon application or invitation?

Taxpayers in most countries with a co-operative compliance model can apply to enter into this programme. This is not the case in Singapore where large corporate taxpayers have to be invited by IRAS to join the ETR programme. In New Zealand the pilot co-operative compliance programme was established by inviting a small group of taxpayers to enter into co-operative compliance agreements. Similarly, the Norwegian pilot project is based on invitation.

Voluntary application seems to be general practice. The Australian Annual Compliance Arrangements can be entered into voluntarily. In the UK it is up to the corporate taxpayer to decide on the nature of the relationship they wish to have with the HMRC and whether they seek the benefits of a more open and trusting relationship. In Denmark, Ireland and the Netherlands large taxpayers can apply to enter into the programme.

Because co-operative compliance is a significant change and challenge for the Swedish organisation and staff, Sweden does not have the capacity to include all large company groups immediately in its co-operative compliance programme. Instead, Sweden is managing this by inviting companies to introductory meetings about co-operative compliance. Extending co-operative compliance to all large companies in Sweden will take two or more years but the process is based on objective criteria and consequently respects the principle of equal treatment.

Mandatory application seems to be the exception, although Italy's 'risk management monitoring' programme is mandatory for the relevant business taxpayers.

What are conditions for acceptance into the programme?

Some countries explicitly exclude high risk taxpayers from entering into co-operative compliance arrangements. The Australian ACA is most suited to those large businesses classified as 'key taxpayers'. Most of Australia's largest businesses fall into this category. Higher risk groups that are viewed as being more likely to have an undisclosed contentious tax position are generally excluded. However, if a higher risk taxpayer wants to take active steps to reduce its risk profile, entering an ACA may be a way of achieving this, but it must be genuinely willing to engage and identify and disclose its material tax risks. In this respect the Risk Differentiation Framework (see also Part 2 of this chapter) is key to assessing tax risk for large businesses and determining the intensity of the revenue bodies' response in a coherent, consistent and considered way. It complements the compliance model which suggests an appropriate choice of remedy. The Italian 'risk

management monitoring' is a risk–based approach driven by the specific features of the industry sector and by any available information concerning the specific taxpayer and potentially affecting its level of compliance. In the UK all taxpayers must comply with statutory requirements to disclose details of avoidance schemes that they are selling to others or planning to use themselves in-house. By signing up to the voluntary 'Code of Practice on Taxation', banks also make a formal commitment to comply with both the letter and the spirit of tax law, including specific commitments on governance. In the US taxpayers voluntarily apply and are accepted into CAP based on criteria that include high expectations of transparent and co-operative interactions. In the Netherlands it is important that issues from past years have to be resolved. Other conditions have to be met too, for instance about the level of a business' control of its tax processes, before a compliance agreement can be signed.

Is disclosure mandatory or voluntary?

Disclosure and transparency by taxpayers is one of the pillars identified in the 2008 Study. This pillar does not stand on its own. The OECD Report "Tackling Aggressive Tax Planning through Improved Transparency and Disclosure"[7] stresses the importance of disclosure: "A system which starts with the upfront disclosure of such information not only allows for quicker dispute resolution and improved legal certainty, but also holds the potential for significant reduction in costs through better allocation of resources for both governments and taxpayers."

Early disclosure of tax risks is an important part of co-operative compliance programmes; it contributes to swift resolution of issues, early certainty and real time working. These are the elements which are also of importance in the Netherlands, where no mandatory disclosure rules are in place. Austria does also not have mandatory disclosure rule in place either, but businesses will be excluded from the programme if they do not provide all relevant information such as access to the accounting system, strategic papers relating to planned or realised changes in the organisation, internal reporting, transfer pricing documentation and agreements with foreign fiscal authorities. This makes the disclosure of information in principle mandatory.

Several countries have enacted disclosure rules with the main or only purpose that certain tax shelter or tax avoidance schemes will be disclosed to the revenue body in advance of the tax return filing process. These generally apply to taxpayers whether or not they are part of a co-operative compliance programmes. Mandatory disclosure rules are currently in place in a number of countries including, Canada, the United Kingdom and the United States. Ireland has also recently adopted legislation requiring mandatory disclosure of certain transactions. In 2012 Australia established a pilot for the introduction of the obligation to disclose reportable tax position; this obligation does not apply to taxpayers in an ACA.

Does Multilateral Co-operative Compliance work?

Looking at the growing number of countries that have adopted a co-operative compliance strategy it seems reasonable to ask whether multilateral co-operative compliance would work. Multilateral co-operative compliance refers to an arrangement between a taxpayer and two or more revenue bodies in which all parties agree to apply the principles of co-operative compliance to the management of the tax issues that are of common interest to all parties. The objective of a cross border co-operative compliance

relationship is to achieve practical certainty and to reduce the compliance burdens associated with international dealings.

Based on the analyses of the survey responses, a multilateral co-operative compliance approach is viewed positively in principle in an environment of trust between the parties, with a common understanding of the factual position resulting in a closer reflection of the reality of the operations of the large business.

However, based on the survey it would seem that at the moment the Netherlands and the UK are the only countries who have jointly and explicitly established a co-operative compliance relationship with a large business covering a variety of different various legal/fiscal questions, as distinct from multilateral Advanced Pricing Agreements (APAs) which are only concerned with transfer pricing. Their collaboration has resulted in rapid information sharing, quick resolution of issues and the prevention of unnecessary and prolonged disputes. Although their experience is positive, there is too little experience, for the time being, to permit the drawing of any more general conclusions.

In this respect it is worth mentioning the FTA Joint Audit Report which concludes that "a joint approach of tax administrations can contribute to the development of enhanced relationships with businesses in an international context, and accelerate certainty for revenue bodies and taxpayers. These relationships will contribute to identifying the opportunities for the use of a joint audit approach."[8] In their responses to the survey a few countries mentioned that they have (limited) experience with early MAP cases and/or joint audits and rather more of bilateral advance pricing agreements (APA). Perhaps these actions and contact will grow in the future towards multilateral co-operative compliance.

Expectations about benefits

The survey results demonstrate that revenue bodies implement co-operative compliance models as part of their compliance risk management strategy to achieve improved taxpayer compliance behaviour. Co-operative compliance models are intended to deliver the following main benefits for revenue bodies:

a. An enhanced relationship: a relationship with business based on justified trust, mutual understanding, openness and transparency, behavioural change in terms of the nature and scale of the tax avoidance/planning undertaken.

b. Understanding the business: increased commercial awareness of tax officials, a professional and helpful approach, regular updates on current significant events affecting the taxpayer, the ability to predict with reasonable confidence what the position of a business will be in relation to tax issues; business insights to inform the debate on the tax code and on its administration.

c. Risk management: being able to address emerging risks sooner, improved risk assessing of a group and direct access to the senior board-level managers as well as tax managers within those groups who influence decisions that impact on tax risk and a more vigorous approach towards non-compliance through audit and enforcement resources.

d. Certainty in advance: working in real time, delivers faster resolution of issues, avoids lengthy correspondence and unnecessary litigation and provides greater certainty in relation to forecasting tax yield.

e. Reduction of administrative burdens; more compliance, accurate and timely filing of tax returns and timely payments, reduced administrative costs and an overall increase in the amount of tax paid on time without dispute.

f. Improved real time information about commercial developments that may be of great value to policy makers.

g. Better use of revenue body resources and practically better allocation of scarce skilled resources to higher risks.

h. Improved confidence in tax system and revenue bodies' and businesses' fair play.

The main benefits of co-operative compliance models for businesses are expected to be:

a. An enhanced relationship: a relationship with the revenue body based on justified trust, mutual understanding, openness and transparency, resulting in reduced uncertainties over tax positions.

b. Reputation: meeting public's expectations of legitimacy and fairness

c. Risk management: ability to better manage tax risks through co-operative compliance agreements with revenue bodies, the ability to predict with reasonable confidence what the revenue body's position will be in relation to tax issues; a better understanding of revenue body's approach and philosophy; an approach by the revenue body based on a better understanding of the business and a recognition of the distinction between business-driven and tax-driven decisions.

d. The opportunity to highlight problems with the tax code or its administration.

e. Certainty in advance: working in real time, decreases uncertainty about tax exposure, secures faster resolution of issues and reduces the need for lengthy correspondence and litigation.

f. Reduction of administrative burdens: reduced compliance costs; less audit intrusion from the revenue body since the audit and enforcement focus will be biased towards those not committed to high compliance standards.

Challenges

The survey results demonstrate that implementation of co-operative compliance programmes comes with challenges. Both revenue bodies and businesses need to address the following challenges:

a. Communicating about the impact of the programme on taxpayers. Taxpayers who enter into a co-operative compliance programme might have the impression that this will lead to increased audit attention from revenue bodies while some taxpayers may fear that they will receive less attention and support through being given 'low risk' status, as revenue body resources are diverted towards highest risk taxpayers.

b. Addressing cultural issues: co-operative compliance programmes require changes in culture and behaviour both for revenue bodies and for business. Work processes and attitudes need to change from working on past tax years to real time, taking a preventive approach with a problem solving attitude. These need to be addressed and when and where necessary training needs to be provided to staff.

c. Maintaining the level of contact required to successfully establish a relationship, creating an environment of openness and trust. This requires commitment from both sides both in time and resources, particularly in the initial stages. While over time the model should reduce the costs of compliance for both taxpayers and revenue bodies, making the initial commitment at a time of staff cutbacks for the revenue body and economic difficulties for businesses can be difficult. When the programme is running, continuous attention needs to be given to proper time management. Internal governance and the risk of attachment is further discussed in Chapter 5.

d. Tax control, which has emerged as a pivotal feature of co-operative compliance, needs constant attention. There is a need for maturity regarding tax control frameworks and both businesses and revenue bodies need to invest in high level expertise in this area. Chapter 4 delves deeper into this topic.

e. Establishing metrics to assess the delivery of the expected benefits. Traditional metrics are of limited value since most of these metrics are calculated by comparing a filed return with the amount of tax due after adjustment. This is because existing metrics are principally focused on measures of non-compliance, whether that is in terms of the yield from interventions that correct non-compliance, or broader measures of the "tax gap". Compliance strategies that aim to increase voluntary compliance are less likely to give rise to intervention yield, although they do generate additional revenue as uncertain tax positions are resolved. The size of the tax gap will reduce as voluntary compliance increases but this tends to be a lagging indicator. We consider the question of metrics in more detail in Chapter 6[9].

Principal findings of reviews or evaluations

Co-operative compliance models have been evaluated by many countries, including Austria, Denmark, the Netherlands, Singapore, South Africa, UK and USA. South Africa for example evaluates its co-operative compliance model periodically and Austria, in co-operation with the University of Vienna, will be evaluating their pilot continuously until 2014.

Singapore's IRAS conducted a survey in 2011 to gauge the effectiveness of the ETR programme. The survey comprised a set of questionnaire with ratings and open-ended questions posed to large taxpayers who are on the programme and internal staff involved in the programme. Seven out of nine taxpayer groups responded positively on the programme. Benefits of the programme cited by these taxpayers include 'single point of contact" and "consultative approach". More than 85% of the staff surveyed responded that the programme had been helpful in finalising tax assessments. About 70% of the outstanding tax issues were resolved by the end of the third year of ETR implementation.

Countries that evaluated their pilot projects include Denmark, Singapore and the Netherlands. So far each pilot has been followed by the (formal) adoption of a co-operative compliance model (see also Part 3 of this chapter). For example, in Denmark, their pilot involving 6 companies was evaluated in 2011 and followed by a programme under which 40 to 50 of the biggest companies were invited to enter into a formal co-operative compliance arrangement. Similarly, Singapore decided to formalise the Enhanced Relationship programme for large business taxpayers after a pilot run. In the Netherlands, participants of the pilot project were surveyed in 2007; the (positive)

outcome of the evaluation was sent to parliament. On 20 June 2012 an independent governmental Committee ("Committee") published an independent review of HM in the Netherlands. The key questions addressed are whether the revenue body has implemented HM in an efficient and effective manner and whether HM increases compliance. The evaluation also examines the measurement of success. The Committee analysed possible bottlenecks and vulnerabilities associated with HM and made proposals to further develop HM. The core conclusion of the evaluation is that the revenue body played a pioneering role with the implementation of HM. It recognised in good time that a paradigm shift in its supervision and compliance risk management strategy was necessary. The review recognises that there have been similar developments in other countries too, although the shift in approach has arguably been more radical in the Netherlands. The overall conclusion of the review is that the Committee endorses the concept of 'horizontal monitoring and considers that it deserves further development. The Committee also highlights various improvements in the implementation that it believes are desirable and necessary, especially with respect to the measurement of the effectiveness and efficiency of the programme. A summary of the review is listed in Annex B of this report.

Ireland carried out an informal evaluation of their co-operative compliance and a formal review will take place in 2013.

Australia has evaluated the effectiveness of their overall compliance programme for the large market taxpayers and that evaluation includes the contribution made by their co-operative compliance products, such as the Annual Compliance Arrangement. The ATO developed a compliance effectiveness framework and methodology to measure the impact of their compliance strategy. Co-operative engagement with large market taxpayers is a mechanism to obtain greater voluntary compliance and allows the ATO to allocate scarce resources to higher risks, address emerging risks sooner and provide practical certainty to taxpayers. Large businesses engaged in this way are better able to manage their tax risks. The overall cost of compliance is expected to be lower in these cases as the intensity of engaging with such business is in most cases less compared to higher risk taxpayers.

Different methods are being used for the evaluation process. For example, Singapore evaluated the ETR programme by gathering feedback from businesses and staff on the benefits and improvements needed for their programme. They also tracked the number of issues resolved since the start of ETR programme. Other evaluation methods include issuing survey questionnaires to the tax departments of large businesses and to the account teams of the revenue body, telephone interviews with Finance Directors or Heads of Tax of large businesses, feedback from independent functions, for example the SARS Service Monitoring Office in South Africa and/or an independent evaluation by an external party. The benefits that co-operative compliance programmes are expected to deliver to revenue bodies and business are outlined above. The criteria for the success of the programmes consequently need to look at the extent to which the benefits that are expected to accrue have been realised in practice. The challenge of making the business case for these programmes and then measuring their effectiveness is discussed at greater length in Chapter 6.

However, the measures of success are likely to be qualitative as well as quantitative in nature. The UK uses two annual surveys, carried out independently, to assess the effects of its approach from a taxpayer perspective. They cover customer service and the behavioural impacts of tax policy and tax administration amongst large businesses. In

Singapore a participant in the ETR programme provided the following feedback on the programme: "The Enhanced Taxpayer Relationship programme provides us with an effective avenue for communication with IRAS through the frank and open dialogue at the various meetings held during the year. The initiative has contributed to an improvement in voluntary compliance with Singapore's tax laws, speedier resolution of issues and agreement on tax assessments."

Notes

1. "Settling large tax disputes" report of the Comptroller and Auditor General of the National Audit Office,14 June 2012 *www.nao.org.uk/idoc.ashx?docId=90AECE38-AD39-4F5B-A0F5-DEE126E95D41&version=-1*

2. Individual compliance agreement: *http://download.belastingdienst.nl/belastingdienst/docs/individual_compliance_agreement_dv4091z1edeng.pdf*

3. Annex 8.1 of the Study.

4. Australia produced a booklet entitled "*Co-operative Compliance - working with large business in the new tax system*" in November 2000.

5. The code adopted by the UK and South Africa is discussed in more detail in the FTA report on the framework of such a code: *www.oecd.org/ctp/taxadministration/45989171.pdf*

6. OECD (2013), *Together for Better Outcomes: Engaging and Involving SME Taxpayers and Stakeholders*, OECD Publishing, Paris. doi: *10.1787/9789264200838-en*

7. The report was published in 2011 and outlines the importance of timely, targeted and comprehensive information to counter aggressive tax planning, provides an overview of disclosure initiatives introduced in certain OECD countries, discusses their experiences with the usefulness of such initiatives (for both taxpayers and tax administrations), and contains a number of conclusions and recommendations.

8. OECD (2010), *Joint Audit Report 2011*, Paris, p 26 *www.oecd.org/tax/administration/45988932.pdf*

9. While not a challenge as such, it may be regarded as paradoxical to suggest that co-operative compliance both increases the overall amount of tax collected and increases certainty and efficiency for taxpayers. The apparent tension between these two statements is therefore worth addressing. In many cases the process of establishing a co-operative relationship involves the settlement of open legacy issues and this can give rise to significant intervention yield in some instances. But longer-term, and more importantly, the establishment of that relationship creates much greater certainty that the returns being submitted can be relied upon and that reduces the risk of underpayment (or overpayment) of taxes. It also releases resources to focus on returns that are higher-risk because they are not supported by the same degree of disclosure and transparency. For the individual taxpayer, entering in to a co-operative

relationship also reduces uncertainty and the related need to make provisions for tax that may be payable, which increases the effective rate of taxation reported in the accounts. It also reduces the risk of taxes being overpaid.

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Chapter 3

Co-operative compliance: Key issues

In the period since the 2008 Study was published, four key issues or concerns about co-operative compliance have emerged. In this chapter we explore each of them in more detail.

Co-operative compliance and the wider compliance strategy

Introduction

The fundamental function of a revenue body is to collect the tax that is due in accordance with the law. Revenue bodies undertake this function in a world where citizens have high expectations of revenue bodies both in terms of service and efficiency. Revenue bodies must manage the tax implications of the steady growth in international trade, changes in employment patterns and demographics, international mobility of capital and labour, innovations in business structures and financial products, rapid changes in technology and information sharing techniques, and environmental and energy concerns. With a changing environment, it has therefore become more critical for revenue bodies to allocate available resources in a targeted and effective manner.

Compliance Risk Management is essential if this goal is to be achieved. The link between Compliance Risk Management and co-operative compliance has already been discussed in the context of the review of the current state of play. However, it is important to set out clearly the principles that underpin risk management and to explain exactly how co-operative compliance fits into the wider compliance strategy, and developments in the business environment that affect compliance. The European Commission's Compliance Risk Management Guide which was published in 2010 gives the following definition of Compliance Risk Management:

> *"It's a systematic process in which a revenue body makes substantiated choices on which interventions could be used to effectively stimulate compliance and prevent non-compliance, based on the knowledge of the behaviour of all taxpayers and related to the available capacity."*[1]

Revenue bodies can benefit from compliance risk management only if they distinguish areas that represent high risk from areas that represent low or negligible risk, and respond and influence them accordingly.

Compliance risk management strategies should also benefit the taxpayers who are willing and able to comply. For example, while taxpayers who demonstrate 'high-risk' characteristics can expect to attract greater scrutiny and enforcement attention, taxpayers who behave transparently and who do not have higher risk tax issues can reasonably expect support and lower compliance costs.

The Framework for Compliance Risk Management

The 2004 FTA guidance note "Managing and Improving Tax Compliance"[2] already emphasises the importance of modern risk management principles in managing tax compliance. The note defines tax compliance as the extent to which taxpayers comply with obligations in the four interconnected areas of registration, filing, reporting and payment. It offers a comprehensive framework for managing compliance risks based on modern risk management principles. In this context the note pointed to the importance of developing a better understanding of the drivers of taxpayer compliance behaviour in order to be better positioned to design and implement adequate responses to compliance risk.

Thinking in the FTA is consistent with the analysis of compliance strategy that has emerged in other international fora, *e.g.* the European Union. In more recent years Risk Management has significantly developed and evolved into a systematic process in which efficient and effective choices are made within a broad range of compliance tools. These tools include interventions that are designed to stimulate voluntary compliance and to prevent non-compliance, and that are responsive to the behaviour of taxpayers.

