International Journal of Advanced Engineering and Management Research
Vol. 2 Issue 1, 2017

www.ijaemr.com ISSN: 2456-3676

LEGAL SECURITY DIFFERENCES: CO-OPERATIVE COMPLIANCE IN THE NETHERLANDS

By

Damy W. Colon

Faculty of Economics and Business/ University of Groningen, the Netherlands;
PricewaterhouseCoopers Europe

ABSTRACT

This paper explores the co-operative compliance approaches implemented by the Netherlands. The OECD principles on co-operative compliance are the paper's framework. The Dutch approach on co-operative compliance is analysed with the OECD framework. The different aspects considered create a thorough understanding of the co-operative compliance approach applied in the Netherlands. Moreover, it contributes to the international discussion of the best method for co-operative compliance.

Key Words: co-operative compliance, tax law, the Netherlands, transfer pricing, tax administrations, corporate governance, tax controlling, tax economics.. .

1. Introduction

The initiative for co-operative compliance has a lot of support internationally. The initiative was developed following meetings of the OECD. The participating countries during these meetings discussed the main developments in the tax field. The result of these meetings was the intention to introduce a new form of supervision: co-operative compliance. The OECD has its progress and recommendations for co-operative compliance documented in several information notes. In this paper a legal security analysis is conducted on the co-operative compliance approach in the Netherlands. This creates an understanding of the Dutch co-operative compliance approach and therefore contributes to the international scientific research to analyse national co-operative compliance policies.

2. OECD documentation

In this section the different documents of the OECD are elaborated. As the OECD is the initiator of the co-operative compliance approach, all the papers together are a thorough framework for considering co-operative compliance approaches.

2.1Seoul declaration

In 2006 delegates of 35 economies held a meeting under auspices of the OECD. This meeting aimed to share knowledge on developments occurring in tax administration and anticipating international tax non-compliance. This resulted in the "Seoul Declaration". It was agreed to cooperate on the two main challenges for tax administrations in the 21st century. The first challenge is achieving effective tax administrations to fulfil the performance of an increasingly wide range of tasks. The second challenge is shaping the national tax laws in such a way that international companies are unable to avoid taxation by its tax structures. One solution mentioned in the "Seoul Declaration", which can be implemented at the national level, is the use of effective risk management techniques at strategic and operational level.

2.2 Cape Town Communiqué

A follow-up to the Seoul Declaration was passed in 2008 in Cape Town by a meeting with delegates from 45 economies[iii]. Central theme was the discussion of a study on taxable enterprises and the role of their tax advisors in this. The conclusion of this study was that tax advisors play a vital role for businesses on the one hand to understand their own tax situation and on the other hand complying with the tax laws and regulations. Conducting an aggressive tax planning policy can be traced back to a part of the tax advisors which operationalize and promote aggressive tax planning within organizations. This does not alter the fact that companies decide how much tax risk they prefer. In the study by the OECD risk management by the taxpayer is considered essential for a rapid response to changing conditions and optimal utilization of the capacity of tax administrations. For the proper mapping of effective risk management within an organization, it is important to have current, relevant and reliable tax information.

The solution for obtaining the required tax information would be to maintain an effective and efficient relationship with taxpayers and their tax advisers. The relationship must consist of five basic characteristics: knowledge of the business, impartiality / unbiased, proportionality (check no more than necessary), responsiveness and openness (transparency regarding the fiscal requirements for the taxpayer). These attributes should underpin any action related to a taxpayer. A relationship between the taxpayer and the tax authorities should be created, which is based on cooperation and trust, or so-called co-operative compliance[iii]. The advantage for taxpayers lies in the greater certainty of tax positions and because of rapid decisions on tax matters less intensive tax audits and reduced compliance costs. The delegates emphasized that this new form of control will not stop aggressive tax planning and the provision of services by tax advisors - which will create aggressive tax planning - will not disappear. Tax compliance should be agreed in the future by allocating more resources to organizations that do not wish to participate in the new tax relationship and to organizations with high inherent tax risk.

2.3 Information notes

The information note “general administrative principles”[iv] examines the relationship between corporate governance and tax risk. It is concluded that companies with good corporate governance and a more transparent relationship with the tax administration are more reliable. This could lead to fewer inspections and thus greater security for organizations. There are also suggestions for practical implementation. A tax administration should have three aspects into consideration when evaluating an organization. These are the extent to which material risks are managed carefully and studied, minimizing compliance risk through effective internal control resources and a proper implementation of legislation. Achievement of the aspects should be based on a tax relationship with mutual respect, transparency and openness. In addition, CEOs, managing directors and boards are made clear about their responsibilities for good corporate governance. For good governance in relation to taxes, a framework can be used that focuses on managing tax risks and compliance with laws and regulations. At least the most important transactions of an organization should be assessed and an organization must have sufficient resources to regularly evaluate the effectiveness of tax governance systems. The OECD leaves open what is material in this context and refers to the meaning assigned in financial reporting frameworks.

