

# FairTax policy brief

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## Large Businesses: Co-operative compliance in action

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### Key Findings

- Understanding how co-operative compliance programmes – collaborations between tax administrations and corporations – have an impact demands a practice-based perspective.
- There is no single model of the co-operative compliance model that works universally.
- Designing and implementing a co-operative compliance programme ought to consider: whether a pilot is needed, fit with existing laws, the formality in agreements between corporations and tax administrations, voluntariness and inclusiveness respectively of participating corporations, points of contact and whether advance rulings are legally binding.
- Tax administrations designing, implementing and working with co-operative compliance programmes should carefully assess seven socio-cultural dimensions: existing tax culture, possibilities for evaluation, required competences, structural and organizational hindrances, resistance among stakeholders in the tax arena, trust and equality.



## Introduction

It is well recognised that large business taxpayers are qualitatively different from other categories of taxpayers; they make a significant contribution to tax revenues collected in most countries and therefore pose a significant risk to tax administration effectiveness. Large businesses, particularly multinationals (MNEs), are also different to other taxpayers because of their complex operations and structure.

From the late 1990s into the 2000s, it became clear that there was a need for tax administrations to adopt new strategies for managing large business taxpayers and by 2005, co-operative compliance strategies began to emerge in several countries, most notably the Netherlands, Ireland, the UK and the US. Co-operative compliance represents a shift in thinking for tax administrations, away from a deterrence approach where taxpayers are coerced to comply with tax rules and threatened by audits and penalties, to a more responsive and collaborative approach. The OECD has been active in promoting the benefits of cooperative compliance, and the model also has support from many large business taxpayers across jurisdictions. There is evidence of benefits for both taxpayers and tax administrations. Co-operative compliance builds on the slogan: “...certainty in exchange for transparency” (OECD 2016, 7).

There is no universal cooperative compliance model, however features commonly found include:

- **Risk assessment:** more sophisticated risk assessment procedures allow for the identification of taxpayers requiring closer monitoring by the tax authority and those who can be trusted to be compliant and/or have more simple business operations and therefore warrant less close monitoring.
- **Real -time working:** rather than wait for tax returns to be filed followed by audit/examination and protracted information requests and dispute resolution, cooperative compliance models generally facilitate real time working. Corporate taxpayers bring tax issues to the attention of the tax authority as they are happening and in advance of filing in order to discuss and hopefully agree the tax position and prevent unnecessary inquiries and disputes.
- **Mutual understanding:** tax authorities with cooperative compliance models generally undertake to commit resources to upskilling tax officials so that they are better equipped to understand the complexities and context of large corporate taxpayers and have frequent engagement with the taxpayer. Taxpayers are required to be transparent about their activities in return for increased certainty about the tax consequences.

FairTax researchers have, over several years, been researching the cooperative compliance practices in several countries in two separate but related projects. One, led by Lotta Björklund Larsen, focuses on the implementation of co-operative compliance programmes in Nordic countries, in Denmark, Finland, Norway and Sweden. The other, led by Lynne Oats, examines developments in the UK and the Netherlands. Both studies use ethnographic techniques, primarily in-depth interviews, to investigate how developments in each jurisdiction are playing out in practice. In each country, the actors interviewed include large business in-house tax specialists, external advisors and industry representative bodies and tax authority large business specialists. In this policy brief, we bring together these strands of research and present our findings.

The Netherlands and the UK share a historical similarity in their general approach to tax administration. These two countries were early adopters of co-operative compliance models, yet the models adopted in these two countries are quite different. In the Nordic countries, which adopted similar cooperative compliance at a later stage, the outcomes were very different. In all countries, the history of previous collaboration and the external environment has been influential in influencing the trajectory of co-operative compliance.

In this policy brief we bring your attention to:

- Key features of the model in its practical implementation and operation
- Dimensions of practice based on the qualitative comparison of co-operative compliance programmes.

## **Key features of the models**

Over the years, as more and more countries introduce co-operative compliance models, it has become possible to identify key features of their implementation and practical operation as follows:

Implementation:

- Pilot: in some countries a formal pilot programme has been introduced to test the model before being made more widely available.
- Explicit programme: the model may or may not be explicitly described as a co-operative compliance arrangement.
- Legislative change: some models of cooperative compliance require changes in laws and regulations to enable implementation. In others, the model is embedded within the existing legal framework;

- **Formality:** may be by way of a formal legal agreement, a more informal memorandum of understanding or an informal arrangement with undocumented elements;
- **Participation:** may be voluntary or compulsory. In some countries participation is voluntary, in others by invitation from the tax authority;
- **Inclusiveness:** in some countries all large businesses are part of the programme, in others only a selection are included, leaving others outside of the model;