The 2010 FTA information note "Understanding and Influencing Taxpayers' Compliance Behaviour"[3] contributed to this end by identifying the most important drivers of individual taxpayers' compliance behaviour. These were grouped into five categories (economy, norms, deterrence, opportunity and fairness) and discussed on the basis of revenue body experience and academic literature. The note established that some drivers are less important predictors of compliance than assumed by standard economic models, and emphasised that the five categories of drivers should not be looked at in isolation, but rather be seen as factors that interact in complex ways to generate sometimes unpredictable outcomes.

The 2004 guidance note and the 2010 information note, have, along with other guidance and information notes published through the years provided a shared framework for discussion on compliance risk management.

Responding to these developments in understanding of compliance risk and the factors that drive taxpayer behaviour, revenue bodies have put in place operational strategies that strike a balance between traditional enforcement activities and more innovative treatments that offer more effective ways to arrive at high levels of compliance. A modern compliance strategy focuses on giving each taxpayer category the appropriate attention. Compliant behaviour requires a different response to non-compliant behaviour. Compliant behaviour requires support, while non-compliant behaviour may, depending on the cause, require severe action.

Compliance or non-compliance with tax rules is the outcome of an ongoing interaction between government, revenue bodies and taxpayers. Compliance management has to take these different factors into account. This implies that revenue bodies should not only focus on taxpayers but also on what revenue bodies do themselves and how they perform. That performance is itself a driver of taxpayer behaviour.

In the past revenue bodies used the command-and-control approach.[4]. Since the end of the last century revenue bodies have shifted the focus to risk management and take action only if there is a real risk to address. The approach could be summarised as co-operation if possible and enforcement if necessary. This is consistent with what academics have been saying since the beginning of 1990s[5] and it is also consistent with the theory of responsive regulation, which is central to the tax compliance strategy of

revenue bodies and which has been discussed in earlier FTA reports.[6] The introduction of the co-operative compliance approaches by revenue bodies fits into this new strategy. The crucial point of the compliance strategy is that compliant behaviour is rewarded and non-compliant behaviour is punished and co-operative compliance has to be seen in this overall context.

The development of co-operative compliance models also has to be viewed in the context of changes in the business environment and the imposition of higher standards of transparency: changes that have been reflected in rules affecting transparency in tax matters. Countries have and are introducing legislation and standards that require large businesses to provide greater transparency in their financial reporting. Notably the Sarbanes-Oxley legislation ('SOX')[7] in the United States of America established new standards for all USA public company boards, management and public accounting firms.

The importance of transparency in tax matters is highlighted by the fact that in the first year of SOX the tax function accounted for around one third of 'material weaknesses' that were reported – and this trend seems to be continuing.[8]

International bodies that set rules for financial accounting standards are actively considering forcing disclosure of uncertainties with respect to tax liabilities. In the United States of America FIN 48[9] requires an analysis of material tax positions in financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 and SOX are not only relevant to US based multinationals. They can also apply to US subsidiaries of foreign based large business and other non US entities that are registered with the US Securities and Exchange Commission.

The United States and Australia have introduced a requirement that companies report their uncertain tax positions (referred to as reportable tax position (RTP) in Australia) when filing tax returns. The IRS announced in January 2010 the reporting of uncertain tax positions (UTP's). The basis for these requirements to report UTP's is based on FIN 48. These requirements provide revenue bodies with information regarding the tax position as included in the financial accounts. As a result many large businesses have changed the way they approach compliance, corporate governance and business ethics.

Understanding taxpayer behaviour

Why people do or do not comply with tax laws is an important question for revenue bodies. The reasons or motives underlying taxpayer behaviour can be used as a starting point for compliance activities. Understanding taxpayer compliance behaviour is therefore crucial for revenue bodies. The academic literature highlights different motives and conditions that can result in tax (non-) compliance.

Economic or instrumental models of tax behaviour assert that people weigh the expected profits of evasion against the (perceived) chances of getting caught and the penalties imposed when evasion is being detected. These economic models appear to form an important basis for policies developed by many revenue bodies to stimulate compliance and reduce evasion. The tax risks associated with large business taxpayers seldom involve tax evasion; rather they generally arise from perfectly legal steps taken to minimise tax liabilities. However, there are some commonalities when it comes to understanding the economic drivers of behaviour. Some tax planning strategies rely to a greater or lesser extent on non-disclosure of tax positions taken that are uncertain and unlikely to be acceptable to the revenue body because they are viewed as aggressive.

Such strategies also take into account the likelihood that such positions will be detected and challenged.

Viewed from the stand point of an economically rational model of taxpayer behaviour, when greater mandatory transparency and disclosure is imposed, it is critical in changing the actual and perceived likelihood that aggressive tax planning by multinational enterprises will be detected. Increased prudence in calculating provisions for uncertain tax positions reduces the pay-off from adopting them, at least in the short term. That, coupled with the increased risk of detection and effective challenge that results from the increased levels of transparency already described, reduces the net present value of many aggressive tax avoidance schemes. As a result the economic value of a tax strategy that is aggressive and assumes non-disclosure of uncertain tax position is diminished. Consequently improved disclosure tips the balance in favour of co-operative compliance.[10]

However, revenue bodies recognise the limitations to the explanatory power of economically rational models of taxpayer behaviour. The importance of personal and social norms as determinants of compliance behaviour has also long been acknowledged; people are not solely motivated by self-interest and do not act as a result of cost-benefit analyses alone. Rather people's personal convictions about the way one should or should not behave and the anticipated reactions from their social environment are important motives for compliant or non-compliant tax behaviour. Moreover, recently factors such as legitimacy, fairness and trust have been recognised as important in studies on compliance behaviour. And this is as true of the people who direct the affairs of large corporations, as it is of individuals[11].

Since the financial crisis began in 2008, there has been an unprecedented level of public interest in the tax arrangements of multinational businesses, and in a number of cases these do not measure up to the public's expectations of legitimacy and fairness. As we discuss in Chapter 4, tax and reputation related issues are now important aspects of good corporate governance.

Developments in socio-psychology (for example, Kirchler, Cialdini and Braithwaite) have resulted in a change in opinions on compliance in recent years, together with the introduction of methods for influencing behaviour in government supervisory practice. Research also suggests that, in general, inspection frequencies and the imposition of sanctions do not exhibit a marked correlation with the degree of compliance[12]. These insights provide an alternative perspective on the factors that drive compliance behaviour to that offered up by rational economic models. But both approaches lead to the same conclusion: that strategies based on co-operative compliance are to be preferred to those that rely on coercion alone[13].

Experts participating in the FTA's Large Business Network have discussed the attitudes and behaviours that tend to support a co-operative relationship and those that are likely to give rise to an adversarial attitude on the part of the parties to the relationship. That discussion took a broad view of the features of a society that were likely to exert an influence on the nature of the relationship, whether directly or indirectly. The results of the discussion are represented diagrammatically and appear in Annex C (*www.oecd.org/site/ctpfta/mindmaps.pdf*).

Co-operative compliance and equality before the law

Since the publication of the 2008 Study some commentators have raised concerns about the compatibility of the "Enhanced Relationship" concept with the constitutional principle of equality before the law. If some businesses are enjoying a relationship that is enhanced and the associated benefits that were enumerated in the 2008 Study, are the remainders being discriminated against?[14] As the issue has been raised it clearly does need to be addressed, although it may prove to be an issue of perception rather than substance. For example the phrase "carrot and stick" is suggestive of an explicit incentive for taxpayers to engage in an enhanced relationship. However, although this phrase was used in one of the published working papers that preceded the final 2008 Study it was not used in the 2008 Study itself.

The principle of equality before the law is a fundamental feature of the constitutions of most countries, whether they are Common Law jurisdictions or jurisdictions governed by a Civil Code. The words of Lord Hoffman, a very senior UK judge, speaking in the Common Law tradition in a case heard by the Privy Council, illustrate both the importance and the essential features of the principle very clearly:

> *"Their Lordships do not doubt that such a principle is one of the building blocks of democracy and necessarily permeates any democratic constitution. Indeed, their Lordships would go further and say that treating like cases alike and unlike cases differently is a general axiom of rational behaviour. It is, for example, frequently invoked by the courts in proceedings for judicial review as a ground for holding some administrative act to have been irrational."*[15]

The principle of equality before the law is frequently stated explicitly in the written Constitution of countries[16]. Notwithstanding the diversity of legal systems, the principle of equality before the law is conceived of in a consistent way in the countries where it applies. In essence it requires that citizens in the same situation should be treated in the same way and that any differences of treatment should be the rational result of objective differences in the circumstances of the cases in question. So equality before the law does not mean that everyone is treated the same, but it does require different treatment to be justified.

What are the implications of the principle of equality before the law for revenue bodies? It does not mean that every taxpayer has to be treated in exactly the same way. So the decision to audit a taxpayer does not require that every taxpayer should be subject to an audit. However, the decision to select a taxpayer for audit must be the result of an objective and rational process and not irrational prejudice. In advanced revenue bodies the process of risk assessment is the objective and rational process that justifies different treatment of specific cases for good reasons and also ensures that the limited resources available to revenue bodies are deployed in the most cost effective manner.

What then is the objective justification for the decision to enter into a co-operative compliance relationship with certain taxpayers and not others?

In answering this question it is important to state at the outset what co-operative compliance is not intended to achieve: it should not result in a different or more favourable tax outcome for the taxpayer. On the contrary, co-operative compliance has been developed by revenue bodies as a more effective means of achieving tax compliance. The objective of securing the timely payment of the correct tax is the common goal of all the compliance strategies employed by revenue bodies. This has been

made clear by revenue bodies that have explicitly adopted the co-operative compliance concept in the public guidance they have produced. For example, the Netherlands Tax and Customs Administration's guide to HM includes the following statement:

> *"The Netherlands Tax and Customs Administration's objective is to promote the appropriate observance of tax, customs and income-related regulations: the maintenance and improvement of compliance. Compliance refers to the (in principle assumed) willingness of taxpayers and persons entitled to benefits to fulfil their statutory obligations."*[17]

As the outcome of co-operative compliance in terms of the tax that is payable by a large business should be the same as that of a more traditional audit or enquiry based approach, this does not raise any issues in terms of equality before the law. However, large businesses do obtain some collateral benefits from being party to a co-operative compliance. These were spelt out in the 2008 Study:

> *"Based on discussions with the corporate tax community, as well as the early experiences of pilot programmes in the USA, the Netherlands and Ireland, we believe that early disclosure and resolution of issues will give taxpayers tangible benefits in their management of tax risks. The desirability of early certainty and its importance for large corporate taxpayers has been a significant feature of these consultations.*
>
> *In particular, disclosures arising from shareholder reporting requirements or corporate governance issues for publicly traded companies as well as unnecessary audit time can be greatly minimised when complex transactions involving potential tax disputes are resolved early, preferably in real time.*
>
> *Additionally, we believe in the longer term there will be a noticeable financial advantage for taxpayers through reduced compliance costs. If revenue bodies are able to succeed in directing more of their resources into high-risk issues and high-risk behaviour by taxpayers, there will be a long-term gain for lower-risk taxpayers.*
>
> *Our consultations also indicated that real-time scrutiny by the revenue body leads to better integration of tax issues as deals are being structured."*[18]

As these benefits are material in their own right, it is reasonable to ask whether the fact that they are only available to some taxpayers is contrary to the principle of equality before the law. To put it another way, can the different treatment be justified as a rational response to differences between cases? The fact that the availability of a co-operative compliance is conditional on the taxpayer adopting certain behaviours is of assistance in answering this question. As the 2008 Study sets out, taxpayers seeking a co-operative compliance relationship with a revenue body need to be ready to offer disclosure and transparency. The 2008 Study sets out what is meant by disclosure and transparency. In brief, disclosure means that the taxpayer will provide all the information that a revenue body needs to carry out a fully informed risk assessment and will not limit the information to that which is required by statute. Transparency provides the framework within which these disclosures are made.

To achieve the necessary disclosure and transparency the taxpayer will have to have in place systems of internal control that ensure that the returns submitted to the revenue body are accurate and that transactions or positions giving rise to material tax uncertainty are disclosed. This is the Tax Control Framework (TCF) which has already been referred

to and which is discussed in greater detail in the next chapter. The importance of the TCF in the current context is that it can be assessed objectively by the revenue body as part of its risk assessment process. The existence of an effective TCF, coupled with a taxpayer's explicit willingness to meet the requirements of disclosure and transparency that go beyond their statutory obligations, provide an objective and rational basis for different treatment. The revenue body can place a justified reliance on the tax returns it receives from taxpayers who meet the requirements and can be confident that material tax risks and uncertainties will be brought to its attention.

In cases where the TCF is inadequate and/or the taxpayer is not prepared to provide more information than is strictly required by statute, revenue bodies necessarily have to use a different and more intrusive approach to ascertain what tax risks may be present in the case. The presence of good governance arrangements within the revenue body, which we discuss in Chapter 5, provides further reassurance that the differences in treatment are the result of a rational process.

The 2008 Study was focused on large corporate taxpayers and this has led to a different concern about fairness. Specifically if the benefits of a co-operative compliance relationship are not available to smaller business taxpayers does that create inequalities[19]. In practice the complexity and scale of the affairs of a large multinational enterprise does demand a different organisational approach than is appropriate to the management of small business compliance. The needs of small businesses are different too and for most their preference is to achieve compliance without needing to have direct or frequent contact with the revenue body. Furthermore, the numbers of small businesses are such that revenue bodies need to rely on approaches that work on a one to many, rather than a one to one basis and intermediaries play a very important part in helping them to do that. However, revenue bodies recognise that the fundamental principles of co-operative compliance are applicable to small businesses and they have been exploring ways in which they can be applied in practice to the SME segment. The FTA has undertaken a review of how revenue bodies are developing co-operative relationships with SMEs through strategies of engagement and involvement and the results are published alongside this report. [20].

Overall, it can be seen that the decision by a revenue body to offer a co-operative compliance to taxpayers that can demonstrate that they are low risk is an integral part of the risk assessment process, a process that is consistent with the principle of equality before the law. After all, provided taxpayers are prepared to deliver the necessary disclosure and transparency and have a robust TCF, they should in principle be able to access the benefits of a co-operative compliance[21].

So long as revenue bodies entering into co-operative compliance with taxpayers do so on the basis of an explicit and objective assessment of the taxpayer's ability and willingness to provide the necessary disclosure and transparency and of the adequacy of the TCF in place, there would seem to be no conflict with the principle of equality before the law. Nonetheless, it is a fact that some commentators believe there may be a conflict and it is worth considering why.

It is possible that this is really a question of perceptions resulting from the language used. The "Enhanced Relationship" terminology adopted by the 2008 Study does not translate well from English into other languages. Even in English, when separated from the explanatory text in the 2008 Study itself, it may unintentionally give the impression that an enhancement of the relationship involves some benefit beyond the very specific advantages set out in the 2008 Study, possibly including some reduction of the tax

payable. The importance that is attached to the equality of outcomes by revenue bodies, which we discuss above, may have been overlooked as a result. As explained in Chapter 1 that is why the term enhanced relationship has been replaced by co-operative compliance.

Co-operative compliance and the spirit of the law

The concept of the "spirit of the law" was not explicitly discussed in the 2008 Study but in 2010 the FTA published "A Framework for a Voluntary Code of Conduct for Banks and Revenue Bodies"[22].The Framework built on the foundations of the relationship of mutual trust between revenue bodies and taxpayers that was first described in the 2008 Study. In particular, the Framework addresses the use or promotion of aggressive tax planning. The 2008 Study defined the aspects of aggressive tax planning that are of concern as:

> *"Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences. Taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law."*[23]

The Framework suggests that Banks signing up to a voluntary code would agree not to engage in aggressive tax planning as described in the 2008 Study and to openly disclose uncertainty about the tax treatment of significant matters in the tax return, including whether a transaction will be seen as an example of aggressive tax planning. When the United Kingdom introduced its Code of Practice on Taxation for Banks on 9 December 2009, it included the following statement:

> *"The Government expects that banking groups, their subsidiaries, and their branches operating in the UK, will comply with the spirit, as well as the letter, of tax law, discerning and following the intentions of Parliament."*[24]

The concept of the "spirit of the law" was directed at the first type of aggressive tax planning, the second being addressed by the obligation to be open and transparent. The concept has achieved international currency since the 2011 revision of the OECD Guidelines for Multinational Enterprises (the Guidelines). The Guidelines conclude with a chapter on taxation which contains the following statement:

> *"In particular, enterprises should comply with both the letter and spirit of the tax laws and regulations of the countries in which they operate. Complying with the spirit of the law means discerning and following the intention of the legislature. It does not require an enterprise to make payment in excess of the amount legally required pursuant to such an interpretation."*[25]

The subsequent commentary provides some further explanation of the concept:

> *"An enterprise complies with the spirit of the tax laws and regulations if it takes reasonable steps to determine the intention of the legislature and interprets those tax rules consistent with that intention in light of the statutory language and relevant, contemporaneous legislative history. Transactions should not be structured in a way that will have tax results that are inconsistent with the underlying economic consequences of the transaction unless there exists specific legislation designed to give that result. In this case, the enterprise should reasonably believe that the transaction is structured in a way that gives a tax result for the enterprise which is not contrary to the intentions of the legislature".*[26]

References to the "spirit of the law" in the guidelines and in the context of co-operative compliance have caused some commentators and practitioners to worry that it may give rise to a degree of over compliance by businesses.[27] Business has also expressed concern about the concept, fearing that it implies an identifiable, separately assessable body of interpretation, beyond the words of the statute or other legislative history. The complexity of modern business operations and tax codes is such that there is scope for legitimate differences of opinion about what constitutes aggressive tax planning and which tax outcome is truly consistent with the spirit of the law. The revenue body will have a view on that and, as the 2008 Study acknowledges, mechanisms that allow taxpayers to obtain advance rulings can be very helpful in providing early certainty about that view. In connection with rulings, some businesses have commented that revenue bodies should take care that levels of certainty in co-operative compliance should not be less than can be obtained through formal rulings: should co-operative compliance provide less certainty, then there is less incentive for business to engage.

In Italy, taxpayers have the possibility (or the obligation depending on the circumstances) to apply to the revenue body for advance rulings in order to obtain clarifications on the applicability of the relevant legislation to specific cases or in relation to possible anti-avoidance cases. With reference to anti-avoidance cases, the Italian tax system provides, in particular, the possibility for taxpayers to apply for different and alternative forms of advance tax ruling in order to obtain advanced certainty on transactions falling, in principle, within the scope of general or specific anti-avoidance rules. Austria and Norway also have systems of advance rulings. They are legally binding for the revenue body (as long as the transaction is carried out in the way it is described in the ruling), but the taxpayer can choose whether to invoke the ruling or not. The Austrian authorities find that bilateral as well as unilateral advance rulings (only possible concerning questions on group taxation, business restructuring and transfer pricing) are a useful way to receive information and detect possible aggressive tax planning strategies very early. The Norwegian authorities find advance rulings to be useful and encourage their use within the pilot project.

However, the taxpayer may not agree with the view of the tax authorities about the consistency of the tax outcome with the spirit of the law and the board of a public company has a fiduciary duty to its shareholders not to pay more tax than is actually due. For this reason members of the business community have some reservations about the usefulness of the concept of the "spirit of the law" in resolving uncertain tax positions. Ultimately it is for the courts to decide how the legislation should be applied to the particular facts of a case if the parties cannot agree. If co-operative compliance did not allow for such differences of opinion and access to the courts to settle those differences if necessary, it could be objected that taxpayers entering into co-operative compliance agreements with revenue bodies are effectively agreeing to accept that the revenue body's view should prevail. And that would entail paying tax in excess of the amount legally due on those occasions when the view of the revenue body is not supported by the courts, or would not have been had they been asked to consider the matter.