The information note "Tax Compliance and Tax Accounting Systems" describes a start of the framework for controlling taxes[v]. It was mentioned that an internal control framework enables organizations to achieve their operational, financial and regulatory objectives and manage tax risk in a proper manner. To meet tax obligations a taxpayer must satisfy several requirements: register for tax purposes, tax information disclosure in a timely manner, to determine the correct amount of tax and pay on time. A distinction can be made between taxpayers who do so voluntarily and taxpayers where correction is required by verification/ coercion. If a tax administration understands the compliance behaviour of the taxpayer, the tax administration’s actions might be more effective. The information note "Tax Compliance and Tax Accounting Systems" refers to the OECD’s in 2004 introduced BISEP model and deriving the taxpayer’s attitude from the BISEP model (Figure 1). In the BISEP model, the following factors are identified as having an impact on the behaviour of a taxpayer: business, industry, sociological, economic and psychological (abbreviated BISEP). The tax administration estimates the attitude of the taxpayer with the compliance pyramid and then determines the associated control strategy.

The OECD argues that the strategic objective of a tax administration should aim at creating as much as possible willingness by taxpayers to comply voluntarily with laws and regulations. This should be based on the improved relationship between the taxpayer and the tax authorities. In this relationship, the information that will be recorded for the benefit of a tax authority is twofold. On the one hand is to provide information taxpayers are required to by laws and

regulations and on the other hand there is information necessary for the tax authorities to make an informed risk assessment.

For an internal control framework that is used for managing risks, the OECD refers to COSO[vi]. This model contains the elements risk assessment, control environment, control activities and information and communication, which are linked to monitoring. The effectiveness of an internal control framework depends partly on the moral and ethical values of the management of an organization (soft controls[vii]). In addition, the effectiveness is depending on how effective the framework works on its own. This is part of management functioning. It is up to management to give an explicit statement ("in control statement") relating to the proper functioning of the internal control framework. An organization that is in control will be able to detect, document and report relevant tax risks to the tax authorities. Where an organization can detect and report tax risks, there might be a shift in the audit by the tax authorities of drastic audits towards assessing the control system itself. This ensures that material tax risks are handled in a proactive rather than a reactive manner and in cooperation with the tax authorities.

In 2011 the OECD published a report on countering aggressive tax planning through transparency and disclosure[viii]. The emphasis of the report was on timely, targeted and comprehensive information to stop aggressive tax planning. To create insight in different countries designing a form of co-operative compliance a display is given of several methods, which tax authorities apply in their countries in connection with disclosure of tax risks: mandatory early disclosure (reporting by the end of the tax period), additional reporting questionnaires, together with compliance with laws and regulations, rulings (in control statement) and required disclosures. In countries where it is mandatory to disclose information at an early stage (Canada, Ireland, Portugal, UK and US) is a fine for failure to comply accordingly. This fine is in some countries focused on two responsible parties: not only the organization that does not timely report the tax information will be fined, the tax consultant who was involved will be fined too. The importance of the timely identification of material tax risks by the TCF is emphasized by this method.

The OECD announced in its information note "Right from the Start" a comparable approach[ix]. This approach aims to shift the focus of control of an accurate tax result to the processes which lead to the amount of tax (internal tax control). A tax authority has a role into stimulating compliance with legislation and / or regulations. In this manner, errors are detected in a timely manner and avoided as much as possible. A tax administration would stimulate a taxpayer optimally through an understanding of the tax internal control environment of the taxpayer.

The "Right from the start" approach of the OECD consists of four dimensions:

Looking forward and real-time action to ensure that tax uncertainties are prevented or detected when they occur.

Put effort on the operations related to taxes (for example, the sales process leads to the payment of VAT and later to the payment of profit taxes, so this process requires attention for taxes).

Make it easy to comply and hard to not comply with laws and regulations.

Involve actively the tax payers, their representatives and other stakeholders with the purpose of better understanding and cooperation between parties.

3. The Netherlands

The Dutch variant of co-operative compliance is called "horizontal monitoring"[x]. Participating in the Dutch co-operative compliance variant requires a covenant between the participating organization and tax administration [xi,xii,xiii,xiv]. In this covenant is regulated how the organization and tax administration act in relation to co-operative compliance.

