



*Alicja Majdańska*

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# An Analysis of Cooperative Compliance Programmes

Legal and Institutional Aspects with a Focus  
on Application in Less Developed Countries

IBFD DOCTORAL SERIES

58



# An Analysis of Cooperative Compliance Programmes

## Why this book?

The recent developments in the international tax agenda prove that the need for a revival of cooperative compliance programmes is greater than ever before. Regardless of whether one places cooperative compliance programmes in the context of the post-BEPS world, mandatory disclosure rules (which are about to become effective in the European Union) or the discussion about the tax implications of e-commerce, it is in the public interest to ensure a framework for a mature, argument-based and (ideally) real-time discussion between tax administrations and large business taxpayers. The benefits of cooperative compliance programmes may prove particularly important in the post COVID-19 environment, when countries will be looking for ways to recover from the crisis.

This book analyses how to ensure that the implementation of the concept of cooperative compliance is underpinned by sound legal principles and enhanced by a robust institutional framework, with a particular focus on the application of the concept in less developed countries. In the context of less developed countries, the concept of cooperative compliance is presented as a legal transplant, able to “travel” across countries, legal systems and legal cultures. The book shows not only how tax administrations and taxpayers may benefit from cooperative compliance programmes, but also what the potential bottlenecks are.

As such, this book promotes the concept of cooperative compliance as a viable solution to the many challenges faced by not only developed countries, but also less developed ones. It contributes to tax policy formulations by providing clear recommendations on the design of a cooperative compliance programme, highlights the potential legal and institutional bottlenecks and presents some good practices on how a cooperative compliance programme can be developed. As such, it offers useful guidance for lawmakers and tax administrations planning to implement cooperative compliance programmes.

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# Chapter 1

## Introduction

### 1.1. Background of the research

The tax policy environment post-BEPS<sup>1</sup> is characterized by mounting tax uncertainty. The implementation of new international standards, treaty renegotiations and ongoing publicity about aggressive tax avoidance and tax evasion pose a heavy burden on tax administrations around the world. The BEPS package includes measures that will assist tax administrations in improving tax transparency – for instance, new requirements with respect to transfer pricing documentation under the country-by-country (CbC) reporting.<sup>2</sup> However, many tax administrations will struggle to reap all the benefits that new international standards and the application of technology are making possible in terms of improved compliance and the greater efficiency and effectiveness of their operations. The application of the new international standards, including their translation into domestic law where necessary, is a complex legal challenge. Exploiting the potential of new technologies and meeting international standards governing the confidentiality of data is a technical obstacle, especially for tax administrations with limited capacity.

Uncertainty in policymaking and administration of tax systems also results in uncertainty for taxpayers. They suffer from unexpected, frequent changes in tax law, regulations and guidance. Taxpayers complain about a lack of clear and timely dispute resolution mechanisms and processes. They criticize the increase in compliance burdens, inconsistent treatment and cumbersome compliance processes, all of which contribute to greater ambiguities.<sup>3</sup>

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1. OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD 2013), Primary Sources IBFD. In the context of this book, “BEPS” refers to a package of 15 actions that was developed by the OECD under auspices of the G20 Leaders. The package was first presented as an action plan (so-called BEPS Action Plan), and in 2015, the OECD issued a series of reports to each of the action points. See <http://www.oecd.org/ctp/beps-actions.htm> (accessed 3 May 2020); see also section 2.2.6. of this book for more information.

2. For more details, see <http://www.oecd.org/tax/beps/country-by-country-reporting.htm> (accessed 3 May 2020).

3. International Monetary Fund (IMF)/OECD, *Tax Certainty. IMF/OECD Report for the G20 Finance Ministers* (OECD 2017) available at <http://www.oecd.org/tax/tax-policy/tax-certainty-report-oecd-imf-report-g20-finance-ministers-march-2017.pdf> (accessed 3 May 2020) [hereinafter IMF/OECD Report].