Co-operative compliance should not give the revenue body an "advantage" in terms of interpreting the law as this could lead to the establishment of "soft law" created by the revenue body supplanting legislative changes decided by the parliament or case law decided by the Courts. When interpreting what is "the spirit of the law", the guideline for the revenue body should be the same within co-operative compliance as in an ordinary audit. It is critical to make clear there are neither advantages nor disadvantages in these aspects within co-operative compliance. To achieve this, revenue bodies could consider

making public to all taxpayers anonymised decisions and interpretations on difficult tax issues.

In practice the concept of the spirit of the law, as spelt out in the OECD guidelines for Multinational Enterprises (MNE Guidelines)[28], provides useful guidance as to what is likely to be of concern to revenue bodies. However, there must be scope for taxpayers and revenue bodies to have genuine differences of opinion about the proper tax treatment of some transactions, even within the framework of a co-operative relationship. Sometimes it is extremely difficult to interpret what "the spirit of the law" is and so it is natural for a revenue body and taxpayer to have different opinions about these matters. This can be accommodated within the framework of co-operative compliance as long as the taxpayer is fully open and transparent about its position. Essential to the relationship is therefore the disclosure of those occasions when the taxpayer has taken a position in the return that is contrary to the view of the revenue body. Tax planning that relies on a "hide and seek" approach to disclosure is clearly not compatible with co-operative compliance. But full disclosure of a position that is contrary to the view of the revenue body is not, in and of itself, inconsistent with a co-operative relationship. There are implications for the way the parties manage disputes that arise within the framework of a co-operative relationship, to which we will return in Part 5 of this chapter, but the taxpayer should still be able to test their point of view before the courts if necessary.

It may be objected that the existence of disputes is likely to erode the benefits (greater certainty and lower costs) that taxpayers and revenue bodies are supposed to derive from a co-operative relationship. But in practice the number of disputes that arise in the context of a co-operative relationship is likely to be self-limiting. A taxpayer that takes up a series of positions that conflict with the view of the revenue body, pursues those positions through the courts, and loses most or all of the cases, is likely to rapidly reassess its tax strategy. By the same token, a revenue body that frequently challenges positions taken by the taxpayer but is frequently unsuccessful before the courts will have to adjust its view of the law. Clearly these are two extreme situations but they illustrate the dynamic that will act to keep disputes within reasonable bounds when both parties abide by the principles of openness and transparency that are central to co-operative compliance.

Regardless of their views about the spirit of the law, a taxpayer whose tax strategy relies on aggressive tax planning is not likely to be attracted to a relationship that requires full disclosure in any case. Tax positions that are intended to thwart the intentions of the legislature are likely to attract attention from that legislature as well as the revenue body. The legislature can choose to put the matter beyond doubt by changing the law. Even when that change is only prospective in effect, this can be costly for the taxpayer if the scheme in question has significant set up costs and its value was predicated on it being effective for a period of time.[29] This further underlines the importance of co-operative compliance within the context of a broader compliance strategy that includes effective responses to those taxpayers who continue to play hide and seek and which were discussed in Part 2 of this chapter.

Managing disputes within a framework of co-operative compliance

Co-operative compliance approaches aim in general for quicker dispute resolution. Disclosure and transparency are key for managing disputes. In this respect it does not matter whether disclosure is mandatory or voluntary, as long as the taxpayer and revenue body are willing to resolve the dispute. The willingness to resolve the dispute as soon as

possible is the reason why it is possible to resolve disputes quicker in a co-operative relationship. A discussion of the dispute resolution process shows why this is so.

Within a co-operative relationship the period in which the dispute arises is of great importance. We should distinguish two types: the first type of disputes are those that already existed before a co-operative relationship was established and the second type of disputes are those that arise once the co-operative relationship has been established.

This new way of working often includes an intensive effort to settle any legacy of existing disputes between the revenue body and the large business. These disputes can be dealt with by agreement or by litigation. In Part 1 of Chapter 2 we refer to the discussion in the 2008 Study about alternative dispute resolution (ADR) techniques as a mechanism that can assist an 'impartial approach' to the resolution of disputes. Once a co-operative compliance relationship has been established alternative dispute resolution techniques may represent a better basis for settling disputes that arise in the context of a co-operative relationship, although the Courts are still available to settle disputes for the reasons discussed in Part 3 of this chapter. Commonly used alternative dispute resolution techniques are mediation and arbitration.

In order to fulfill the principle of equal treatment, it is of great importance to demonstrate that there are no differences in terms of equal judgment and treatment inside and outside co-operative compliance. There is no room for special arrangements for resolving disputes within co-operative compliance that would not be applicable to taxpayers in general. In the Swedish co-operative compliance model, legal disputes between taxpayer and the tax agency can be solved in just two ways that are generally available. One way is through litigation and the other way is for the company to seek a binding advance ruling from a special and independent, judicial committee.

In Canada, taxpayers remain entitled to their right to recourse under the various legislative authorities that the CRA currently administers. The CRA does not anticipate that there will be significant changes or adoption of alternate dispute resolutions as a result of a co-operative compliance arrangement. In Norway there are no special dispute resolution mechanisms under the project programme. The general dispute mechanisms apply such as the Board of Appeal, litigation, MAP and APA. On the other hand it is assumed that earlier involvement and quicker response to the companies' questions are beneficial to the dispute resolution process.

The UK's primary approach is co-operative compliance. Where this is unsuccessful it may also use ADR techniques such as using independent third party mediators, or facilitation using HMRC trained mediators, often working in partnership with the taxpayer's advisors, to intensively explore whether an agreement can be reached that is consistent with the UK Litigation and Settlement Strategy, or if this is not possible to improve the efficiency of resolution by litigation.[30]

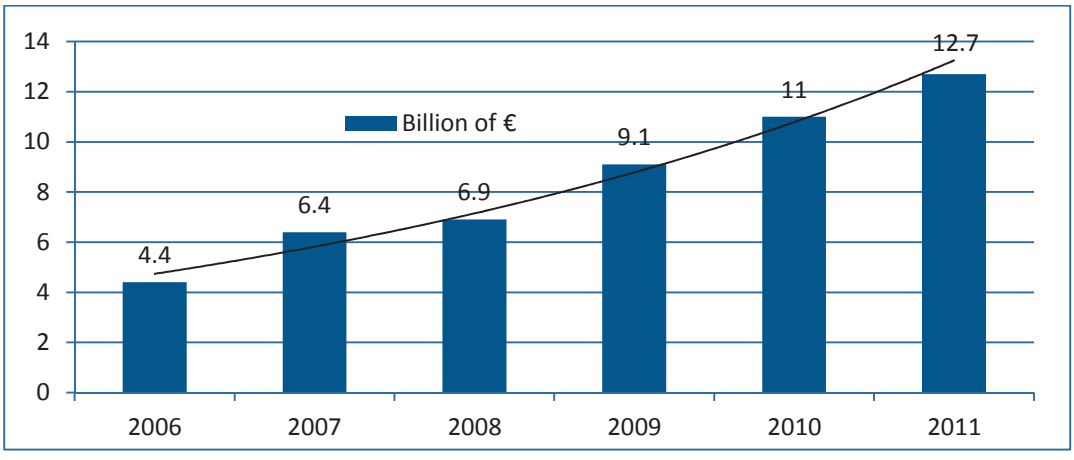
More generally, alternative approaches to dispute resolution are both consistent with co-operative compliance and can help to accelerate the settlement of cases and earlier collection of the taxes due, which is one of the objectives of a co-operative approach. For example, in Italy domestic legislation provides for different dispute resolution procedures, depending on the phase of the assessment/litigation. The following table summarises the main procedures available for taxpayers wishing to settle their cases:

Table 3.1 Italian dispute resolution procedures

Description	Penalties	Conditions
Agreement on the auditors' report ("*adesione al verbale*")	1/6 of the due taxes	Full acceptance of the tax adjustment proposed by the auditors.
Agreement on the note of assessment ("*accertamento con adesione*")	1/3 of the minimum	Partial acceptance of the tax adjustments.
Judicial agreement ("*conciliazione giudiziale*")	40% of the "agreed" taxes	Partial acceptance of the tax adjustments in the litigation phase.

These procedures generally involve technical discussion between the revenue body and tax payers, with the aim of establishing if the arguments challenged are susceptible to a different evaluation and if, and by how much, the amount of taxes claimed can be reduced. In Italy dispute resolution procedures have been widely used (especially from 2009) with significant monetary impacts on the revenues actually collected. The following graph shows the trends of taxes (EUR billions) actually collected as a consequence of tax assessments.

Figure 3.1 Trends of taxes actually collected



Source: Italian Revenue Agency, www1.agenziaentrate.gov.it/inglese/

The increase in taxes collected is also explained by the reorganisation of the Italian Revenue Agency and the introduction and extensive use of risk management monitoring.

Co-operative compliance approaches do not guarantee that there will be no disputes. However, when disputes do arise, a co-operative relationship will help to ensure that parties manage the dispute in the most efficient manner possible. Disclosure and transparency are essential in this respect. It is only possible to have an effective discussion about the interpretation of the law if all facts are clear and accepted by both parties. Within a co-operative relationship the parties try to obtain a common understanding of all the relevant facts and circumstances in order to speed up the process and resolve disputes quicker. In the Netherlands it is acknowledged that parties can "agree to disagree". This principle provides flexibility and the possibility to go to court without jeopardising the relationship. The revenue body and taxpayer will jointly present the case to the court. This ensures that there is no discussion about the facts, but only

about the interpretation of law. This results in a faster and more effective resolution of disputes.

Notes

1. *http://ec.europa.eu/taxation_customs/resources/documents/common/publications/info_docs/taxation/risk_managt_guide_en.pdf*
2. *www.oecd.org/ctp/administration/33818656.pdf*
3. *www.oecd.org/ctp/taxadministration/46274793.pdf*
4. According to the Philippine Institute for Development Studies (2002) the command-and-control approach is the principle "to command people or firms not to do something by enacting a law that makes it illegal and by delegating authorities to enforce such law through the imposition of fines or penalty to violators." According to the Encyclopedia of Earth the command and control approach "generally relies on detailed regulations followed up by an ongoing inspection program."
5. R. Happe, *Multinationals, Enforcement Covenants and Fair Share*, INTERTAX, Volume 35, Issue 10, page 537 – 547, Kluwer Law International 2007. Happe pointed out that in the 1990s the Netherlands tax administration came to the realisation that its traditional approach to compliance and the examination of tax returns was no longer fit for purpose. There were a number of reasons for this. For large businesses the increasingly global reach of their operations mean that the tax administration was losing its control on taxpayers. Happe makes the point that the national perspective of the tax inspector limits their ability to fully understand transactions, or "tax devices" that are international in nature. Stiglitz called this the problem of 'asymmetric information' in short: a lack of transparency. Stiglitz, J.E., The roaring Nineties, New York/London: W.W. Norton & Company, 2003 p.154.
6. See "Understanding and Influencing Taxpayers' Compliance Behaviour", November 2010; "Managing and Improving Compliance: Recent Developments in Compliance Risk Treatments", March 2009; the Study and "Guidance Note-Compliance Risk Management: Managing and Improving Tax Compliance", October 2004.
7. *Sarbanes-Oxley Act of 2002*, United States of America
8. *Tax Risk Management*, Ernst and Young, LexisNexis Butterworths 2007
9. The Financial Accounting Standards Board (FASB) issued interpretation no. 48, Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109 (FIN 48)
10. See for example De Simone, Sansing, & Seidman, "When are Enhanced Relationship Tax Compliance programs Mutually Beneficial?", McCombs School of Business research paper series No. ACC-07-11.
11. Wim Huisman A. Beukelman 'Invloeden op regelnaleving door bedrijven; inzichten uit wetenschappelijk onderzoek', *Background factors of regulatory compliance and violation by corporations* Boom juridische uitgevers, first edition, 2007

12. J. Andreoni, B. Erard, & J. Feinstein, 'Tax compliance', Journal of Economic Literature 1998/36, p. 818-860.

13. A detailed discussion of the relevant concepts in social psychology is beyond the scope of this report. However, as an example the Slippery Slope Framework of Kirchler, Hoelzl, & Wahl illustrates how thinking in this area can be applied to issues of tax compliance.

14. See for example the International Fiscal Association study entitled *IFA Initiative on the Enhanced Relationship-Key Issues Report* *www.ifa.nl/publications/enchancedrelproject/pages/default.aspx*.

15. Matadeen and Others v. M.G.C. Pointu and Others (Mauritius) [1998] UKPC 9*: see Professor Jeffrey Jowell Q.C., Is Equality a Constitutional Principle? [1994] Current Legal Problems 1, 12-14 and De Smith, Woolf and Jowell, Judicial Review of Administrative Action, paras. 13-036 to 13-045*.

16. See for example the 5th and 14th Amendments to the Constitution of the USA, Article 3 of German Constitution, Article 14 of the Indian Constitution and Section 9 of the Constitution of South Africa, to name just a few.

17. "Horizontal monitoring within the medium to very large business segment guide", version 1.0, page 9, unofficial English translation published November 2010.

18. 2008 Study, page 41.

19. See for example "Responsive Regulation, Risk and Rules: Applying the Theory to Tax Practice", Judith Freedman (2011) *44 UBC Law*, pages 649-650).

20. OECD (2013), *Together for Better Outcomes: Engaging and Involving SME Taxpayers and Stakeholders*, OECD,Paris.

21. In those countries where the enhanced relationship is available only to the largest taxpayers, it is important to explain to the public that it is justified by the complexity of large taxpayers' affairs (and of the associated risks); and that SMEs and others who show themselves to be 'willing and able' to comply with their obligations will receive corresponding benefits of experiencing less intrusive attention from the revenue body and earlier certainty.

22. *www.oecd.org/ctp/taxadministration/45989171.pdf*

23. 2008 Study page 10-11.

24. *http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMRC_PROD1_030008*

25. *http://publications.oecd.org/acrobatebook/2011101e.pdf*

26. *Ibid*.

27. See for example Judith Freedman, *ibid*.

28. OECD (2011), *OECD Guidelines for Multinational Enterprises, 2011 Edition*, OECD Publishing. doi: *10.1787/9789264115415-en*

29. And in extreme cases, legislatures can respond with retrospective legislation; see for example *www.hm-treasury.gov.uk/press_15_02.htm*.

30. The Litigation and Settlement Strategy, which was published in 2007 and refreshed in 2011, sets out how the UK tax authorities will seek to work on a collaborative basis to resolve disputes about tax liability by agreement, but that any agreement must accord

with an outcome that could be reasonably expected if the dispute were determined by the independent Tribunal service.

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Chapter 4

The importance of the Tax Control Framework

MNE guidelines-the principles of good tax governance

The OECD has worked for many years on developing standards and tools for a stronger, cleaner and fairer economy. The MNE Guidelines are one of these standards.[1] The MNE Guidelines are a voluntary set of principles and standards for responsible business conduct. The revised MNE Guidelines were adopted by the 42 adhering governments on 25 May 2011 at the OECD's 50th Anniversary Ministerial Meeting.

The chapter about Taxation highlights that businesses should comply with both the letter and the spirit of tax laws. Tax governance and tax compliance are important elements of the broader risk management system. Corporate boards should adopt tax risk management strategies to ensure that the financial, regulatory and reputational risks are fully identified and evaluated. The commitment of businesses to co-operate, to be transparent and to be tax compliant should be reflected in its risk management systems, structures and policies. A comprehensive risk management strategy that includes tax will allow the enterprise to act as a good corporate citizen but also to effectively manage tax risk.

To raise awareness and promote adherence to the MNE Guidelines the FTA decided to issue a survey to key MNEs in co-operation with BIAC. It was agreed with BIAC that there would be a pilot survey and following that pilot the survey was extended. Survey responses received at the time this report was completed, indicate that the MNEs surveyed comply with the MNE Guidelines.

Tax control frameworks-translating the principles into practice and reliable systems

"The effectiveness of an Internal Control Framework starts with the moral and ethical values of the management of an organisation and the way management ensures the implementation of these values in the day to day operation.[2]" This quote from the FTA Information Note Tax Compliance and Tax Accounting Systems (2010) is key to understanding the impact and importance of Internal Control Frameworks, of which Tax Control Frameworks are an integral part. "Transparency in exchange for certainty" cannot exist without disclosure of tax risks and the underlying frameworks provide assurance that these risks surface.

While the degree of statutory prescription of corporate governance and the extent to which it extends to taxation varies, the trend towards increased transparency and disclosure is clear, for the reasons discussed in Part 3 of the previous chapter. It is equally clear that adequate transparency and disclosure is dependent on a robust system of Internal Control. An obligation on the board of enterprises to issue an 'Internal Control Statement' (ICS) lies at the heart of almost all Corporate Governance legislation or codes. The objective of the ICS differs from the long-standing Financial Reporting rules and is

concerned with the effectiveness of the Enterprise Risk Management (ERM) system of the enterprise. Enterprises use an ERM system to manage risks and opportunities in order to achieve their enterprise's strategy. ERM provides a framework for risk management. By effectively and efficiently applying this system of risk management, enterprises protect and create value for their stakeholders. Designing, implementing and maintaining an efficient and effective system of internal controls is therefore essential if enterprises are to achieve their objectives. The part of the system of internal control that assures the accuracy and completeness of the tax returns and disclosures made by an enterprise is sometimes referred to as the Tax Control Framework. None of the countries we surveyed has sought to prescribe the design and implementation of the Tax Control Framework in legislation.

However, the part played by the Tax Control Framework within the overall Internal Control Framework (ICF) of an enterprise is discussed in the FTA Information Note: Tax Compliance and Tax Accounting Systems[3] and in particular in Chapters 5, 6 and 7. This Information Note shows the coherence between the concepts of Internal Control and Tax Control. Annex D contains an extract from the Information Note that explains this in more detail.

The results of the survey show that in most OECD countries corporate governance obligations are set out in legislation and/or in a specific code. Australia, Ireland, The Netherlands, New Zealand, Norway Singapore and Sweden have incorporated governance rules in their corporate or companies act. France included provisions concerning corporate governance in the Financial Security Act. The USA passed the Sarbanes Oxley act of 2002 (SOX) following the financial scandals involving Enron and Worldcom and the impact of that on transparency has already been discussed in Chapter 3. In most countries legislative obligations are supplemented by specific codes that are issued for limited or listed companies.

Revenue bodies rely on general corporate governance codes or legislation and the requirement that there are systems of internal control that these impose. Only three countries (Australia, UK and The Netherlands) report that tax is an explicit element of these general corporate governance regulations. For example, the UK has introduced the Senior Accounting Officer concept into its legislation (SAO). As we have seen, at the international level the OECD Guidelines for Multinational Enterprises specifically encompass the governance of tax matters.

Revenue bodies in most FTA countries have issued additional guidance designed to ensure the disclosure of tax risks. The undertakings by businesses to provide full disclosure are often voluntary and part of a co-operative compliance programme (*e.g.* Australia, Austria, Ireland, The Netherlands, New Zealand, Singapore, South Africa and the USA). But several countries, including Canada, Ireland, South Africa, the United States and the UK also have mandatory disclosure regimes. In the UK, the Tax Compliance Risk Management (TCRM) Framework and the Code of Practice on Taxation for Banks are underpinned by statutory penalties for failures to comply with Senior Accounting Officer (SAO) and Disclosure of Tax Avoidance Schemes (DOTAS) obligations. We have already mentioned that the USA and Australia also have specific statutory rules requiring the disclosure of uncertain tax positions. Overall, these disclosure regimes reinforce the need for good systems of internal control and provide revenue bodies with evidence that they can use to check the effectiveness of those systems.