The principles of a compliance agreement with the tax administration are mutual trust, understanding and transparency[xv,xvi,xvii,xviii]. A compliance agreement does not lead to the tax authorities not monitoring a company. The basic principle of the tax administration is that it does not perform work, what has been done by an internal or external auditor. Monitoring by the tax administration in a co-operative compliance agreement is as much as possible based on the TCF. The tax administration wants to focus on a review of the design, implementation and operations of a TCF. For this, they require the taxpayer that it controls the overall tax system. The TCF will not only have to cover the main taxes, but also – if applicable –, for example, the gambling and environmental taxes.

In the first instance, the tax administration focused with co-operative compliance on the largest organizations. For these organizations, the tax administration published its first guidance[xix]. This guideline states that getting in control through a TCF is the responsibility of an organization itself. An organization must be able to make a statement about the extent to which it is in control. The role of the tax administration is one in which it provides feedback on what they have observed. The shape and intensity of the audit by the tax administration is tailored to the degree to which the organization is in control.

The tax administration highlights in its guidance several areas for practical implementation and strengthening fiscal management. First, it appoints the fiscal organization. An organization needs to know which parts of the organization are liable for the tax. In addition, the tax duties, powers and responsibilities should be clearly assigned. This must be designed in such a structure that an organization is aware of all relevant tax events. Tax structures should also encourage employees to comply with tax processes (soft controls).

Second, the tax authorities would like to understand the communication of the tax strategy within an organization. A tax strategy that is adopted by the board of the organization but not communicated afterward to the employees of the organization to operationalize this strategy, generally does not lead to the execution of the strategy. Therefore, the tax authorities require insight in the communication of the tax strategy. This is not only concerned with communication but also with complying with the rules / guidelines. If members of the organization do not respect the rules / guidelines, drafting a tax strategy may not bring the desired results.

Third, the tax administration emphasizes tax compliance. An organization must be able to indicate that it derives certainty that all transactions are accounted and stored. This is the requirement for the information systems. In addition, the accuracy plays a role in the tax compliance. This requires sufficient tax knowledge. Employees must be aware of the tax implications of their actions. For example, a sales department which carries out inter-company deliveries must be aware of the tax consequences. The tax administration wants to understand how the presence of current tax knowledge is guaranteed (internal or external). In addition, for accuracy of the taxable amount timely consultation of tax issues with a tax specialist is essential. The tax administration considers timeliness of financial settlement also as a part of tax compliance. It is important that an organization monitors that taxes are recovered and paid in time.

For SMEs an agreement can be concluded through a tax service provider and/ or an industry association. An industry association requires some form of supervision on which the tax administration can relay before an agreement is accomplished[xxxxi]. For both self-employment and industry association a TCF is not required and the tax administration therefore proposes no detailed rules for the establishment of a TCF for this group.

The Dutch co-operative compliance approach has been analysed within the Netherlands[xxii]. For implementing co-operative compliance the tax administration put pressure on large companies to participate in co-operative compliance[xxiii]. In this relation the tax administration has been criticised for the pressure it put without creating sufficient guidance for companies. Moreover, the co-operative compliance policy is inefficient for self-employed and SME companies. In addition, it appeared that co-operative compliance had no legal basis in the laws and regulations. The laws and regulations were completely based on compliance after the activity has occurred. The laws and regulations had no possibility for agreeing on tax matters before the tax filing. An adjustment to the laws and regulations was necessary to make co-operative compliance possible.

4. Analysis

In this section an analysis is performed on the co-operative compliance approach in the Netherlands. This approach follows a model earlier applied for analysing the United Kingdom[xxiv]. This model is as follows:

- Companies have clarity about how to comply with co-operative compliance (Clarity);
- Looking forward and real-time action to ensure that tax uncertainties are prevented or detected when they occur (timely);
- Put effort on the operations related to taxes (non-tax);
- Make it easy to comply and hard to not comply with laws and regulations (enforcement);
- Involve actively the tax payers, their representatives and other stakeholders with the purpose of better understanding and cooperation between parties (involvement).

Clarity. In the Netherlands the tax administration has put limited in effort in setting a framework for compliance. The only guidance created is that COSO might be an usable model. It

is not compulsory to apply COSO. Moreover, there is no model at all which must be applied for co-operative compliance. It is questionable how to comply with co-operative compliance. Every company is free to apply their own insights and therefore the practice can be in many waysxxv. Companies within the same industry can apply different TCFs. Another inconvenience is the structuring of TCF requirements. A lack of guidance does not only limit the structuring, an unclear interpretation also limits it. Tax inspectors can make their own professional judgement about a company. Without specific guidelines from the tax authorities the view of the individual inspector is the guideline for complying. If a company gets a new tax inspector the view on the TCF is not essentially the same as before. To conclude, the clarity of the co-operative compliance regime is insufficient.