#### Operation:

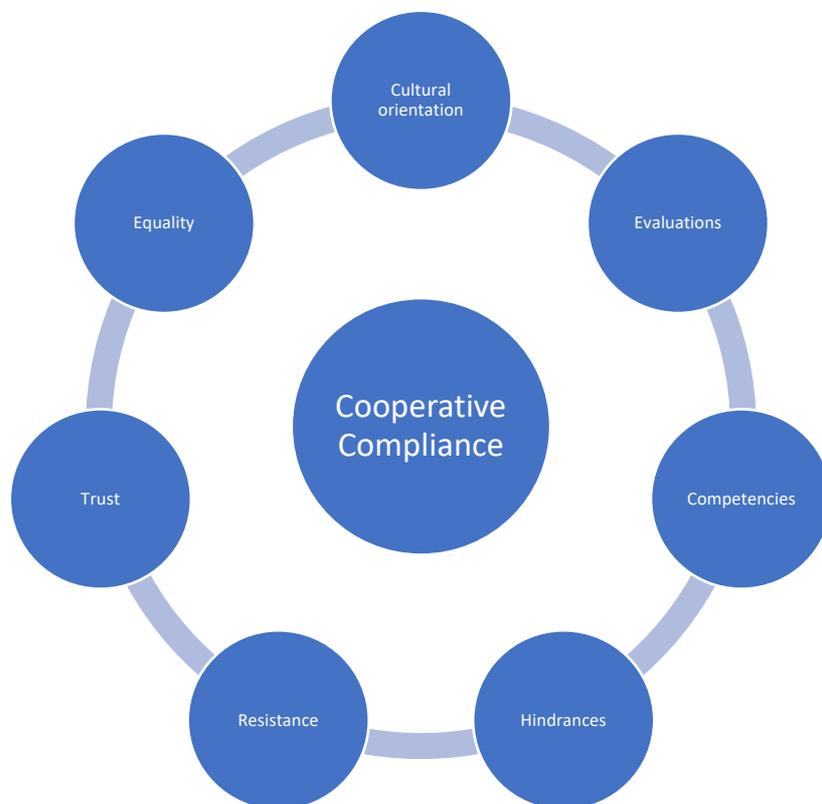
- **Single point of contact:** most models provide for a single point of contact with the relevant large taxpayer unit;
- **Provision of advance rulings:** where applicable, the provision by the tax authority of advance rulings as to the tax outcome of large business' activities may or may not be binding on the tax authority.

#### Co-operative compliance model elements:

	Denmark	Finland	Netherlands	Norway	Sweden	UK
<b>Implementation</b>						
Pilot?	√	√	√	√		√
Explicit programme?	√	√	√		√	
Legislative change?						
Formal agreement?	√	√	√		√	
Voluntary participation?	√	√	√	√	√	
All large businesses included?						√
<b>Operation</b>						
Single point of contact?	√	√	√	√	√	√
Binding advance rulings?	√	√	√			

## Dimensions of Practice

These dimensions are based on comparisons between the countries. The focus is on how compliance programmes were applied in practice and how they have an impact on existing relations between actors in the national tax arenas.



### Cultural orientation

Co-operative compliance programmes have resulted in cultural reorientations. These can be seen in terms of time and space as well as relationships to some extent in all the studied countries. The timing of interactions between large businesses and tax authorities under co-operative compliance shifts from regular, spaced events such as filing of returns, to more irregular, needs based interactions. Spatial changes include the creation of new or reorganized large taxpayer units. Relationships shift from a command and control, coercive style to a collaborative and more consensual approach.

In the case of Denmark, Finland and the Netherlands, we find the introduction of new principles and routines working according to the cultural orientation. In Norway, the main concern was temporal reorientation. Each tax payer had to work out the meaning of a number of changes individually. In Sweden, the spatial reorientation evoked strong reactions in the absence of a strong collaborative tradition. In the

UK, the cultural reorientation was much more gradual and therefore muted.

### **Evaluations**

The evaluation of co-operative compliance programmes against the criteria of effectiveness and efficiency is very difficult in all cases. It is not unproblematic to try to find a point of comparison in order to determine what the outcomes would have been without co-operative compliance. Therefore, it is difficult to infer which outcomes are attributable to the co-operative compliance model, or overall attributable to the tax administration's actions. Based on the data collected for the present research, it is not possible to say whether the use of tax administration's resources in any of the countries is more efficient than before or that co-operative compliance has brought about direct cost savings.

### **Competences**

The requirement for changed competences as a result of co-operative compliance was articulated differently both between countries and between stakeholders e.g. between corporations and the tax administrations. First, the view was expressed by corporations in all six countries that tax officials lack knowledge about business and commercial reality. Secondly, the additional, 'new' knowledge required from a tax official was in Denmark expressed as a skill to resolve conflicts, in Finland as providing good customer service, in Sweden that the contact persons should be a 'people person', in the Netherlands as in the UK as having 'commercial awareness' and being able to 'avoid disputes'. There were also issues raised as to who should be responsible for building competence within the tax administrations.