Enterprises, advisors, auditors and revenue bodies need to be aware of the fact that to be in control for tax means the need to be in control of tax consequences of all processes and transactions within the enterprise and not only the tax processes. So this report, defines the focus of the "Tax Control Framework" (TCF), as the internal control of all processes and transactions with possible tax consequences. This means that the specific requirement to be "in control" of all tax issues – able to detect, document and report any relevant tax risks to the revenue body in a timely way - needs to extend to all processes in scope of the ICF.

The board of an enterprise is responsible for the design, implementation and effectiveness of the TCF of that enterprise and, when requested, should provide an "in control statement" on tax. This approach is in line with most corporate governance legislation in which the Board is held accountable for the effectiveness of enterprise risk management and internal control systems.

Assessing the frameworks-a systems approach and how this can be used to give society (including bodies that audit revenue bodies) assurance about the rigour of the concept and the reliability of the outcomes

When we look at the tax control solutions implemented in practice it shows that enterprises modify generic frameworks like that of the Committee of Sponsoring Organisations of the Treadway Commission (COSO) to reflect the specifics of their own business or industry (see also Annex E for some background information on COSO). This means revenue bodies cannot use a "one size fits all" approach in the systems based assessment of frameworks. To form an opinion on the effectiveness of a particular TCF the revenue body needs to assess its scope and effectiveness in the context of the specific business in view.

None of the countries we surveyed has sought to prescribe the design and implementation of the TCF in legislation. However, there is a clear demand from the business community for publicly disclosed guidelines from revenue bodies about the criteria they adopt in assessing the scope and effectiveness of the TCF. The Government Committee's review in the Netherlands concluded that too many uncertainties about the design and assessment of tax control frameworks exist and these are undesirable given their importance.

Revenue bodies need to decide how to assess tax control frameworks and whether to provide guidelines for business; the survey shows that their response varies and that development of TCFs is in its early stages. There is a need for further research and discussion in this area. For revenue bodies, a number of considerations have to be taken into account when determining their role:

- TCF's are an integral part of business control frameworks; these are the primary responsibility of the board of a business and governed by corporate governance rules.
- The quality and effectiveness of a TCF should be fully understood under a co-operative compliance relationship. This understanding should be clearly reflected in the revenue body's adjustment of its audit activities as a result of the level of control of tax risks on the part of business.
- Transparency demands openness from the revenue body about its compliance strategy.

- Evaluation of TCFs takes place at an individual taxpayer level.
- In this respect, also the manner in which the revenue body builds on the work done by others (such as external auditors) needs to be taken into account.

The design and implementation of a TCF is something that takes place over a period of time. The starting point is a solid and clear plan of how to ensure the ICF encompasses the specific requirements necessary to be "in control" of tax. The execution of this plan is a process with several iterations because of changes in the organisation, the business, law and regulations. This means a TCF is never finished. It is an on-going process to establish the effective conditions to meet the tax requirements. The enterprise needs to be transparent about its plan and the progress of execution. The revenue body takes this information into account in the risk assessment and allocation of enforcement resources. Enterprises working on the improvement of tax control can be assumed to have a lower risk profile, because they are working to eliminate those tax risks that result from error and poor control. Of course the validity of that risk profile needs to be checked by the revenue body performing its own checks on the integrity and robustness of the tax control framework. A revenue body should be open with the taxpayer about its risk profile and how it will satisfy itself that the tax control framework achieves the level of assurance in practice that it offers in principle. This can be done using well understood methods of systems audit.

It should be emphasised that the obligation for taxpayers to be in control is not reserved to those who participate in co-operative compliance programmes. This obligation applies to all taxpayers. The difference for taxpayers engaged in a co-operative relationship with their revenue body is that both parties have agreed to be transparent. This transparency extends to the design, implementation and effectiveness of the TCF. The effectiveness of a TCF can be made transparent to the revenue body by the taxpayer sharing the results and follow up actions that flow from the internal monitoring that is a crucial part of the TCF. That monitoring provides essential evidence of the effectiveness of the TCF and is the starting point for improvements that ensure that the TCF keeps pace with changes in the business being undertaken by the enterprise and the tax obligations it is subject to. In the absence of this degree of transparency, the revenue body has to obtain the same degree of assurance about the tax position of the enterprise by other, more costly and intrusive means.

Scope of the TCF

In general the scope of a TCF can be thought about on three levels:

a. Enterprise: because of the complexity and work involved in the development and implementation of a holistic TCF (covering the overall tax risk management of the whole enterprise) businesses tend to divide the overall tax risk into more manageable pieces. They can do so by reference to the different jurisdictions in which they operate, or by looking at each separate subsidiary entity, or at specific departments and functions. In practice enterprises often start the development and implementation in their home country and when the TCF is considered to be effective there, it is rolled out to other jurisdictions.

b. Tax: this approaches the problem from the perspective of different tax types (indirect tax, as distinct from direct tax for example) or even on a tax by tax basis (*e.g.* VAT, or Corporate Income Tax).

c. Risks: in this approach the design of the TCF is generated by reference to the biggest known risks.

In practice a fully developed TCF will need to address all of these dimensions. The risk based approach reflects the need to manage the biggest risk or tax exposures of the taxpayer. The specific design of the TCF is a matter for the taxpayer and will be adapted to the particular structure of the enterprise, the activities it engages in and the jurisdictions in which it operates. However, the essential purpose is the same: to provide a verifiable assurance to the taxpayer and the revenue body that tax risks will not arise because of a lack of control and a poor understanding of the tax risks on the part of the enterprise itself. As we have discussed in Chapter 3, this does not mean that tax risks and even disputes will not arise at all, as the taxpayer and the revenue body may not agree about the correct tax treatment of a particular transaction.

In the survey revenue bodies report that co-operative compliance strategies often encourage discussion in advance with taxpayers about the risks that should be within the scope of the TCF. Ireland for example reported that:

> *"As part of co-operative compliance, Revenue, the business and, where necessary, its tax advisors, will draw up and agree a set of action points for each side, with timeframes, for a review of tax risk and the implementation of a set of compliance actions for each risk.*
>
> *The first step will involve the parties engaging in a risk review meeting, or meetings, at which Revenue will give an overview of its perspective on potential tax risks for the business and its sector, and the business will point up risk areas of which they are aware – essentially working towards an agreed view of an initial tax risk profile for the business.*
>
> *The business will then prepare and implement annual tax risk management plans focusing on agreed risk areas. Where risks are identified by a business they can make an unprompted voluntary disclosure, which reduces the amount of Penalties that will arise."*

Australia and the Netherlands also mentioned dialogue and early engagement. Australia publishes areas of concern in its annual "Compliance program" and expectations on tax risk management and governance in its Large Business and Tax Compliance booklet. The Netherlands shares the Strategic Supervision Plan and the opinion on tax compliance behaviour with Large Businesses.

The effectiveness of the TCF

The effectiveness of the TCF has several aspects:

a. detection of tax related risks and opportunities;

b. disclosure of tax related risks and opportunities;

c. preventing tax related errors;

d. detection and correction of errors; and

e. the learning cycle; errors need to be followed by actions to improve the TCF.

The importance of monitoring

Effective internal control systems supply business management with reasonable assurance on the achievement of the objectives of the organisation. As we recognised earlier, monitoring is the component in ICFs that delivers this assurance.

In 2009 COSO issued a note "Guidance on Monitoring Internal Control Systems".[4] The importance of monitoring is explained by the COSO board as follows:

> *"The COSO Board recognises that management's assessment of internal control often has been a time-consuming task that involves a significant amount of annual management and/or internal audit testing. Effective monitoring can help streamline the assessment process, but many organisations do not fully understand this important component of internal control. As a result, they underutilize it in supporting their assessments of internal control."*[5]

An effective internal control system consists of controls and monitoring. The objectives of these components differ. Controls prevent, detect and correct shortcomings or errors in business processes. The objective of monitoring is to assess and improve the effectiveness of the controls. Shortcomings in controls need to be detected by monitoring. Detection needs to be followed by improvement of the internal control system (the learning cycle).

The effectiveness of monitoring is determined by the processes, transactions and related controls in scope and the standards being used. Effective monitoring assesses the effectiveness of the internal control framework. This is essential information for revenue bodies making use of internal control systems for their own purposes. When the monitoring of the taxpayer is transparent to, and viewed as effective by, the revenue body, the extent of reviews and audits conducted by the revenue body itself can be reduced significantly. Where the internal control system is demonstrated to be effective in this way, the revenue body is able to rely on the returns submitted to it and be confident that issues of doubt or difficulty in the tax positions taken in that return will be brought to its attention. That underpins the successful operation of a co-operative compliance relationship.

Notes

1. See in this respect the Propriety, Integrity and Transparency (PIT) Declaration. The PIT Declaration sets out the political commitments of OECD and other adhering countries in the areas of responsible business conduct of competition, corporate governance, investment and, tax co-operation, anticorruption, interaction between government and business, quality of regulation and financial literacy and consumer protection http://www.oecd.org/corruption/proprietyintegrityandtransparency.htm
2. OECD (2010), *FTA Information Note Tax Compliance and Tax Accounting Systems* (*www.oecd.org/tax/taxadministration/45045662.pdf*)
3. OECD (2010), *Ibid.*
4. *www.coso.org/documents/COSO_Guidance_On_Monitoring_Intro_online1.pdf*
5. COSO (n 11), p 1.

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Chapter 5
Internal governance of co-operative compliance programmes within revenue bodies

The importance of explicit governance in providing assurance to wider society about these programmes

Since the publication of the 2008 Study some commentators have questioned whether relationships based on the principles of co-operative compliance could affect the impartiality of the tax officials involved. Internal Governance arrangements are key for all revenue bodies that have introduced a Co-operative Compliance Programme. Within these programmes large taxpayers and revenue bodies base their relationship on mutual transparency, understanding and justified trust. This means that tax officials are expected to combine two roles: they are expected to maintain an open relationship with the taxpayer but they are also required to remain impartial and professional and to retain a critical attitude towards the taxpayer and the information and tax risks it discloses. The maintenance of taxpayer confidentiality is an important aspect of building trust and helps taxpayers share information more freely with the revenue body. At the same time it can be seen as an obstacle to the process of providing assurance to external stakeholders about the impartiality of the revenue body. Failure to maintain a professional critical attitude could have damaging effect on overall confidence in revenue bodies.

However, as we have discussed in earlier chapters, changes in the environment, ranging from corporate governance, (tougher) mandatory rules concerning transparency and in wider society mean that there is an increasing recognition that revenue bodies and large taxpayers share the same interests regarding compliance. Both large taxpayers and revenue bodies benefit when a large taxpayer is ´in control´ with regard to its tax position, so that they are able to swiftly resolve uncertainty about the tax treatment of certain transactions. This coincidence of interest is clear when we consider the integrity of control systems. However, both large businesses and revenue bodies recognise that their interests are not the same in every respect. The degree of divergence will largely be determined by the tax strategy of the large taxpayer. This strategy could range from avoiding all tax risks to a very aggressive approach to tax planning. There is a concern that tax officials may be less inclined to challenge aggressive tax positions if they feel this may damage the overall functions of a co-operative relationship with the taxpayer. Equally, we have already mentioned the concern that the taxpayer may be put at a competitive disadvantage if, in the interests of a good relationship with revenue bodies, it eschews tax planning that other large businesses continue to use effectively. There is a need to ensure that the revenue body continues to deal with taxpayers in a way that ensures an equality of outcomes, even if the way in which those outcomes are achieved varies in response to the regulatory attitude of the tax payer (as discussed in Chapter 3). Transparency and uniform interpretation of tax law are indispensable aspects of revenue body behaviour.

Separately, it has been remarked that there tends to be a situation of ´information asymmetry´: the large taxpayer holds more (also more up-to-date) information about its

business than the revenue body. The intent of co-operative compliance is that this information asymmetry is addressed because the large business is transparent and discloses relevant information and tax risks. However, this is not something that revenue bodies can take for granted. Transparency around the principles of the control framework operated within a large business must be supplemented by a process of effective monitoring of the kind described in the previous chapter. Tax officials need to maintain a professional and critical attitude towards the large businesses they deal with and the information they disclose, even where a co-operative relationship has been established.

In this respect it should also be recognised that there might be a risk that co-operative compliance is abused to escape liabilities. Large businesses could secure the relationship and then relax their standards. Tax officers should remain alert also to ´the risk of moral hazard´, which actually implies in this case that a taxpayer only implements the minimal measures to obtain the benefits of the enhanced relationship but does not invest in being in control and does not really internalize the core of the concept.

In the Netherlands aspects of the impartiality of revenue bodies and individual tax officials were addressed by the Committee in its report on HM. In the UK, the National Audit Office has considered HMRC's processes for resolving tax disputes and the reasonableness of particular settlements, in the 2012 report `Settling large tax disputes´.[1]

The Netherlands Committee emphasises that a loss of a professional critical attitude is a risk of co-operative compliance. This risk is known as the risk of attachment (also known as the risk of regulatory capture).

The NTCA has stated that it performs its duties on the basis of trust in and understanding of the position of the individual taxpayer. The 'Guide to HM within the medium to very large businesses segment' warns the NTCA's staff of the risk of losing their ability to form objective opinions, a risk which is referred to as the 'risk of attachment'. The Committee is of the opinion that NTCA needs to remain continually alert to the risk of attachment. Non-professional relationships increase the risk of corruption. The Committee advocates an adequate supporting policies, for example the rotation of staff, reviews of the quality of dossiers, or the separation of duties. The Committee leaves the further formulation of these supporting policies to the NTCA.[2]

The conclusion of the Committee is that revenue bodies should create an environment in which they support their officers in starting and maintaining co-operative compliance but also to take adequate supporting and countervailing measures with regard to Internal Governance.

In June 2012 the National Audit Office (NAO) in the UK issued the report ´Settling large tax disputes´. In this report the reasonableness of five large tax settlements and the processes within HM Revenue and Customs for reaching the settlements were examined.[3] The purpose of the audit was to address concerns about cases in which alternative governance processes had been used or where steps in the governance process had been overlooked. The key findings of the NAO were that in settling the five cases, the Department had resolved multiple, long-outstanding tax issues, that all the settlements were reasonable (and that at least one may have been better than reasonable) and that in almost all cases settlements were fully compatible with the Litigation and Settlement Strategy. Nevertheless, there was scope to enhance HMRC's internal governance arrangements.[4]

Some examples of governance models described

As part of this study the revenue bodies were asked to answer the following question:

"Do revenue bodies have a system of checks and balances or procedures in place to ensure that there is appropriate governance of co-operative compliance and to reassure external stakeholders that they do not involve so-called 'sweetheart' deals? Please describe your measures (such as any specific governance functions and systems of peer review involving a 'second pairs of eyes')."

Revenue bodies report that they have processes and other measures in place to ensure transparency on decisions made, consistency and equitable treatment. These processes and measures range from (predefined) integrity rules to (retrospective) quality measurement. Sweden has rules for the compliance co-ordinator's documentation of his or her work in co-operative compliance. This should include minutes from meetings with the company, diary covering the day to day work and measures, taken by the co-ordinator and a summary annual report. The documentation will make sure that the co-operative compliance work can be evaluated and assessed retrospectively.

In the Netherlands internal governance starts with integrity rules and a code of conduct for all tax officers. In Norway work in this field is based on the revenue body's core values, general principles of conduct and codes of ethics. In Singapore, every IRAS officer is expected to adhere closely to the core values of integrity and fairness in carrying out his duties and responsibilities. In the UK decisions are made in accordance with HMRC's published Litigation and Settlement Strategy and it has taken specific steps to strengthen internal governance that are outlined below.

Standard working programmes and operating systems that guide the tax officers through a decision making process are another measure that revenue bodies have taken to improve the quality of the decision making process.

The Netherlands has published the Guide on HM in which they explain their way of working regarding HM to make the process transparent to both the tax officers and representatives of large businesses. Both parties can speak to each other about their expectations and the quality of the process, are in this respect both accountable. In the Netherlands the Guide on HM is supported by standard working programmes (an IT tool for audits called TOP). The Netherlands has also developed an online quality control process (called KMO), that is carried out prior to finalising an audit with a Large Business. Additional functionalities for this tool have been developed for (up to now) three new processes that are typical for the ´individual account management´ and thus horizontal monitoring. The processes of giving certainty in advance, the compliance scan and the strategic supervision plan.

Sweden believes that it is vital to produce a public written guide for co-operative compliance that explains the method's objectives, purposes and ingredients. This will support stability, equality and legitimacy in the method.

In a number of countries the work of CRMs (Client/Customer Relationship Managers) is overseen by senior managers and specialist staff. Decisions are escalated to a higher level. In Italy complex cases involving large business taxpayers are subject to strict coordination and are monitored at central level by the Large Business Taxpayers Division. New Zealand has an internal escalations policy and reports that all settlements are monitored centrally. In the case of Singapore, management staff is involved in driving the ETR programme and meet regularly with the companies.

In Ireland the Revenue's overall management hierarchy in the Large Cases Division ensures a "second pair of eyes", *e.g.* in an audit intervention the line manager is involved in the audit settlement approval process and it may be escalated to a Revenue Board Member for approval depending on size of the settlement.

South Africa has a similar policy to the extent that certain contentious issues are resolved through negotiated settlements, all approvals of such settlements are prepared by independent legal teams and approved by independent committees in accordance with the SARS governance framework.

The second pair of eyes is not confined to hierarchical arrangements, but is also integrated into peer review. Almost all revenue bodies have developed working methods in which teamwork and peer review (four eyes principle) should secure that independent decisions are made. In Denmark the contact person from the tax department does not act alone when making an appointment with the company. In some cases there are always two people involved as contact persons and in other cases the manager of the contact person is involved in the decision making. New Zealand comments that significant technical issues inevitably involve a number of tax and industry experts which limit the ability for one person to make a decision in isolation.

Some countries have established a specific multidisciplinary team for each large business. Generally this means that at least two of the team members participate in meetings with the taxpayer. South Africa ensures that minutes of these meetings are maintained. Norway reports that the work is based on teamwork (multidisciplinary team for each group of company) and joint decision making. Sweden appoints a compliance co-ordinator and a deputy co-ordinator for each co-operative compliance engagement. This ensures that continuity of the engagement can be maintained even if the ordinary compliance co-ordinator has to step aside from the case for some reason. Responsibility for decision making in significant tax issues, especially when this involved giving the company certainty in advance, is allocated to an "independent" specialist and not to the compliance co-ordinators.

Higher risks are escalated to specialists in Australia. This mechanism assures that more persons are responsible for the decision. In the Netherlands the client co-ordinator takes care of the day to day matters, including the relationship with the taxpayer and the tax expert is involved when technical discussion arises. In (complex) technical cases, when the client co-ordinator and the tax expert are not able to solve the case together, the client co-ordinator involves so-called knowledge groups or coordination groups. A knowledge group or coordination group is a group of tax experts who share their expertise nationwide and establish the tax position in (complex) technical cases. The client co-ordinator and tax expert will provide the knowledge group or coordination group with all the relevant knowledge (attitude of the taxpayer, facts and circumstances, technical information, etc.) on which the knowledge group can base its decision. This process assures also equality before the law.