The risk of growing uncertainties, particularly in relation to taxation, is seen as a threat to innovation-driven and inclusive growth.<sup>4</sup> This may have particularly pernicious effects on less developed countries. While many less developed countries are currently striving to strengthen domestic resource mobilization by securing sustainable revenues, they often face significant challenges of capacity. This may hinder their implementation of the OECD's BEPS Action Plan, which requires capabilities going beyond tax technical knowledge. In general, weak administration, poor governance and corruption are sources of concern for less developed countries and contribute to low revenue collections. These factors magnify the challenges they face when taxing large business taxpayers,<sup>5</sup> and although large business taxpayers are criticized for pursuing aggressive tax planning that deprives poor countries of revenue, it is also true that they are often the most significant contributors to government budgets.<sup>6</sup>

Against this background, the World Investment Report for 2015 raised the question: "how can policymakers take action against tax avoidance to ensure that MNEs pay 'the right amount of tax, at the right time, and in the right place'?"<sup>7</sup> without resorting to measures that might have a negative impact on investment?"<sup>8</sup> Other questions include (i) how to improve legal certainty, seed trust, transparency and mutual understanding in the context of less developed countries; and (ii) how to reconcile the need for sufficient revenue to support public investment with a business climate that supports sufficient return on capital to promote private investment.

The reform of tax administration may be part of the answer. It is widely recognized that how revenue is raised matters. The methods employed for tax law implementation can incentivize tax compliance and attract investment.<sup>9</sup>

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4. R. Torvik, *International Taxation*, in *Tax Havens and Development* (Commission on Capital Countries from Developing Countries ed., Government Administration Services Information Management 2009).

5. United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2015 – Reforming International Investment Governance* p. 190 (United Nations Publication 2015) [hereinafter UNCTAD Report].

6. J.P. Owens, *Tax and Investment: UNCTAD's contribution to the ongoing BEPS debate* (6 Oct. 2015), available at <https://investmentpolicy.unctad.org/blogs/44/tax-and-investment-unctad-s-contribution-to-the-ongoing-beps-debate> (accessed 3 May 2020).

7. UNCTAD Report, *supra* n. 5, at p. 178.

8. *Id.*

9. IMF, OECD, UN, World Bank Group, *Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries: Prepared for Submission to G20 Finance Ministers* p. 9 (2016), available at <http://documents.worldbank.org/curated/en/337691503666961906/Enhancing-the-effectiveness-of-external-support-in-building-tax-capacity-in-developing-countries-prepared-for-submission-to-G20-finance-ministers> (accessed 3 May 2020).

Unfortunately, however: “Most of modern tax theory, (...), completely ignores administration and enforcement. The policy formation process is not much better, too often addressing implementation only after reform has been determined, rather than as an integral part of the decision-making process.”<sup>10</sup>

Reform of how the tax system is administered also matters, particularly in the context of less developed countries. The reform of tax policy and administration can enhance overall governance. It can improve the fairness of the tax system by eliminating exceptions or special treatment for those who are able to exploit the inadequacies of the existing system. Sustainable tax reforms need to rely on improved respect for the rule of law, accountability and transparency standards.<sup>11</sup> Tax reforms are an essential part of state building. They require accountability and responsiveness on the part of the state.

The 2017 International Monetary Fund (IMF)/OECD report on tax uncertainty suggested that multilateral cooperative compliance programmes could play a part in addressing the problem.<sup>12</sup> In the meantime, the OECD, in connection with its work on implementing BEPS Actions 13 (transfer pricing documentation and CbC reporting) and 14 (mutual agreement procedure),<sup>13</sup> launched a pilot of the International Compliance Assurance Programme (ICAP) (first ICAP 1.0 and the year after – after some design modification – ICAP 2.0). This international mechanism has its origins in a domestic practice. The design of domestic cooperative compliance programmes has been on the international agenda for around ten years. Given the move to elevate the practice from the domestic to the international level, it is essential to revisit the original concept of cooperative compliance.

At the domestic level, different countries have adopted different approaches to the implementation of the concept of cooperative compliance and, as a

10. J. Shaw, J. Slemrod, and J. Whiting, *Administration and Compliance*, in *Dimensions of Tax Design: The Mirrlees Review* p. 1103 (J. Mirrlees et al. eds., Oxford University Press 2010).

11. R. F. Junquera-Varela et al., *Strengthening Domestic Resource Mobilization: Moving from Theory to Practice in Low- and Middle-Income Countries* pp. ix–x (World Bank Group 2017), available at <https://openknowledge.worldbank.org/handle/10986/27265> (accessed 3 May 2020).

12. IMF/OECD Report, *supra* n. 3, at p. 96.

13. OECD, *Transfer Pricing Documentation and Country-by-Country Reporting – Action 13: 2015 Final Report* (OECD 2015), Primary Sources IBFD; and OECD, *Making Dispute Resolution Mechanisms More Effective – Action 14: 2015 Final Report* (OECD 2015), Primary Sources IBFD.

result, programme designs often vary. The 2013 Report<sup>14</sup> demonstrated that. This raises some questions about how a multilateral programme will work if the underpinning concept of cooperative compliance is still contested to some degree and if there remains a degree of confusion about its scope and design. Furthermore, it is largely terra incognita for less developed countries. This is unfortunate, given the potential there is for a cooperative compliance programme to help address some of the challenges faced by these countries. If less developed countries do not have a domestic programme in place, they are going to find it difficult to participate in its multilateral phase.

