

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

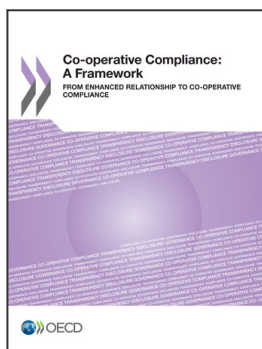
1. National Audit Office (2012), *Settling large tax disputes*, London, June 2012, www.nao.org.uk/report/settling-large-tax-disputes/.
2. Committee Horizontal Monitoring Tax and Customs Administration (2012), *Tax supervision – Made to measure*, The Hague, page 51.
3. This followed an earlier report 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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