In Sweden there is a steering group where issues of conduct are brought up as well as issues of equality. The measure keeps the answers given in advance on a separate track. The wider role of this steering group is to discuss and support the co-operative compliance work in general and the decision making about how the compliance co-ordinator should act in relation to sensitive suitability issues. The purpose is to promote equal treatment in accordance with the concept in the different co-operative compliance engagements and to support the compliance co-ordinator in the role of being

a "co-operative partner" to the company at the same time as a critically scrutinising tax officer.

Several countries invest in training programmes for their officers. These include both training for tax officers to discuss and review/monitor tax control frameworks (Netherlands and Norway) but also social skills (Ireland) and communication skills (Norway). In the Netherlands all tax officers working in Large Business units were obliged to attend a training programme in 2012 dedicated to the so called professional critical attitude. In this programme officers take part in workshops where typical dilemmas are discussed regarding the tension that might arise between on the one hand a straightforward application of law and regulation and on the other hand a co-operative compliance relationship.

Norway has established a new specific routine related to confidentiality and inside information. Since this work is based on working with the companies in real time and not in retrospect, the Client Relationship Manager get more information that is classified as inside information, than before. Norway organised a training to brush up the skills on this subject, in addition to establishing a specific routine on how this information is handled.

In the Netherlands experiences with horizontal monitoring and TCF specifically are shared and discussed in dedicated meetings of a network of experts from all tax regions and the national level. The aim of this network is to create a working process that is transparent, clear and predictable for large businesses and tax advisors.

Almost all revenue bodies have institutionalised rotation systems. The United Kingdom reports that Customer Relationship Managers are moved typically after four years to help ensure propriety. Sweden has a rotating system that limits the co-ordinators' and the deputies' assignments with the same company group to maximum five years. It is worth noting that a co-operative compliance relationship between large taxpayers and revenue bodies also requires that professionals on both sides of the table get enough time to build their personal relationship and to become familiar with the tax related special features of the large taxpayers. From the perspective of the quality of the co-operative relationship and the maintenance of service levels, revenue bodies should realise that time is required for succession and transfer of files.

Almost all revenue bodies report that they conduct in real time and/or retrospective quality reviews on a regular basis. The United States created their LB&I Quality Measurement System (LQMS) in 2001 to establish a quality measurement system for LB&I. This system includes reviews of CAP cases either in process or upon closure to ensure compliance with auditing standards. Australia has ongoing quality assurance processes to evaluate adherence to internal policies and procedures to ensure that there is transparency on decisions made when in the enhanced relationship. In these processes Australia undertakes monthly reviews of the case work, independent reviews of cases and external membership on quality review panels under our Integrated Quality Framework. Canada has an enhanced quality assurance/monitoring regime (Continuous Program Integrity Review) to assess completed audits of large entities on an ongoing basis for consistency and equitable treatment, among other elements.

In the UK HMRC has introduced strengthened governance arrangements for significant tax settlements, recognising that public confidence in its internal processes is highly important. In February 2012 HMRC announced changes to its governance for significant tax settlements, including the appointment of a new assurance Commissioner responsible for overseeing all large settlements and protecting the interests of taxpayers at

large. The Commissioner has an explicit challenge role in the decision making process on large tax disputes and has no part in HMRC's engagement with specific taxpayers.

Essential issues/principles concerning governance in revenue bodies that revenue bodies may want to take account of

In summary, revenue bodies have improved internal governance (and as a result thereof internal control) of the relationship with large business in a number of different ways. These measures can be divided into six categories.

The first category consists of integrity rules and core values and also includes formal measures and rules for filing and documentation. These measures are essential so that professionals are aware of the ethical rules and expectations that the revenue body has. This category includes also formal measures within a revenue body as well as those specifically applied to co-operative compliance cases which are applied generally. The rules of the game should be clear and professional staff should know what is expected of them.

The second category is composed of standard working programmes and operating systems. Written guides can also be included in this category. These measures contribute to an unambiguous and predictable way of working and also support the officers within revenue bodies. Working programmes and guides are based on the legislation and on ethical rules and core values. If the working programmes and/or guides are shared with or even developed in consultation with large taxpayers and their representatives (such as tax advisors) and also publicised, the support offered by these products can be increased.

The third category can be summarised as the involvement of a second (or even more) pair(s) of eyes, which should ensure that decisions regarding large taxpayers are not made by a single individual. Experiences of the revenue bodies are different, which may reflect cultural differences and differences in regulations. Some countries have a system of peer review, others build on joint decision making and teamwork. Some countries have chosen escalation models in which senior management and specialist staff have important roles, and some have developed distinct tracks for giving certainty in advance. Most countries apply combinations of these measures.

The fourth category consists of training programmes and programmes of regular contact between experts involved, whether as members of case teams or as technical experts operating at the national level. The goal of these programmes is to enable tax officers to learn together and to learn from each other. Topics of these programmes can involve social and communication skills but also new phenomena such as knowledge about tax control frameworks. It is also an opportunity to discuss and share dilemmas and best practices.

The fifth category includes rotation systems. These measures ensure that from time to time fresh ideas come into the team within the revenue body and thus the relationship with the large taxpayer. They also address the risk that officers lose their independent and professional critical attitude or may be perceived as having done so.

Last but not least the sixth category consists of review and monitoring systems that revenue bodies use to measure the quality of the work that is done on an ongoing basis. Usually these measures have a retrospective character. However, they also include the involvement of senior officials who are not party to the co-operative relationship with taxpayers in the decisions making process for large tax disputes. These measures give

revenue bodies' insight in the way that an individual large taxpayer is treated but also in how this treatment relates to the treatment of other comparable large taxpayers. This provides added assurance that the process is impartial and delivers consistent outcomes. It also helps revenue bodies to get an overview on how their concept of co-operative compliance is working and to consider the need to make adjustments to the concept. In this way a ´learning cycle´ can be created. The challenge for revenue bodies is to develop review and monitoring systems that work and are effective ´in real time´ or at least shortly after an event.

It is recommended that countries consider all six categories when designing their Internal Governance frameworks. Some of the measures are about the design of the co-operative compliance programme and the concept (categories one and two), other measures concern actually working with the programme (categories three and four), one is a preventive measure (category five) and some measures are needed to assess the quality, impartiality and effectiveness of the individual decision making and the programme as a whole (category six).

Notes

1. National Audit Office (2012), *Settling large tax disputes*, London, June 2012, *www.nao.org.uk/report/settling-large-tax-disputes/*.
2. Committee Horizontal Monitoring Tax and Customs Administration (2012), *Tax supervision – Made to measure*, The Hague, page 51.
3. This followed an earlier report by the NAO in July 2011 on HMRC's process for resolving tax disputes, in which 27 major cases were reviewed. The NAO endorsed the strong governance that HMRC had in place for large business tax settlements.
4. National Audit Office (2012), *Settling large tax disputes*, London, June 2012, *www.nao.org.uk/report/settling-large-tax-disputes/*.

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Chapter 6

Evaluating the value of co-operative compliance

Introduction

A revenue body has a responsibility to ensure it manages its compliance risks in a cost-efficient and effective way. New strategies or new instruments as part of a sound compliance risk management system must contribute to the strategic goals of the organisation (effectiveness) against the lowest possible costs (efficiency). In addition society will require the revenue body to be able to demonstrate how any new strategy or instrument adds value to the public asset that is the tax system. In the specific case of the co-operative compliance model this entails both making visible how the model operates in practice and how it contributes to a higher level of compliance and a higher level of assurance that the correct tax is being paid and that there is a consequent decrease in the tax gap.

The goal of this chapter is to provide inspiration and information about the design of measures of effectiveness and efficiency for co-operative compliance approaches and to give examples demonstrating the added value of such approaches. Co-operative compliance approaches are part of an overarching compliance risk management strategy and it is important to understand how they contribute to the desired outcomes of those strategies, being improved compliance.

Business case

The introduction of a co-operative compliance strategy is designed to deliver improvements to compliance outcomes but also involves the allocation (or reallocation) of the tax authorities financial and human resources. A business case assists in determining the strengths and weaknesses of a proposal for the implementation of a new strategy or instrument in a systematic and objective manner. It will substantiate arguments for a proposal and justify resource investment.

The business case should set out:

- The goals to be achieved by the new approach;
- The features and scope of the new approach;
- The options considered and the rationale for choosing the solution proposed;
- The conformity of the approach with existing policies;
- The implementation plan;
- The expected costs and the time it takes to realise benefits from the investment;
- The anticipated outcomes and benefits and how these will be measured; and
- The expected risks associated with the implementation of the new instrument.

Box 6.1. The Netherlands – Business Case

The Committee Horizontal Monitoring[1] stressed the importance of a proper business case in its evaluation report. "….the Committee also notes that at the time of the implementation of horizontal monitoring there was no business case, no benchmark measurement had been carried out and no explicit performance indicators and/or critical success factors had been formulated, as a result of which an adequate management mechanism has been lacking to date."

In Annex F we summarise some of the practical lessons that revenue bodies have learnt in the process of implementing co-operative compliance strategies, which may assist in the development or refinement of business cases for such strategies. In this chapter we are concerned more specifically with the process of evaluation in terms of costs and benefits, both for revenue bodies and large businesses, and the measurement of effectiveness.

Costs and benefits for the revenue body

Generally speaking the cost of implementing a co-operative compliance strategy for a revenue body will be relatively easy to track, using the cost accounting systems of the administration. They will tend to be dominated by the salary costs of the professional staff involved. As with any programme involving a significant change in ways of working, the transition to a co-operative compliance model involves some initial investment. The nature of that investment is evident from some of the lessons that countries have learnt from early implementations of the model, which are discussed in Annex F. However, in most countries that were surveyed it seems this initial investment was made by redirecting resources from traditional interventions in order to establish the new way of working, sometimes starting with a pilot project. Often that has included an intensive effort to settle any legacy of existing disputes between the revenue body and the large business. But in aggregate, the move to a co-operative compliance model does not necessitate an increase in the total resource devoted to the management of the large business segment.

The UK's experience is that it has been possible to increase compliance yield with reducing resources, by focusing those resources on the most significant risks. Whilst this could have been attempted without developing co-operative compliance relationships, HMRC believes that the taxpayer transparency achieved through those relationships has greatly assisted the effective targeting of resources to risks.

Given the pressures on revenue bodies to constrain or reduce their overall costs, it is perhaps not surprising to find that, generally speaking, the adoption of the co-operative compliance model has not been associated with an increase in the costs of dealing with the large business segment. That suggests that it has either improved, or at least not degraded the efficiency of the operations of revenue bodies that have adopted it. But the more important question is whether, in addition to controlling or even reducing costs, the combination of co-operative strategies and audit type interventions that was outlined in Chapter 3 has proved to be a more effective model in terms of assuring a better overall level of compliance and as a result a more secure yield from the tax system than traditional strategies, which rely on audit interventions alone. To answer that question it is necessary to look at the ways in which revenue bodies have measured the effectiveness of the co-operative compliance strategy.

Indicators for measuring effectiveness

The trend in the evaluation of how effective revenue bodies are in securing high levels of tax compliance is to place greater emphasis on measures of outcomes (the total tax yield secured) rather than output measures, such as the frequency of audit interventions and the direct yield from those interventions. This trend reflects an increased demand for outcome measurements within revenue bodies to improve compliance risk management and also from external stakeholders.

Evaluation can take place at different levels. At a global level evaluation can help indicate how the administration is meeting its long term objectives of maximising compliance (*e.g.* reducing the tax gap). Some countries have sought to develop more sophisticated measures of the tax gap in recent years and these may provide new insights into the macro trends in compliance over time. An improved understanding of the tax gap and its components arguably enables the legislative and executive branches of government to make better decisions about tax policy and a better allocation of resources for the administration of taxes. However, tax gap measures remain controversial, with opponents questioning their accuracy, reliability and value as a tool for the management of the tax system. At the tactical level (target groups or economic sectors) or at the operational or activity level there is a need for measures that help guide activities towards those actions that are most effective in terms of outcomes. In the survey we asked about the measures revenue bodies use to measure the effectiveness at operational level of their compliance risk management activities and in particular, co-operative compliance.

Results of the survey

As we acknowledged in Part 7 of Chapter 2, establishing good quality metrics is a challenge, because existing measures are output focused and generally measure the results of correcting non-compliance. It is therefore not surprising to find that the vast majority of revenue bodies we surveyed are in the process of developing new indicators that are designed to assess the added value of co-operative compliance. A few countries already have a system of outcome based measures or indicators in place to 'measure' either a specific programme (such as 'co-operative compliance') or the overall impact of their compliance strategy.[2]

The results of the survey show that Australia is evaluating the effectiveness of the overall compliance strategy and not of 'co-operative compliance' as such. The Australian Taxation Office (ATO) developed and uses a Compliance Effectiveness Framework for their overall measurement.

In the Netherlands the Committee was asked to evaluate HM. The Committee has not been able to research effectiveness and efficiency because insufficient data were available. The Committee therefore recommended that the revenue body develop a coherent set of indicators to measure both effectiveness and efficiency in its dealings with the taxpayer. The efficiency can be reviewed on the basis of the relationship between the available capacity and the financial resources, the activities carried out within the scope of horizontal monitoring and the results achieved by these activities (output management). The effectiveness can be reviewed based upon a set of indicators related to the overall goals and sub-goals the NTCA wants to achieve with horizontal monitoring.

The United Kingdom evaluates the effectiveness of the Large Business (LB) strategy as a whole, using as key indicators: maximising revenue, customer experience and cost reduction. In Italy the traditional evaluation methods adopted to evaluate the first three

years of activity of this new programme demonstrated excellent outcomes. Although an estimate of the increase in tax compliance is not available, evidence shows that the increase in taxes collected due to self- compliance is significant.

The United States has been developing metrics to assess the effectiveness of their Compliance Assurance Process (CAP) programme. The Internal Revenue Service (IRS) has developed metrics for CAP that are used in assessing taxpayer satisfaction, employee satisfaction, quality, cycle time, time applied, and cases closed. Metrics for the impact of CAP on reporting compliance are still being considered. Equivalent metrics used for traditional post-file examinations are not useful in CAP since they are calculated using adjustments proposed by the IRS on filed returns and CAP is a pre-filing programme. The IRS is continuing to study alternative methods for assessing the compliance of CAP taxpayers, though current efforts are not focused on creating metrics. As such, a metric for impact of CAP on compliance remains elusive.

Some countries that have not (yet) measured the effectiveness, such as Ireland, New Zealand and Norway have mentioned criteria they would be using if evaluating. Norway (evaluation of pilot) mentioned a survey of taxpayers' opinions, mapping of internal controls changes and contact history. Ireland mentioned monitoring Large Taxpayer compliance, number of self-reviews and voluntary disclosures. New Zealand (evaluation of pilot) mentioned the objectives of the programme, the approach taken to realize objectives, experiences since inception and the issues arising in effectiveness, timeliness, and appropriateness.

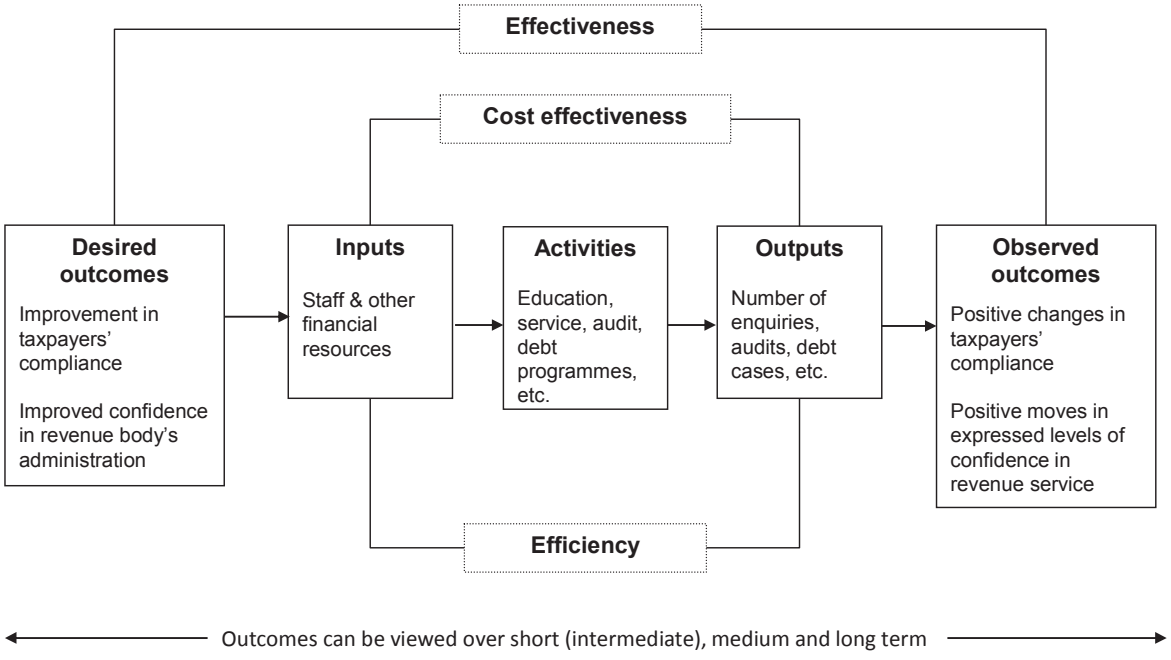
Experience to date demonstrates that co-operative compliance strategies can deliver measurable improvements in terms of the improved efficiency of the process (such as reduced time to resolve issues and reduced costs). These programmes have also produced significant benefits in terms of traditional measures, as substantial legacies of open issues have been settled and taxes due as a result have been collected. The results of the survey with respect to "effect or outcome indicators" that are used, show that most countries are at an early stage in developing a measure (or measures) that focuses on improved outcomes and that is forward looking and relevant at the operational and activity level.

As we noted in Chapter 5, existing output measures focus on the consequences of non-compliance, as they measure the yield from the successful detection and correction of that non-compliance. In the longer-term, interventions that are designed to improve levels of voluntary compliance inevitably do not score well against such measures. What is needed is an approach that focuses on the degree to which voluntary compliance has improved, rather than amounts of non-compliance that have been detected.

Measuring effectiveness of co-operative compliance in practice

Measurement of effectiveness is not a stand-alone activity. In developing a coherent system of measures and indicators to evaluate compliance strategies, both effectiveness and efficiency are important, whether the subject matter of the measurement is the compliance strategy as a whole or a specific programme. In designing such measures, it is helpful to have a clear understanding of how the overall system operates to derive outcomes from outputs, and how these are linked in a cause-effect chain. The figure below, which is taken from the FTA's 2010 guidance note[3] illustrates how this can be done.

Figure 6.1 Tax compliance programme logic



Source: OECD (2010), FTA Guidance note, www.oecd.org/ctp/taxadministration/46274278.pdf

The starting point for measuring effectiveness is the key hypothesis of the organisation's overall compliance strategy or the key hypothesis of the (new) instrument. For example, the ATO has developed a Compliance Effectiveness Framework to measure the effectiveness of their overall compliance strategy. The hypothesis of ATO reads: if our compliance strategies have been effective then we should see positive and sustainable changes in compliance behaviour with one or more of the key compliance obligations (i.e. registering, timely filing of the tax return, correct and complete declaration of taxes and timely payment).

When the revenue body has enough information to be satisfied that a particular taxpayer is able and willing to be "in control "it will be possible to adjust its supervision plan and redirect time and resources to other taxpayers that have not met this standard. The revenue body bases this decision on an understanding of the tax control framework that is in place, the awareness of and access to the results of the taxpayer's internal monitoring processes and its own tests of the reliability of the system (reality checks). It is an evidence based decision, rather than a subjective judgement.