Timely. In the Netherlands companies has a dedicated tax inspector. The inspector is the direct contact person in tax uncertainties occur. Companies can apply forward looking and real-time tax activities. These activities are agreeable with the relevant tax inspector. From the evaluation of co-operative compliance timely response of the tax inspectors was sufficient. With timely responses companies can apply forward looking and real-time tax decisions. To conclude, the timely handling in the co-operative compliance regime is sufficient.

Non-tax. The use of non-tax processes is integrated in the TCF. There is no guidance on the implementation of a TCF. So, there is no guidance on how use non-tax processes in the TCF. However, in the co-operative compliance regime is mentioned that the TCF is the basis for co-operative compliance. The TCF is the aspect the tax inspector relies on (or not). Without the integration of non-tax processes the TCF is not optimal. Complete reliance on the TCF is in such a circumstance impossible. No matter the lack of guidance on non-operating processes, the non-operating processes are required to be integrated in the TCF. If the use of non-tax operations is actually part of the considerations of the tax inspector is doubtful, as there is no guidance on the interpretation of a TCF. To conclude, it is doubtful whether non-tax processes are actually considered for co-operative compliance. Based on professional judgement it is reasonable that non-tax operations are part of the TCF. The focus on non-tax operations in the co-operative compliance regime is moderate.

Enforcement. Large companies are put under pressure of the tax administration to agree "voluntarily" with participating in co-operative compliancexxvi. The method applied is based on enforced participation of at least large companies. This is not the definition of "enforcement" considered in this research. Enforcement is used as making it hard not to comply. The tax administration enforces large companies in co-operative compliance. This is not essentially making it easy to comply. Participation in co-operative compliance is possible with a limited TCF. Moreover, the enforcement applied by the tax administration can create a hostile company environment, where an environment of easy-compliance requires a 'friendly' tax environment. Companies not willing to participate in co-operative compliance and willing to apply an aggressive tax planning are still possible within the co-operative compliance regime. To conclude, the co-operative compliance regime has an insufficient enforcement method.

Involvement. In the evaluation of the co-operative compliance regime the relevant stakeholders are considered. The co-operative compliance regime is similar to this involvement. The critics on the co-operative compliance regime did not result in changes in the co-operative compliance regime. To conclude, the tax administration involves stakeholder without actually involving them in the co-operative compliance structure. For the involvement the tax administration is given the benefit of the doubt: involvement is sufficient in the co-operative compliance regime.

Analysis. The Dutch co-operative compliance regime creates many uncertainties for the tax payers. The benefit of the co-operative compliance structure is the timely response of the tax administration. Whenever a tax uncertainty is arising the taxpayer can contact the relevant tax inspector directly. This limits the uncertainty arising from the lack of guidance on the co-operative compliance regime. However, the uncertainty is the downside of the co-operative compliance regime. Taxpayers must contact the tax administration every time an uncertainty occurs. The company's professional judgement is always at doubt as the tax administration always remain the right to audit the taxpayer. Moreover, the consistency of co-operative compliance is at risk. The Dutch tax inspector has its own professional judgement and can make unguided decisions on a tax uncertainty. The risk arising is twofold. On the one hand it is possible that companies with comparable tax structures and tax risks are interpreted differently by different tax inspectors. On the other hand, the tax inspector is not life-long dedicated to the same companies. So, the company's tax inspector changes after several years, which causes changed perceptions after the change in tax inspector. Over the years companies have no certainty about the tax administration's decisions about their tax internal control environment. The lack of certainty is also a not stimulating companies to participate in co-operative compliance. The benefits of participating in co-operative compliance are not clear, assuming that there are benefits at all. The lower total compliance costs as proposed by the OECD are not in the Dutch co-operative compliance regime. The tax administration can apply the same tax audit as without co-operative compliance.

5. Conclusion

In this paper the Dutch co-operative compliance approach is considered. The findings are remarkable. The Netherlands has applied a free-format for both designing a TCF and auditing a TCF. This creates no legal security for the participants. It is therefore questionable whether participating in the Dutch co-operative compliance approach is beneficial for participants. This research contributes to the existing scientific literature by researching a country not researched before with the legal security framework. In addition, it gives insight from a legal perspective on a policy which is probably hardly applied in common law. Therefore scholars and policy makers of common law countries should consider this paper and conclude on a concept that is hard to apply in their own territory. The limitation of this paper is that there might be subjectivity in the analysis/ interpretation. However, a well-recognized legal co-operative compliance framework is applied making the results reliable. Further research can focus on other countries by applying the framework applied in this research. In addition, further research can build on the results of this

paper and further analyse the shortcoming and required changes in the Dutch co-operative compliance approach.

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