### **Hindrances**

We find similar kinds of hindrances across all six cases, some of which are external structural hindrances and some of which are internal organisational hindrances. External structural hindrances include legal issues—such as public access to documents, equality and possibilities of attaining binding responses from the tax administration. They also include more diffuse hindrances such as increased public scrutiny. The internal organisational elements comprise organizing principles (in both the tax administration and the corporations) challenging the work with the co-operative compliance programme; different but co-existing 'schools of thought' in the tax administration and internal discussions in the tax administration on impartiality. Overall, regarding the external structural hindrances the comparison shows that legal matters can come to impede a programme. If the external structural hindrances become too large to overcome, the co-operative compliance programmes might not get as far as to be faced with internal organizational hindrances - as in the Swedish case. The effect of increased public scrutiny has been felt

more acutely in the Netherlands and the UK. The internal organisational hindrances are more subtly shaping the way the programmes unfold.

### **Resistance**

The comparison shows that outspoken resistance has played a minor role in the implementation of co-operative compliance measures in some of the countries. In case of Denmark, Finland and Norway the most apt description of the stance of the corporations is “Voice” and “Loyalty”. It can be described as characterized by the co-existence of silent resistance—declining the invitation to participate or postponing letters and meetings—and loyalty—stay in place and cope in either a proactive way or through a more passive stance of accepting the premises, but not taking the lead in the collaboration. In the Netherlands resistance is manifest in a failure to apply to join the programme. In Sweden the stance was “Voice” and “Exit”, which stalled the implementation of the co-operative compliance programme. In the UK, because the programme is compulsory for all large businesses, less overt forms of resistance include continuation of old practices of withholding information from tax authorities leading to new legislative measures more aligned with coercive relationships.

### **Trust**

Trust is widely recognized as being essential in building enduring co-operative compliance programmes and relationships between tax administrations and corporations. In all six countries, the dominant form of trust involved appeared to be the inter-organisational trust. In most cases trust seems to persist even if the individuals on either side of the relationship change. There were differences between the countries as to the types of trust, however. The interpersonal trust between the tax officials and tax directors in the corporations plays a significant role, especially in the Danish, Finnish and UK cases. However, as the case of Sweden shows, a generally high level of measured trust towards tax administrators is not a guarantee for a success of the co-operative compliance approach. In the Netherlands, resource constraints in the tax authority appear to lead to an erosion of trust in the system by large businesses.

### **Equality**

The last dimension shows that with regards to fair competition and equitability there was a substantial variation between the countries. In Norway, it was not problematic because the tax law is structured according to industrial sectors, which means that corporations accept that different industries might be subject to different treatment. In Denmark, the discussion focused on potential favorable treatment of corporates. The discussion was pronounced in terms of consultancy vs. guidance. The first type of activity is not allowed for Skat’s tax officials,

whereas the latter is. In the context of the Finnish Syvennetty, discussion about unequal treatment has been limited. In Sweden, the discussion of inequitable treatment was one of the major obstacles to both versions of the programme. The very idea of a VIP lane for certain ‘customers’ at a public bureaucracy was not well received by Swedish society. In the Netherlands, the external perception that Horizontal Monitoring comprises an exchange of illegitimate favours leads to speculation that it would not be possible to implement it now. In the UK the model applies to all large businesses and there is equal treatment within that category of taxpayer, there are nonetheless public concerns that large businesses as a whole are treated more favourably by HMRC. Our six country cases differ most strongly regarding the dimension of equal treatment.

## Conclusion

The research conducted across the six countries provides evidence that a number of cultural, institutional and societal factors significantly influence compliance practices. First, tax compliance does not only depend on the will of the taxpayers but is as much shaped in the course of the actual interaction between the taxpayer and the tax administration as well as by contextual factors. Second, key principles of the OECD guidelines, namely voluntary disclosure and real-time responses are too narrow, and perhaps too idealistic, to be feasible guidelines for all circumstances. Realtime responsiveness is generally highly valued but is neither welcome nor possible under all circumstances. Third, in all countries, there is a growing need for reliable evaluation mechanisms. A key ambition for the co-operative compliance measures has been to increase efficiency and effective use of resources for tax administration and many stakeholders demand ‘proof’ for efficient usage of resources, not least the taxpayers themselves. All countries are facing the difficulty of measuring the impact of these programmes and more knowledge exchange between tax authorities would be beneficial for further developing the programmes and evaluating their effects. In actual practice, such evaluations of costs and effects need to combine subjective and objective criteria, statistical analysis, logical argument, common sense, human skills and judgement.

We do find considerable learning between jurisdictions but an important heterogeneity in the local implementation of these models. This has implications for countries considering adopting cooperative compliance models, since what works well in one jurisdiction may not necessarily translate into efficiencies in another jurisdiction.

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