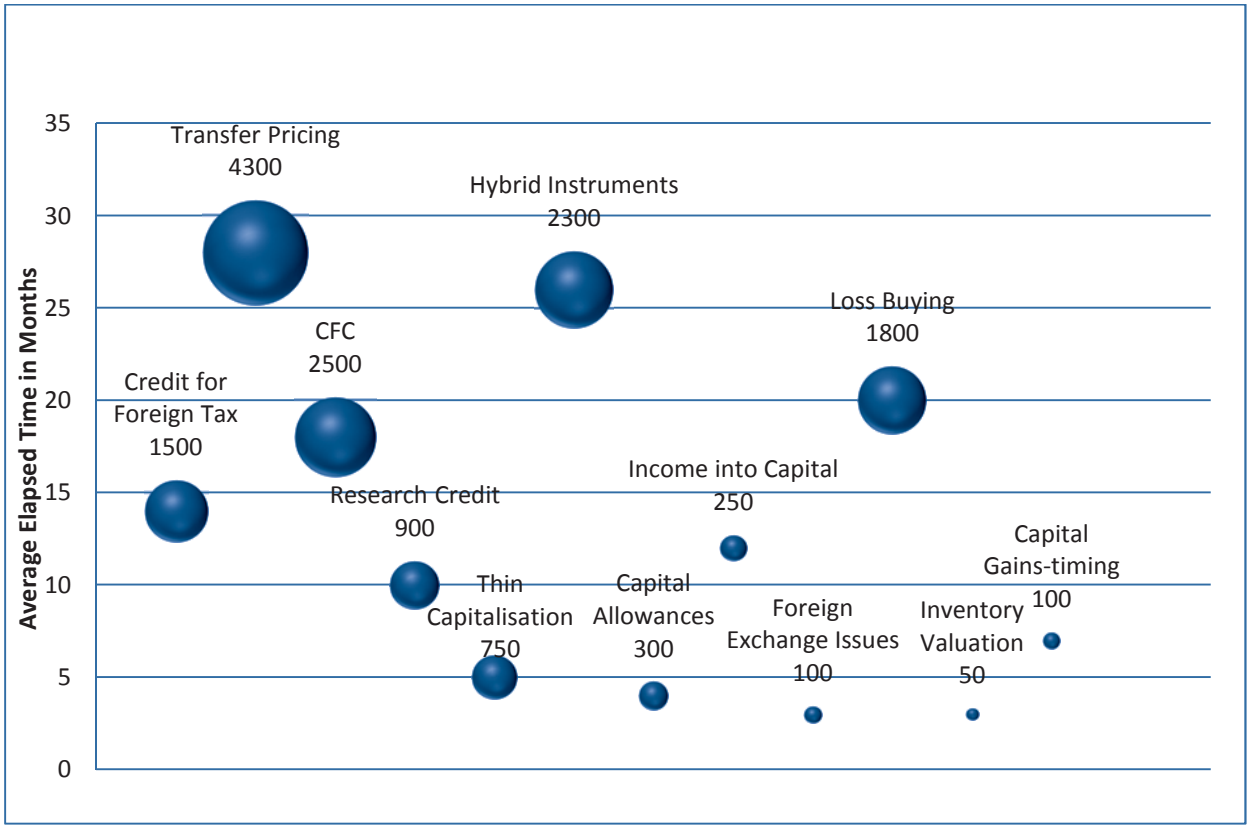
All those taxpayers who have entered into a co-operative relationship and met the necessary standard of tax control therefore represent that proportion of the tax base that is assured as accurate[4]. That is a measurable number and as the numbers of taxpayers who match that description grows, so does the proportion of the corporate income tax base that is assured. That can be measured as a year on year improvement and is a forward looking measure. At the operational level it is therefore a good guide to the progress being made towards the ideal state, which is to have all large corporate taxpayers demonstrating desired standards of transparency, disclosure and tax control. Over time the increase in the proportion of the corporate income tax base that is "assured" will correlate with a

reduction in the tax gap attributable to corporate income tax.[5] Measures of the tax gap tend to be backwards looking by nature, depending as they do on the analysis and comparison of historic data. This means that they are less helpful as an operational success factor and guide for managers. The overall value of tax gap measures remains a controversial subject but those countries that make use of them can cross check measures of success that are used at the operational level against their estimates of changes in the tax gap.

Where the desired level of assurance is achieved, there can be confidence that the correct tax is being paid, at least to the extent that what is payable is clearly understood and agreed. However, we also have to acknowledge that, as discussed in parts three and four of chapter 3, uncertainties and differences of opinion about the tax treatment of certain transactions will arise, even in the context of co-operative compliance. A strong tax control framework is consistent with that. It means that tax returns are submitted that can be relied upon but also that any aspects of the return that may give rise to a difference of opinion about the operation of the law are explicitly identified. As a result, the quantum of uncertainty about the tax liability is identified at the outset. The tax at risk as a consequence is a known quantity and can be tracked as the process for resolving that uncertainty unfolds.

Measures of the effectiveness of a co-operative compliance strategy will need to include data about dealing with disputes. That will include metrics of the kind already used to track the time taken to reach resolution. It will also include data about the results of that resolution in terms of the additional tax arising, or in some cases the reduction in liability that results. There is also the potential to use this data to derive other information about the operation of the tax system that is of strategic value. At a minimum, it will be possible to track the aggregate quantum of doubtful issues and to see if that is increasing or decreasing over time. But it is possible to go further than that. This depends on there being in place a rigorous typology of the issues of doubt or difficulty that are being reported. However, as long as issues that are the same are recorded in the same way, it is possible to see in which parts of the tax system issues are arising, how much in aggregate appears to be at stake and how long on average the issue has been working across the whole population of large businesses. This is an approach that the UK is already using to analyse the main issues that are arising in its population of large business taxpayers. It makes it possible to see which parts of the tax system are giving rise to difficulties, which may be very valuable to those responsible for the overall design of the system. It is possible to represent this information in visible form as a chart. The chart below has been populated with fictional data to illustrate how this may be done.

Figure 6.2 Large Business issues – Total tax at risk in million EUR



Source: FTA Large Business Network

Taken with the metrics that countries have already developed, the measure of the degree to which the tax base has been assured, coupled with the measure of the value of uncertain tax positions, would seem to form a suite of measures that can be used to assess the effectiveness, as well as the efficiency, of co-operative compliance strategies. The validity of these measures depends, however, on the rigour and consistency with which tax control can be assured and uncertain tax positions identified and quantified. The tax control framework needs to enable an objective assessment of the reliability of the systems that ensure the accuracy of the tax return, and the associated disclosure of uncertain, or contentious, positions that are contained within that return.

Qualitative benefits for revenue bodies and business

Introduction

The primary focus of this chapter has been the measurement of the contribution that co-operative compliance can make to the overall effectiveness and efficiency of a revenue body's compliance strategy. However, some of the benefits that can be expected from co-operative compliance, and which were listed in Chapter 2, are not quantitative but qualitative in nature. Revenue bodies are an integral part of the changing environment in which large business operates. This requires an approach to managing tax compliance that is dynamic. By moving to a more consultative and collaborative relationship, the revenue body can better understand the business and its environment. The administration is

therefore better placed to identify risk and help business improve certainty through ongoing open dialogue.

The Communiqué which was issued following the fourth meeting of the FTA[6] summarised the benefits of enhanced relationships between revenue bodies and taxpayers:

> *"An enhanced relationship offers benefits for revenue bodies as well as taxpayers….taxpayers who behave transparently can expect greater certainty and an earlier resolution of tax issues with less extensive audits and lower compliance costs. An enhanced relationship between revenue bodies and tax intermediaries would also yield significant benefits."*

The value of co-operative compliance approaches must be demonstrated clearly and in quantitative terms. This is a joint responsibility and role for businesses and revenue bodies. The business has a strong case for the enhanced relationship: certainty in exchange for transparency. This fits with the business' wish to pay the right amount of tax on time and to reduce risk; transparency is key. Revenue bodies and businesses want greater certainty and to reduce risk and administrative costs; there is a combined benefit. Measuring these quantitative benefits poses some challenges that have been discussed. However, these quantitative measures can be enhanced by measures focused on the more qualitative aspects. In particular, it is natural to expect that successful co-operative compliance regimes will positively influence the ways in which the revenue body and the compliance process are viewed. It is possible to obtain evidence about this in various ways, including by means of surveys. The experiences of countries that have sought qualitative feedback about their programmes are discussed below and serve to illustrate the types of insight that can be obtained. Finally, the quantitative benefits for business are hard for revenue bodies to measure directly but we outline the benefits that arise to business, based on the surveys undertaken by countries and comments from the business community.

In the United Kingdom, an independent evaluation was carried out. In 2008 HMRC commissioned an independent evaluation of the Review of Links with Large Business (RLLB) by an external research agency reporting in spring 2009 to evaluate Large Business customers' experience of doing business with HMRC. The research found that:

- HMRC large business staff were more commercially aware, professional and helpful – particularly CRMs;
- the CRM role was welcomed and was making a difference – bringing a more pragmatic approach to tax administration;
- there was unanimous support for the risk-based approach;
- the quality of website guidance had improved;
- UK compared well with other countries as a place to do business.

But there were still areas for improvement at that time in:

- access to guidance and advice;
- commercial understanding in other parts of HMRC;
- a more strongly co-ordinated infrastructure within HMRC;
- further development of online services;
- less complexity.

In 2010, HMRC also carried out an evaluation of their intensive engagement with certain customers, which takes place in the High Risk Corporates Programme (HRCP). The HRCP Board maintains a close watch on cases post settlement and businesses are only removed from the programme if there is clear evidence over a period of time of measurable improvements in behaviours. As a result of the Programme the following evidence of behavioural change has been gathered:

- Some high risk businesses had already been taken out of the Programme because there was clear evidence of behavioural change in terms of the nature and scale of the tax avoidance/planning undertaken and the degree of openness and transparency.
- There was evidence from a number of businesses of tax schemes not being implemented or the benefits not being claimed because the businesses had recognised that those schemes were not consistent with the behavioural assurances they had given during the HRCP process.
- There was also evidence in HRCP cases that Corporate Boards were taking more accountability for tax and for developing the relationship between the corporation and HMRC.
- Generally the levels of openness and transparency on tax had improved.
- HMRC recognises that the influences on the behaviours of these businesses are complex and that many aspects of the overall strategy, as well as HRCP, will have caused these changes.

In Ireland the approach and methods of introducing and implementing of the co-operative compliance approach proved to be very successful. Accordingly, if the Irish tax office was to commence the process again it is likely that they would use the same formula to engage taxpayers in the model. Their experience to date has been that the ongoing interaction between large business and the Large Case Division provides a channel for constructive dialogue within an environment of trust where issues can be resolved in a professional manner. The co-operative compliance approach has helped the Irish Revenue to gain a better understanding of the needs and behaviour of large business and to further refine their strategies, including provision of suitable and targeted services, to improve compliance based on this understanding.

Overall, countries which carried out a qualitative evaluation of their co-operative compliance programmes indicate the following main benefits:

- A very efficient means of profiling/risk assessing a group and gaining direct access to the senior tax managers.
- No surprises on either side.
- A better and real-time information position (understanding of businesses and their position in relation to tax issues); updates on current significant events affecting the taxpayer, awareness of commercial knowledge,
- Greater certainty in relation to forecasting tax yield and accurate and timely tax returns and payments.
- Faster resolution of issues from committed parties.
- Enhanced and more open relationship between revenue body and the taxpayer.

Box 6.2. The Netherlands – Horizontal monitoring

A written questionnaire was sent to all tax directors and tax inspectors participating in the first pilot (20 large businesses) in 2007. According to both parties the pilot resulted in an improvement of the tax climate in the Netherlands and that the new method of working was more effective and efficient. Also both parties stated that their relationship had improved and that working in real time was an advantage as well as speedier certainty. In particular the decrease of uncertainty was listed as an advantage by businesses while the revenue body mentioned the involvement of their higher management level as positive. Finally parties disagreed about compliance: while tax officials noted an improvement, the businesses did not report a change in their compliance behaviour.

Report Horizontal Monitoring Committee

The outcome of the evaluation of HM by the independent Government Committee was published in June 2012. With regard to the advantages of the HM approach Committee's report confirms the advantages for the revenue body (greater transparency, speedier certainty and increased mutual understanding) reported in 2007. The Report's overall conclusion with regards to the LB segment reads as follows.

1. Compliance with the regulations can be promoted by giving taxpayers more trust and personal responsibility. The taxpayers in turn need to place more trust in the NTCA. Ultimately, the success of this approach depends on both parties demonstrating that the trust placed in them is justified.
2. The NTCA's supervision can be conducted more effectively and more efficiently when it can rely on measures implemented for the administrative organisation and internal control, as well as internal and external audits of, in particular, Very Large Businesses.
3. The above two points will result in a reduction of both the supervisory burden imposed on taxpayers and the implementation costs incurred by the NTCA.

The Committee concludes: The truth of the first two principles (hypotheses) has been more than confirmed for the Very Large Businesses segment. The pilot within the Very Large Business segment demonstrated the willingness of the businesses taking part in the trial to give shape to the trust placed in them by the NTCA: they also assumed the responsibility for the more adequate fulfilment of their tax responsibilities. In conclusion, the question as to whether the supervisory burden and implementation costs have actually been reduced in this segment: the Committee has observed satisfaction on the part of taxpayers in the Very Large Businesses segment. Although solid substantiation in the form of data is lacking, the perceived supervisory burden imposed on businesses in the Very Large Businesses segment would appear to be lower. However, the NTCA has not been able to demonstrate to the Committee that the supervisory burden imposed on the Very Large Businesses segment has also been reduced in an absolute sense. The Committee assumes that taxpayers in this segment will actually be prepared to withdraw from agreement relationships that are unfavourable to them, since this option is available to them by virtue of the mutual voluntariness: it takes two to tango.

The Committee is also of the opinion, on the basis of the practical experiences stated by the partners to the discussants,that it is probable that the Tax and Customs Administration's implementation costs have not declined to date. This opinion is based on the fact that a lot of time will need to be devoted to the development of a relationship based on trust in the initial phase of horizontal monitoring: time will be required to conclude the agreements, gain an insight into the business and its culture, review the tax control framework, give the appropriate shape to the preliminary consultations and, in particular, to the Tax and Customs Administration's development of an adequate organisation for horizontal monitoring in this segment.

The main benefits for a business

The benefits for business would appear to be a follows:

- Improved compliance: By appropriately considering and working to reduce significant tax risks, boards of large businesses can increase the standard of their corporate governance and their awareness of the implications of major transactions. The standard of corporate governance has a direct bearing on whether a company has a high, moderate or low tax risk level. Business will be better able to manage their tax risks through products such as the Annual Compliance Arrangements in Australia.
- Improved compliance through an enhanced relationship due to increased transparency, understanding and trust founded on an improving TCF.
- Lower compliance costs: revenue bodies focus the majority of their large company compliance resources on high risks, particularly where taxpayers are not transparent, open and compliant. Large businesses that have good corporate governance practices and enhanced relationships with the revenue body will generally experience fewer audit interventions, since the audit and enforcement focus will be biased towards those not committed to high compliance standards.
- This contributes to greater certainty and the potential to reduce compliance costs. The cost of compliance is expected to be lower for those large businesses in an enhanced relationship as the intensity of engaging with such business is in most cases less when compared to higher risk taxpayers.
- Quicker tax audits, more focused on improving internal processes and (future) compliance, faster filing and settling of returns and fewer post filing audit adjustments thanks to the Tax Control Framework and joint tax risk assessment, can also reduce administrative costs and the compliance burden.
- Greater use of the work of others by the revenue body (for example internal and/or external auditors) could reduce the costs for the taxpayer.
- Greater certainty: Greater certainty in relation to tax exposure; faster and more certain tax positions (taking into account commercial deadlines). Increased control of the tax position should reduce the need for reserves for tax risk. Greater certainty from reliable and quantifiable tax positions that can be reported almost immediately results from dialogue between the revenue body and large business about tax risks in 'real time'. Discussing transaction as closely as possible to the time that the transaction is implemented, if not earlier, can reduce the incidence of tax shortfalls and administrative penalties. There are also significant benefits for the large business as it can address any concerns that the revenue body has whilst the details are fresh in the 'corporate memory'.
- Corporate Social Responsibility: Co-operative compliance models will also help to boost community confidence in the fairness of tax systems demonstrating that revenue bodies are addressing non-compliance in an effective way.
- Highlighting problems: The opportunity to highlight problems with the tax code or its administration. The increased ability to identify and bring to the relevant law-making body's attention, areas where the law is not operating satisfactorily or is producing unacceptably high compliance costs.

Box 6.3. The Netherlands – Tax Monitor

Large Business Compliance Monitor 2011

NTCA annually researches (through a survey) taxpayers' attitudes towards the revenue body and paying taxes (Tax Monitor). LB's opinion about Horizontal Monitoring was also examined in 2011; a few figures:

- almost all LB's are aware of HM and indicate it's clear what is expected under HM;
- 84% of the respondents from the LB's who came into contact with HM had a favourable to very favourable perception of HM developments;
- most of the LB's indicate there are many benefits for the revenue body;
- around 75% indicate that there are benefits for the business;
- LB indicate there as a result of HM has been an increase in mutual transparency, mutual trust and understanding, more actual and real-time working position, more questions in advance and more certainty tax position;
- HM has led to an increase of quality of internal control of the taxpayer (69%);
- around 33% of LB indicate they believe the level of supervision will decrease;
- around 50% of LB do not think that the cost of their consultant or their internal control has been reduced.

What taxpayers expect to gain from transparency – an overview of expectations from a bank[1]:

- Better Policy;
- Transparency on decision making in government;
- Improvements in the audit process;
- Less frequent, more focused audits;
- Better/Quicker dispute resolution;
- Greater certainty;
- Lower Tax Reserves.

1. Seminar "Developing the enhanced relationship in the banking sector" organised by Agenzia delle entrate (Italian Revenue Agency), in co-operation with the Italian Banking Association AIBE (Italian Association of Foreign Banks) and the OECD Centre for Tax Policy and Administration, October 10-11, 2011.

Notes

1. *http://download.belastingdienst.nl/belastingdienst/docs/tax_supervision_made_to_measure_tz0151z1fdeng.pdf.*
2. There is a difference between measures and indicators. Where measures are direct and precise, indicators are less direct and proxy.
3. OECD (2010) E*valuating the effectiveness of compliance risk treatment strategies*, OECD, Paris. *www.oecd.org/tax/administration/46274278.pdf.*
4. By accurate we mean within the tolerances of accuracy that the revenue body has indicated are acceptable, given that the principle of proportionality requires revenue bodies not to pursue points that are not material. Accuracy in this context is also subject to the general constraint that audit processes rely on sample checks and a systems approach, rather than a 100% check of every transaction, which would be wholly impractical and unaffordable.
5. And indeed to other taxes that the large businesses in question are liable for, or account for (such as VAT and payroll taxes).
6. OECD (2008), Forum on Tax Administration, *Cape Town Communiqué*, January, *www.oecd.org/ctp/administration/39886621.pdf.*

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OECD (2008), Forum on Tax Administration, *Cape Town Communiqué,* OECD, Paris, *www.oecd.org/ctp/administration/39886621.pdf.*

OECD (2010) E*valuating the Effectiveness of Compliance Risk Treatment Strategies*, OECD, Paris. *www.oecd.org/tax/administration/46274278.pdf.*

Chapter 7

Conclusions, recommendations and next steps

Key conclusions

The principal conclusions of this report are as follows:

- The original concept of a relationship based on co-operation and trust set out in the 2008 Study has proved its worth. The number of countries that have a programme based on the concept has grown markedly since 2008: of 26 countries contributing to this report, 24 have established some form of co-operative compliance programme. Countries also report that they have secured significant additional yield as they have settled the legacy of open disputes with large taxpayers entering into co-operative compliance relationships.
- The term "co-operative compliance" more accurately describes the concept than the original label "enhanced relationship" and avoids misinterpretation.
- Co-operative compliance is entirely consistent with modern compliance risk management strategies.
- Since the publication of the 2008 Study some commentators have voiced concerns about the compatibility of the approach with equality before the law, possibly because of perceptions arising from the use of the term "enhanced relationship". This issue has been addressed directly and co-operative compliance does not conflict with equality before the law.
- Separately, concerns have been voiced about the increasing emphasis on compliance with the spirit of the law. The report concludes that a co-operative compliance relationship does not preclude conflicts between revenue bodies and taxpayers about the application of the law to a particular set of facts. However, in practice the incidence of such disputes is likely to be lower and their resolution swifter.
- The original pillars of co-operative compliance relationship described in the 2008 Study remain valid but certain additional features are now seen as essential. In particular, the central importance of the Tax Control Framework (TCF) is now clear.
- Basing the relationship on an explicit and objective assessment of the taxpayer's ability and willingness to provide the necessary disclosure and transparency (the TCF) means that it is and can be seen to be based on justified trust and empirical evidence. It also provides a foundation on which it is possible to develop a measure of the contribution made by co-operative compliance to securing the tax base.

Recommendations

There is scope to further develop and strengthen the co-operative compliance concept. Revenue bodies are encouraged to consider the following:

- Given the central importance of Tax Control Frameworks, there is a need for more research and discussion of how these frameworks can best be assessed and what additional guidance could be given to business about revenue bodies' expectations of them.
- Effective internal governance of the decision making process within revenue bodies is essential if they are to address and be seen to address the risk of attachment associated with co-operative compliance strategies. If they have not already done so, revenue bodies are encouraged to consider the principles of governance set out in Chapter 5 and procedures that ensure that decisions regarding large taxpayers are not made by a single individual.
- Measures of the effectiveness of co-operative compliance strategies need to be refined and integrated into the assessment of the overall compliance strategy. Measures which rely on audit interventions alone will not suffice. Revenue bodies need to place greater emphasis on a basket of measures with an outcome rather than an output focus. At the tactical/operational/activity level measures are needed that help guide activities towards actions that are most effective in terms of outcomes.
- Measures of co-operative compliance will need to focus on the portion of the tax base that is assured as accurate as a result of there being a co-operative relationship. There is also scope for revenue bodies to make much better use of data about disputes to inform strategic thinking and policy making.
- Revenue bodies should use improved measures to validate the business case for co-operative compliance and to make the contribution it makes to overall compliance outcomes more transparent to their key stakeholders.

Looking ahead

As the number of countries adopting co-operative compliance and businesses involved in co-operative compliance approaches continues to grow, so will the collective knowledge about and experience of Tax Control Frameworks. These will mature and it is important to keep sharing that experience and the consequent refinements of the co-operative compliance concept. It will be important that this sharing takes place, not only between revenue bodies but also with the business community.

Of equal importance is to keep our attention focused on opportunities for multilateral co-operative compliance; in an increasingly globalised world in which more countries are adopting co-operative compliance strategies. Increasing cross border transparency, disclosure and early certainty are of vital importance to both revenue bodies and MNEs.

Finally, this Study has established that many revenue bodies are in the process of developing indicators for measuring the efficiency and effectiveness of their compliance strategies in general and co-operative compliance in particular. Revenue bodies will benefit from sharing best practices and experiences in this specific area.

Annex A
Overview of websites and links to public information about co-operative compliance

Country	Websites and links
Australia	*www.ato.gov.au/* Large business and tax compliance *www.ato.gov.au/content/33802.htm* Annual Compliance Arrangements *www.ato.gov.au/content/00167346.htm* Lead Relationship Manager program – Opening Speech by the Commissioner Michael D'Ascenzo at the Corporate Tax Association Convention Melbourne, 15 June 2009 *www.ato.gov.au/corporate/content.aspx?doc=/content/00197255.htm* Large Business Advisory Group *www.ato.gov.au/businesses/content.aspx?doc=/content/00172756.htm&pc=001/003/112/002/004&mnu=0&mfp=&st=&cy=* Large Business Advisory Group charter *www.ato.gov.au/businesses/content.aspx?doc=/content/00190470.htm&pc=001/003/112/002/004&mnu=0&mfp=&st=&cy=* ATO Compliance Program 2011-12 *www.ato.gov.au/corporate/content.aspx?doc=/content/00284023.htm&pc=001/005/008/009/002&mnu=0&mfp=&st=* Reportable Tax Positions *http://group1.www.ato.gov.au/businesses/content.aspx?menuid=0&doc=/content/00302809.htm&page=1&H1* Risk Differentiation Framework *www.ato.gov.au/content/00246010.htm* Compliance effectiveness *www.ato.gov.au/content/00149070.htm* GST governance and risk management guide *www.ato.gov.au/content/00256428.htm* Condition 13 of ASX Listing Rules *www.asxgroup.com.au/media/PDFs/Chapter01.pdf* Corporate Governance Principles and Recommendations with 2010 amendments issued by the AXS Corporate Governance Committee, refer to Principle 7 *www.asxgroup.com.au/media/PDFs/cg_principles_recommendations_with_2010_amendments.pdf* Settlement of tax disputes code *www.ato.gov.au/content/8249.htm*
Germany	Co-operative approach for tax audits in Lower Saxony *www.ofd.niedersachsen.de/portal/live.php?navigation_id=17549&article_id=67842&_psmand=110*

Country	Websites and links
Ireland	www.revenue.ie Revenue's document "The Co-operative Approach to Tax Compliance" *www.revenue.ie/en/business/running/large-businesses.html*
Italy	Transfer pricing documentation requirements: Unofficial Translation of the Decision of the Commissioner of Italy Revenue Agency dated September 29, 2010 (ref.2010/137654 29.09.2010) *www.agenziaentrate.gov.it/wps/wcm/connect/407e6800444f85af891ceb536ed3dbc9/ItalyCommissionerDecision_29_09_2010_transfer_pricing.pdf?MOD=AJPERES&CACHEID=407e6800444f85af891ceb536ed3dbc9* International Tax Ruling: First Bulletin of the activities carried out in the period 2004-2009 *www.agenziaentrate.gov.it/wps/wcm/connect/a091c080426dddc1860a9fc065cef0e8/Bollettino_URI+2010_ENGLISH_+21+4+10.pdf?MOD=AJPERES&CACHEID=a091c080426dddc1860a9fc065cef0e8*
Netherlands	Horizontal Monitoring Tax and Customs Administration, Tax supervision – Made to measure, Flexible when possible, strict where necessary *http://download.belastingdienst.nl/belastingdienst/docs/tax_supervision_made_to_measure_tz0151z1fdeng.pdf* Guide "Guide Horizontal monitoring within the medium to very large businesses segment" (an updated version will be published in 2013) Standard individual compliance agreement: *http://download.belastingdienst.nl/belastingdienst/docs/individual_compliance_agreementincl_customs_dv4111z3edeng.pdf* Memorandum Tax Control Framework *http://download.belastingdienst.nl/belastingdienst/docs/tax_control_framework_dv4011z1pleng.pdf* Flyer "Thinking differently, behaving differently and working differently" *http://download.belastingdienst.nl/belastingdienst/docs/thinking_differently_behaving_differently_working_differently_dv4001z1pleng.pdf*
New Zealand	Helping you get it right – Inland Revenue's compliance focus 2009–10 (see page 18)- *www.ird.govt.nz/aboutir/reports/compliance-focus/compliance-focus-2009-10/* Helping you get it right – Inland Revenue's compliance focus 2010–11 (see page 25) *www.ird.govt.nz/aboutir/reports/compliance-focus/compliance-focus-2010-11/* Helping you get it right – Inland Revenue's compliance focus 2011–12 (see page 20) *www.ird.govt.nz/taxagents/compliance/focus/current-focus-index.html*
Slovenia	A public call for all large taxpayers to inform the tax administration if they wish to participate in the horizontal monitoring pilot project (May 2010) *www.durs.gov.si/si/medijsko_sredisce/novica/article//5631/627ecf389690505be03aec56189f67ff/* IOTA Article: Practical Experience in Implementing the Horizontal Monitoring Pilot Project in Slovenia (Darija Šinkovec) *www.iota-tax.org/images/stories/library-files2/1401_vl.pdf* Tax administration annual report for 2011 (Slovene version), page 5, 19, *www.durs.gov.si/fileadmin/durs.gov.si/pageuploads/Davcni_uradi_in_uradne_ure/Letna_poro__ila_o_delu_DURS/Porocilo_o_delu_v_letu_2011.pdf* Tax administration annual report for 2010 (English version), page 5, 24, *www.durs.gov.si/fileadmin/durs.gov.si/pageuploads/Davcni_uradi_in_uradne_ure/Letna_poro__ila_o_delu_DURS/Porocilo_o_delu_v_letu_2010_-_ang.pdf*

Country	Websites and links
Spain	An unofficial translation of the Code of Best Tax Practices *www.agenciatributaria.es/static_files/AEAT/Contenidos_Comunes/La_Agencia_Tributaria/Segmentos_Usuarios/Empresas_y_profesionales/Foro_grandes_empresas/CBPT_english.pdf* Information about the Forum and the Code *www.agenciatributaria.es/AEAT.internet/Inicio_es_ES/_Segmentos_/Empresas_y_profesionales/Foro_Grandes_Empresas/Foro_Grandes_Empresas.shtml*
Sweden	Brief information in Swedish *www.skatteverket.se/download/18.71004e4c133e23bf6db800017298/24801.pdf*
Switzerland	"Code of Conduct for Tax Authorities, Taxpayers and Tax Advisors": *www.estv.admin.ch/dokumentation/00078/00733/index.html?lang=en*
UK	*www.hmrc.gov.uk/large-businesses/strategy.htm* *www.hmrc.gov.uk/manuals/tcrmanual/index.htm* *www.hmrc.gov.uk/practitioners/lss.pdf*
USA	The Internal Revenue Manual announcing CAP as a permanent program The document titled "CAP Permanency in a Nutshell" Frequently Asked Questions (FAQs) The CAP application The MOU for CAP *www.irs.gov/Businesses/Corporations/Compliance-Assurance-Process*

Annex B
Summary of the report 'Tax supervision – made to measure. Flexible when possible, strict where necessary'

The tasks assigned to the Committee were to (1) carry out an evaluation of the Tax and Customs Administration's horizontal monitoring, (2) identify any bottlenecks and vulnerabilities in this approach and (3) submit proposals for its further development. The increasing regulatory pressure results in a heavier administrative burden and higher implementation costs. A reduction of the regulatory pressure is the best approach to keep this burden under control. The government is also implementing improvements in efficiency and effectiveness – for example, by means of horizontal monitoring – in an endeavour to limit the burden.

Adjusted compliance risk management strategy

On the introduction of horizontal monitoring, in 2005, the Tax and Customs Administration made a strategic change to its supervisory philosophy. This new approach is based on the concept that compliance with the regulations can be promoted by placing greater trust in taxpayers and assigning them their personal responsibility. The Tax and Customs Administration is prepared to invest in this relationship of trust by concluding agreements in which the Tax and Customs Administration and taxpayers lay down the requisite working agreements. This relationship is based on 'trust', 'transparency' and 'mutual understanding'. This relationship of trust is elevated to the level of 'justifiable trust' by making use of the taxpayer's administrative organisation and internal control, supplemented with internal audits and accountants' audits.

Segmentation

The Tax and Customs Administration opted for a design of horizontal monitoring which is based on segmentation into Very Large Businesses, Medium-Sized Businesses and Small and Medium-Sized Enterprises. Very Large Businesses are, by their very nature, governed by the most stringent corporate governance requirements (such as the SOX, Netherlands Corporate Governance Code and the Netherlands Authority for the Financial Market's reporting supervision). Very Large Businesses which comply with these requirements meet the criteria for the conclusion of an individual agreement with the Tax and Customs Administration that lays down the arrangements for the supervisory relationship.

The large group of Small and Medium-Sized Enterprises lies at the opposite end of the spectrum. A statutory supervisory structure of the aforementioned nature is not available for this group: consequently, in view of the large number of taxpayers in this group, individual agreements are not an option. However, Small and Medium-Sized Enterprises can benefit from the advantages offered by horizontal monitoring by participating in an agreement concluded with a financial service provider. Measures will then be required to achieve 'justifiable trust' which compensate for the lack of the

reliability guarantees that Very Large Businesses can readily provide. These measures will need to be implemented throughout the Tax and Customs Administration's entire chain, from financial service provider right through to the taxpayer (client or business).

The Tax and Customs Administration is evidently having struggling with Medium-Sized Businesses, in particular: firstly, individual account management costs a great deal of capacity and, secondly, this group of businesses needs to make great efforts in developing adequate tax control frameworks.

Medium-Sized Businesses compelled to meet the same standards as the Very Large Businesses segment shall need to incur costs of a level that may result in horizontal monitoring losing its appeal. However, the alternative – adopting the same approach to part of the Medium-Sized Businesses segment as that adopted for the Small and Medium-Sized Enterprises segment – also has its disadvantages. The Tax and Customs Administration now (2012) wishes to find a practical solution for this 'struggle' by merging the upper range of the Medium-Sized Businesses segment with the Very Large Businesses segment and bringing the lower range under the service provider agreements governing the Small and Medium-Sized Enterprises segment. However, this – as such understandable – decision will need appropriate substantiation. Taxpayers and financial service providers will be prepared to invest in sustainable relationships based on trust that enhance compliance only when the reasons for the decision are both clear and recognisable.

Conclusions for the Very Large Businesses and Medium-Sized Businesses segments

Sufficient reliability guarantees have been incorporated for the Very Large Businesses segment. However, the Committee has concluded that this is not the case for the Medium-Sized Businesses segment: the tax control framework, 'onion-skin' model and other internal control measures do not currently provide adequate assurances. As a result, it is not possible to state that the Tax and Customs Administration actually observes the principles governing horizontal monitoring in the Medium-Sized Businesses segment. Moreover, the Tax and Customs Administration is unable to demonstrate that the burden and costs have declined for either the taxpayers or the Tax and Customs Administration.

Conclusions for the Small and Medium-Sized Enterprises segment

As stated earlier, the relationship of trust with the Small and Medium-Sized Enterprises segment is not developed directly with the taxpayers, but rather with their financial service providers. It is essential financial service providers organise their processes in a manner that results in acceptable returns from their clients. As a result, horizontal monitoring in the Small and Medium-Sized Enterprises differs fundamentally from the identically-named supervisory form implemented for the Very Large Businesses and Medium-Sized Businesses segments. The Tax and Customs Administration can rely on tax control frameworks even less in this segment: for this reason it is necessary to seek compensatory measures. The Tax and Customs Administration has implemented this compensation in the form of meta-supervision of the financial service provider's quality assurance system. This meta-supervision also needs to extend to reality checks in the form of audits of random samples of returns.

The highly diverse group of financial service providers employs a variety of forms of quality assurance, such as disciplinary proceedings and internal (desk) audits. The

financial service provider's quality assurance system determines the degree of justifiable trust the Tax and Customs Administration places in the provider: it will, for example, be self-explanatory that the Tax and Customs Administration can place more trust in financial service providers that have been issued a licence by the Netherlands Authority for the Financial Markets and operate under the Authority's supervision than other service providers which are not governed by this form of statutory supervision. The Tax and Customs Administration has not made its approach to this diversity clear and, as a result, horizontal monitoring is not transparent for the parties working with the Tax and Customs Administration. The Tax and Customs Administration staff is also confronted with the same problem: some feel that they need to work based on a message that is insufficiently clear to them. The Committee is not convinced that the taxpayers' administrative burden will be reduced – in fact, the Committee is of the opinion that this is unlikely. This is because the financial service providers can only vouch for the acceptability of returns when they perform more duties than in the past. Moreover, the financial service providers will need to observe the Tax and Customs Administration's Audit Approach that stipulates more stringent materiality and sampling standards than those customarily adopted by other parties, such as auditors. It is evident that the financial service providers will charge their clients for these extra duties. The Committee would have welcomed better accountability for the costs and benefits accompanying the introduction of horizontal monitoring in the Small and Medium-Sized Enterprises.

However, the above does not imply that the Tax and Customs Administration's decision to introduce horizontal monitoring was incorrect, although it does imply that the principles governing this segment differ from those originally adopted for horizontal monitoring (in the Very Large Businesses segment). A triangular relationship can be discerned in this segment in which the relationships between the horizontal monitoring interests of the Tax and Customs Administration, financial service provider and taxpayer (who is also the financial service provider's client) are not always clear. The Tax and Customs Administration will, if it is to succeed with Small and Medium-Sized Enterprises, need to make carefully-considered, continuous and substantial investments in the implementation of horizontal monitoring in this segment – a segment with a very different structure. Moreover this is highly desirable, since it is clear to the Committee that the Small and Medium-Sized Enterprises segment offers the Tax and Customs Administration the greatest potential savings – and certainly in terms of efficiency gains. There are about 600,000 taxpayers in this segment.

The position of horizontal monitoring in the Tax and Customs Administration's range of instruments

Following the successful pilot with Very Large Businesses the Tax and Customs Administration proceeded to the (too) rapid rollout of horizontal monitoring and, in the Committee's opinion, the Tax and Customs Administration staff were not offered an opportunity to keep up with the pace of the process. Although a group of staff have a favourable attitude towards horizontal monitoring, there is also a group who have not developed at the same pace as horizontal monitoring. They often have the impression that the Tax and Customs Administration no longer devotes any attention or time to other (vertical) forms of supervision. For this reason it is extremely important that the management makes the investments in the change in the organisation's culture required following a major policy change and that it manages this change in the culture in the appropriate manner. In the Committee's opinion this is being carried out too late and to an inadequate extent.

It is understandable that the Tax and Customs Administration management has promoted horizontal monitoring in an appealing manner. A different approach would probably have resulted in failure or in a too slow and troublesome implementation. As a result, the internal and external impression that horizontal monitoring was the (sole) supervision instrument of the future has persisted for too long. During recent years the Tax and Customs Administration has corrected this impression by explicitly positioning horizontal monitoring as an element of its supervisory approach, its 'compliance risk management strategy'. The Committee is of the opinion that this is a wise move. The objective of this strategy is to influence the behaviour of citizens and businesses in a manner such that the available staff and resources can be deployed to achieve optimum compliance: *flexible when possible, strict where necessary*. The Tax and Customs Administration has a wide range of instruments at its disposal to achieve this objective, including the provision of service, vertical supervision, investigation – and horizontal monitoring.

From intuitive choices to a rational management model

The Tax and Customs Administration's introduction and further development of horizontal monitoring was primarily based on intuitive considerations. Solely a concise start document listing the principles had been prepared at the time of its introduction. In the first instance the horizontal monitoring concept was developed further during the implementation and its introduction was of the nature of an incremental process: horizontal monitoring was subsequently rolled out to encompass entire segments without supplementing the initial intuition with an appropriate compass in the form of a policy strategy based on rational substantiation. All in all, in the Committee's opinion the Tax and Customs Administration has persisted with its intuitive substantiation of horizontal monitoring for too long and it has devoted insufficient energy and effort to a management approach on the basis of adequate (management) information. The Committee also notes that at the time of horizontal monitoring's implementation there was no business case, no benchmark measurement had been carried out and no explicit performance indicators and/or critical success factors had been formulated, as a result of which an adequate management mechanism has been lacking to date. A business case was drawn up for the Small and Medium-Sized Enterprises segment only in April 2012 (and which, in the Committee's opinion, is not very convincing).

Effect measurement

The Committee's report included a comprehensive review of effectiveness and efficiency. The Committee was surprised to discover how little (relevant) information the Tax and Customs Administration has at its disposal to measure and manage the development and effect of horizontal monitoring. On several occasions it proved impossible either to obtain self-evident qualitative and quantitative policy information or to obtain this information on the basis of regular (management) information. This problem is due to the Tax and Customs Administration's navigating without a rational compass for too long and continuing to navigate on the basis of its intuition.

The *efficienc*y can be reviewed solely on the basis of the relationship between the available capacity and the financial resources, the activities carried out within the scope of horizontal monitoring and the results achieved by these activities (output management). However, it is also necessary to review whether the horizontal monitoring efforts made by the Tax and Customs Administration have been *effective* (outcome management) and are resulting in an improvement in compliance with tax regulations –

and certainly in these times in which the same work needs to be carried out with fewer staff and fewer resources and the Tax and Customs Administration is compelled to make choices.

The manner in which the effectiveness of supervision is measured has not been made clear and the cost-effectiveness is not transparent: the necessary indicators need to be developed. In other words, horizontal monitoring is provided insufficient support from information systems that can assist in decision-making on the appropriate format of supervision and the measurement of the effects and efficiency of the selected form. Moreover, this lack of insight into the effects of horizontal monitoring results in uncertainty about its effect on compliance with tax regulations and, consequently, on tax revenues.

Legitimacy

The legitimacy issue is, above all, a transparency issue within the Tax and Customs Administration's implementation practice. In the Committee's opinion the integration of horizontal monitoring in legislation is unnecessary. The introduction of detailed regulations at this stage would result in disadvantages that outweigh the advantages. However, this transparency can be further increased by the implementation of measures that clarify the tax inspector's role when making decisions, i.e. either as an administrative body reaching a decision on a return or as an implementer of horizontal monitoring involved in an agreement relationship. Taxpayers, financial service providers and other parties must always be aware of the capacity in which a member of the Tax and Customs Administration staff is acting.

International

There is also a great deal of interest in what is referred to as *enhanced relationship* at an OECD and EU level. Tax authorities all over the world are seeking effective and efficient supervisory models based on entering into relationships with taxpayers founded on trust and co-operation. Larger businesses in the international business community increasingly regard the emergence of enhanced relationship as a favourable development. In the Committee's opinion the Netherlands is playing a pioneering role in the development of enhanced relationships. Moreover, the Committee observed that the pace of the development of enhanced relationships in other states is slower than in the Netherlands. To date, the development of enhanced relationships in other states has been restricted to the (very) large businesses: the Netherlands is the sole state that has introduced this concept for Small and Medium-Sized Enterprises.

Reduction of costs / increase in burden

There is no doubt, the Tax and Customs Administration wishes to fulfil the qualitative and quantitative expectations of horizontal monitoring at the time it was introduced. This will, for example, require an overall insight into the costs and benefits for taxpayers taking part in horizontal monitoring either directly or indirectly via a financial service provider. The Tax and Customs Administration also needs an insight into the cost of a compliance agreement and the maintenance of a horizontal monitoring relationship for the management of its operations. In the current absence of this type of information there is a risk that taxpayers will experience horizontal monitoring primarily as a means of shifting the government's implementation costs – in the form of an additional supervisory or compliance burden – onto taxpayers and their financial service providers. Horizontal

monitoring would then, in effect, constitute a transfer of the burden within the chain. Moreover, the Tax and Customs Administration staff are concerned that although the efficiency benefits offered by horizontal monitoring *will* materialise, the pressure imposed by the government economies will curtail the necessary associated intensification of the planned (vertical) supervision of taxpayers who do not participate in horizontal monitoring, in particular of non-bona fide taxpayers. As a result the volume of fraud could, on balance, increase. The Committee recommends that the Tax and Customs Administration convincingly demonstrates that the efficiency gains achieved from the improved relationship with taxpayers are converted into capacity that can be deployed to reinforce vertical supervision as required. In addition, it will be necessary to combat the Tax and Customs Administration's loss of high-grade knowledge and, at the same time, bear in mind that the competences required for horizontal monitoring differ from those for vertical supervision.

The Committee drew attention to the fact that horizontal monitoring was introduced at a time when the economic conditions were much more favourable than at present. It is debatable whether we may continue to assume that a trust approach and compliance strategy based on relatively favourable conditions will achieve the same effect during an economic downturn. Nor is it possible to ignore the fact that all national government bodies, including the Tax and Customs Administration, are confronted with difficult targets and cost reductions. A major change in the culture, such as the introduction of horizontal monitoring, is not promoted when the change coincides with a large-scale reorganisation which some members of staff feel is having a great effect on their personal lives.

The core conclusion

The Tax and Customs Administration deserves praise for its fulfilment of a pioneering role and its timely appreciation of the need for a fundamental change to its supervisory philosophy. A similar transition in supervision is also taking place outside the Netherlands, albeit on a more limited scale. The Dutch example is attracting a great deal of interest and is regarded favourably. In essence, the Committee's report endorses the 'horizontal monitoring' concept and recommends that it be developed further. However, the Committee also states that a number of implementation issues exhibit room for the necessary improvements to solve or alleviate the bottlenecks and vulnerabilities it has identified. The Committee hopes that its report will be of assistance in making these improvements and that it has provided an additional impetus to horizontal monitoring.

Annex C
Mindmaps features of co-operative relationships

This annex consists of diagrams that illustrate features of the overall compliance environment that are likely to encourage an adversarial relationship between revenue bodies and large taxpayers and that would encourage a co-operative relationship:

Please see: *www.oecd.org/site/ctpfta/mindmaps.pdf*

Annex D
The coherence between the concepts of Internal Control and Tax Control

Box D.1. Risk Management by taxpayers using International Control Framework

Due to regulatory requirements and the demands of shareholders, modern businesses need to have in place an Internal Control Framework (ICF) [1]. These frameworks enable businesses to ensure that their operating, financial and compliance objectives are met and provide for the proper management of risk:

Risk assessment — Each organisation is faced with external and internal risks that may affect the goals of the organisation. Risk assessments identify relevant risks to the objectives and determine how the organisation can manage the risk.

Control environment — This component focuses on the risk management culture within organisations. Relevant questions include: are people throughout the organisation aware of the importance of risk management and do they understand the risk profile of the organisation? Do management and the board of directors set the tone at the top? Is risk awareness and mitigation embedded in the values of the organisation, the integrity and competence of staff? Is risk management part of management's philosophy and operating style and the way management assigns authority and responsibility?

Control activities — These refer to the internal control system of the organisation, including policies and procedures that define approval processes, authorisation levels, security of assets and the segregation of duties, etc.

Information and communication — This component refers to an organisation's information and communication systems, including the production of operational and financial reports.

Monitoring — This component is often confused with the "control activities" component. While control activities define an organisation's internal control system, the monitoring component focuses on the monitoring of these systems, such as direct supervision and evaluation.

The effectiveness of an ICF starts with the moral and ethical values of the management of an organisation and the way management ensures the implementation of these values in the day to day operation. The moral and ethical values of the management are sometimes referred to as "soft controls". The incorporation of these values in the procedures is then referred to as "hard controls". This note deals with hard controls as applied in electronic business and accounting systems.

Where an ICF is in place, the taxpayer will undertake a "self-risk assessment" of all its control and monitor functions and will be in a position to provide a statement, known as an „in control statement", in relation to those functions. With an "in control statement", a management board affirms that it is in control of the processes taking place in its business.

Monitoring of the hard controls should be implemented to help ensure that the internal control continues to function effectively. Monitoring in businesses can refer to internal (specific) and external (annual accounts or tax) monitoring.

Tax Control Framework

If a taxpayer is "in control" they should be in a position to detect, document and report any relevant tax risks to the revenue body, provided that specific tax requirements are incorporated into the ICF. These specific tax requirements are sometimes described as a "Tax Control Framework" (TCF), which focuses on the internal control of tax processes.

The taxpayer should provide the revenue body with both a description of the main tax risks related to the company

and the design and effectiveness of the internal risk management and control systems for the main tax risks during the relevant financial year.

If the taxpayer is in a position to detect and report any meaningful risk to the revenue body, the role of the revenue body can change to assessing the monitoring system of the taxpayer itself, rather than intrusive auditing. Additionally, in a number of countries there are corporate governance codes and laws which emphasise internal control, requiring businesses to continuously monitor their risks.[2]

Meaningful Risks: Materiality

Meaningful risks should be monitored by management and in case of misstatements or debatable issues these should be reported to the revenue body in a timely manner so that these risks can be addressed in a proactive, rather than reactive, manner. The concept of materiality is used in practice by the auditing profession to explain meaningful risks.

The concept of materiality is often discussed in financial reporting frameworks in the context of the preparation and presentation of financial statements. These frameworks generally explain that:

Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;

Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and

Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.[3]

Materiality will vary across countries and types of tax. Revenue bodies need to consider the level of transparency about the risks that they would consider as material and therefore meaningful. This could include discussions between the taxpayer and the revenue body over what risks are material.

1. *www.coso.org*

2. For example, the United States" Sarbanes-Oxley Act of 2002 imposes requirements for the establishment of internal controls by public companies.

3. International Federation of Accountants, ISA 320, www.ifac.org

Annex E
Background information on Committee of Sponsoring Organisations of the Treadway Commission (COSO)

The COSO Internal Control Framework,[1] is the most widely used framework in the world. The Committee of Sponsoring Organisations of the Treadway Commission (COSO) is a joint initiative of five private sector organisations[2] and is dedicated to providing leadership in the field by developing frameworks and guidance on enterprise risk management, internal control and fraud deterrence.

This internal control framework recognises in the Administration Activities of an enterprise the process of Tax Compliance. Tax Compliance in COSO serves three objectives:

a. Accurately process prepare and file required tax document on a timely basis

b. Reduce tax liabilities to the legal minimum

c. Record the effect of all tax transactions or economic events completely and accurately

Notes

1. COSO (1992) Internal Control - Integrated Framework, *www.coso.org/documents/VolumeI-ExecutiveSummary.pdf*

2. Five major professional associations headquartered in the United States: the American Accounting Association (AAA), the American Institute of Certified Public Accountants (AICPA), Financial Executives International (FEI), The Institute of Internal Auditors (IIA), and the National Association of Accountants (now the Institute of Management Accountants [IMA])

Annex F
Overview of lessons learnt

Countries experience: Difficulties encountered, solutions and lessons learnt

In Chapter 2 we listed the countries that have developed and implemented a co-operative compliance model. Between them they have built up a considerable body of experience and the lessons they have learnt will be very valuable for countries that are in the early stages of developing a co-operative compliance strategy. For that reason we have tried to capture here the difficulties countries encountered, the solutions they developed and the lessons they learnt, in the hope this may help others to overcome any obstacles they encounter in the development and implementation of their own approach.

Staff skills

Implementation of co-operative compliance models s should be seen as a change programme. A co-operative compliance model is a relationship driven approach which places high demands on staff working with large businesses. They need to have high levels of customer understanding and technical expertise. Transitioning from an adversarial environment into a co-operative environment can present challenges that require cultural change by both parties. Therefore co-operative compliance requires persons involved to have the requisite skills or experience to understand the business i.e. they have an entrepreneurial attitude and decisiveness, they know the business, they have the ability to understand tax and finance, they have interpersonal personal skills like a problem solving attitude, etc. Communication skills like the attitude that support and open dialogue and the ability to have difficult conversations are vital in this respect. The UK responded to this by making a significant investments in skills, including the development and roll-out of a 'common operating model', to ensure consistency and enhanced training to ensure that staff have the core skills they need to work effectively with large businesses. In the Netherlands training in soft skills was developed and is mandatory to all staff working in compliance activities.

Change programme: Analysis

The Netherlands recommends a step by step approach, starting with less complex businesses and industries and to work out any procedural questions first. Australia's approach is basically similar and they are selective in deciding which taxpayers to engage. Ideally any pilot programme should commence with entities that have a relatively simple risk profile, so that the pilot can successfully work through and resolve the procedural issues that arise. Such an approach makes it easier to tackle cases that are substantively more complex as the programme unfolds. Ireland has attempted to analyse more closely what type of service large taxpayers actually need. There was evidence that some resource was being spent delivering assistance on issues that should be capable of being dealt with internally by the taxpayer.

In Norway one of the main reasons for business not participating in the project is the 'lack of internal resources'. New Zealand learnt with hindsight that businesses were included that are not necessary suitable for this approach. Both countries recommended to have from the beginning a clear description of the taxpayer suitable for co-operative compliance.

Taking the first step: Trust breeds trust

In the Netherlands one of the main pillars of its co-operative compliance model is 'justified trust'. The benefits of the programme can only be reaped if both the taxpayers and the revenue body trust each other. However, revenue bodies should consider taking the first step, because 'trust breeds trust'. It requires a level of trust on both sides, including a willingness to deal with legacy matters in an appropriate manner to make this approach work. Revenue bodies should trust both its own professionals and the businesses. It should also be consider building on the work done by others *e.g.* the business accountant or the bookkeeping department.

Managing perceptions

Managing perceptions is one of the more significant challenges that have to be addressed. It is all too easy for an external (media) and internal perception to arise that companies in this programme are being treated more favourably than either their peers or smaller enterprises. The current economic and social climate has also given rise to much greater public and media scrutiny and mistrust of large businesses and that has extended to the way they manage their tax obligations. In dealing with this countries should consider to provide clarity around its approach and the objectives both internally and externally. Sweden ensures that any (external) communication, *e.g.* public statements of the revenue bodies position in specific matter, meets the standard of objectiveness, impartiality and proportional by involving the legal department. The legal department should be aware and agree with the purpose and aim of the concept of co-operative compliance. Since 2007, the UK has published its Litigation & Settlement Strategy which makes clear how decisions on resolving disputes are reached. And the UK is looking at ways how to reinforce the message around its approach and how to communicate, externally and internally, that the approach is coherent, consistent and even-handed. The UK has also introduced enhanced governance arrangements for significant tax disputes to provide greater transparency, scrutiny and accountability.

Given the need to manage perceptions the importance of communications (both external and internal) should not be underestimated. Engagement with all stakeholders should be considered at an early stage. In particular, extensive communication and engagement with staff is essential to securing their buy-in. Australia learnt that early engagement and support of staff in the development of co-operative compliance is an important element in the implementation process. Internal concerns in Ireland were allayed through discussion at workshops during which the strategy was explained, including how it would work in practice and the potential benefits for the Revenue. Initially New Zealand large corporates did not see the benefits of entering co-operative compliance agreements (CCAs) with Inland Revenue (IR) in light of the existing good relationships and level of service from IR. In addition there were no specific statutory concessions for entering into a CCA. IR's communication was focussed directly on a selection of large corporates and in particular meetings at board level. However, after IR participated in tax conference sessions on CCAs (late 2010) and engaged in dialogue with

the Corporate Taxpayers Group (which represents many of NZ's largest corporates) in early 2011, the level of understanding of the benefits of a CCA pilot programme greatly increased, in particular that the CCA agreement formalised the commitment between the Commissioner of IR and the taxpayer's Board

Senior level engagement on both sides has been found to be important by a number of countries. Full engagement at the level of the Board of both the revenue body and the business (the tone at the top) should be considered Appointing a customer relationship manager to deal with a taxpayer on a day-to-day basis is a strategy that several countries have found to be successful. This person can build a strong relationship with the taxpayer and good knowledge of the business and the sector in which it is involved. Changes in key personnel can have a significant impact on the co-operation. It can put stress on some of the engagements. These impacts can be mitigated by being clear about the importance of continuity in personnel and by involving the other party in the hand-over of responsibilities. Some change in personnel is inevitable and indeed healthy from a governance point of view. It is a question of striking the right balance.

Co-operating with business: Expectations

Managing expectations can also be difficult and good communication is vital here too. It is important to be very clear about the terms of engagement, time requirements, the roles and responsibilities when entering into such an approach. Australia experienced that getting to 'real time' with legacy matters can be a substantial challenge and can require a significant investment up-front. South Africa has found that it is also important that the parties have a clear appreciation of the benefits of the engagement for each of them. Definitions of *e.g.* transparency and co-operation are necessary to ensure a clear understanding of requirements as well as to provide consistency and uniformity across the programme. The US has learnt that this is very important in order to avoid misunderstanding. For instance, the CAP programme requires taxpayers to be transparent and co-operative. The multi-year pilot informed the IRS that definitions of transparency and co-operation are necessary for IRS teams as well as Taxpayer teams to ensure a clear understanding of requirements as well as to provide consistence and uniformity across the programme. In addition the IRS defined requirements for a Taxpayer to fully and adequately disclose completed business transactions[1]. Another example is the requirement of a clear understanding of materiality threshold and how they are used in the cap programme. The IRS explained the materiality thresholds are used differently in CAP than in a traditional post-file examination. The IRS also provided an example to make this difference clear.[2]

It should also be considered to assess and outline the benefits of an individual agreement, whether it is working and perhaps detail the circumstances under which the revenue body needs to end the relationship. In July 2010 members of the Dutch Parliament raised a question about the termination of an agreement with a taxpayer who deliberately avoided taxes. The Dutch Minister of Finance responded as follows:

> *"Compliance agreements are not terminated when taxpayers are fully transparent and submit issues of relevance to tax to the inspector in advance. Nor are compliance agreements terminated in the event that taxpayers and inspectors are unable to reach agreement on the tax consequences of a specific body of facts; any such dispute can ultimately be submitted to the court. However, the basis for a compliance agree falls away when a taxpayer employs aggressive tax structures and is not (fully)transparent in their use. Taxpayers who have concluded a*

compliance agreement are expected to refrain from continually seeking the limits of the relevant tax legislation."[3]

The ongoing interaction between large business and revenue bodies provides a channel for constructive dialogue. Therefore this engagement should be with the large business and not only with its tax advisor. Dialogue will result in a better understanding of the needs and behaviour of large business. Co-operative compliance has helped Ireland to gain a better understand of the needs and behaviour of the large business and to further refine its strategies, including provision of suitable targeted services, to improve compliance.

The role of the tax intermediary

Tax intermediaries play an important role in businesses tax affairs and they are consequently another group that it is important to involve at an early stage. If they have been accustomed to an adversarial relationship, they may take some convincing that the new approach is truly in their clients', or indeed their own, interests. For this reason, it may be sensible to make a start with a small group of intermediaries that are prepared to work with the revenue body on a pilot basis. Co-operative compliance requires something of a 'change' in mindset and/or a cultural change on the part of advisers, whether they work within businesses or for tax intermediaries and of course it also has significant implications for the mindset of revenue officials too.

Notes

1. See the Memorandum of Understanding on *www.irs.gov/Businesses/Corporations/CAP-Memorandum-of-Understanding*
2. *www.irs.gov/Businesses/Corporations/Compliance-Assurance-Process-(CAP)---Frequently-Asked-Questions-(FAQs)*, questions 31.
3. Translation taken from the Committee Horizontal Monitoring Tax and Customs Administration's report "Tax supervision – Made to measure", paragraph 3.4.4.2, p. 39.

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FROM ENHANCED RELATIONSHIP TO CO-OPERATIVE COMPLIANCE

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