The time is ripe for an in-depth discussion on a domestic phase of cooperative compliance programmes. It may help to address growing tax uncertainties in the post-BEPS world. It may also be a means to solve some of the challenges that less developed countries face in tax administration. Above all, if there is an international will to develop the concept of cooperative compliance as a multilateral tool, robust research on the legal and institutional limitations that should govern programme design is key.

So far, the topic has not been discussed extensively in academia. Most academic papers on the topic are concerned with the implementation of a specific new cooperative compliance programme in a particular tax system. These papers are focused on the domestic setting only.<sup>15</sup> There have been a few articles providing an overview of selected domestic programmes.<sup>16</sup> The most comprehensive contribution to the tax community's knowledge

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14. OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance* (OECD 2013).

15. For example: K. Bronzewska & V. Tamburro, *Cooperative Compliance in Italy – Does It Stand a Chance?*, 53 Eur. Taxn. 12, pp. 595-602 (2013), Journal Articles & Papers IBFD; J. Freedman, F. Ng & J. Vella, *HMRC's Relationship with Business OUCBT* Working Paper (2014); R. Sanz-Gómez, *Cumplimiento Cooperativo Y Grandes Empresas En España: Un Pacto de Cristal* (Instituto de Estudios Fiscales 2017); L. van der Hel–van Dijk and T. Poolen, *Horizontal Monitoring in the Netherlands: At the Crossroads*, 67 Bull. Intl. Taxn. 12, pp. 673-678 (2013), Journal Articles & Papers IBFD; M. Manca, *The New Italian Cooperative Compliance Regime*, 56 Eur. Taxn. 4, pp. 152-160 (2016), Journal Articles & Papers IBFD; F. Ng, J. Vella & J. Freedman, *Cooperative compliance and the Litigation and Settlement Strategy: results from a survey* (15 May 2014), available at <https://docplayer.net/2744708-Cooperative-compliance-and-the-litigation-and-settlement-strategy-results-from-a-survey-judith-freedman-francis-ng-and-john-vella-may-15-2014.html> (accessed 5 Dec. 2020); and M. Stiasny, *Horizontal Monitoring* (LexisNexis 2015).

16. For example, E.M.E. van der Enden & K. Bronzewska, *The Concept of Cooperative Compliance*, 68 Bull. Intl. Taxn. 10, pp. 567-572 (2014), Journal Articles & Papers IBFD; K. Bronzewska and E.M.E. van der Enden, *Tax Control Framework – A Conceptual Approach: The Six Nuances of Good Tax Governance*, 68 Bull. Intl. Taxn. 11, (2014), Journal Articles & Papers IBFD; D. de Wit and L. Oats, *Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison*, British Tax Review 2, pp. 230-248 (2017).

about cooperative compliance programmes so far was a doctoral thesis by Katarzyna Bronżewska, and the study offered a SWOT<sup>17</sup> analysis of cooperative compliance programmes combined with a review of potential programme implementation in Poland.<sup>18</sup>

In contrast to previous works, this one represents the first comprehensive study of legal and institutional requirements for the implementation of the concept of cooperative compliance programme. In addition, it is also the first piece of research that demonstrates and justifies the concept's potential for less developed countries.

The inspiration, and also an important source of knowledge for this book, has been the project “Co-operative compliance: Breaking the Barriers” that was initiated by the WU Global Tax Policy Center (GTPC) at the Institute for Austrian and International Tax Law in partnership with tax administrations from African countries.<sup>19</sup> The project has involved discussion of the cooperative compliance with tax administrations in several developing countries, and the GTPC has supported a small number of tax administrations from Africa that have decided to run pilot programmes.

## 1.2. Research problems

The main objective of this book is to present the concept of cooperative compliance as a legitimate tax compliance strategy, underpinned by sound legal principles and enhanced by a robust institutional framework. By providing a platform for a constructive dialogue between tax administrations and large business taxpayers, the concept can promote certainty, transparency and good tax governance. To achieve that, this book examines how to design a cooperative compliance programme, with a specific focus on potential implementation in less developed countries. As such, the book suggests a legal transplant of the concept of cooperative compliance from developed to less developed countries. Although the main recommendations from this book focus on less developed countries, the study should be useful for developed countries too.

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17. Within the SWOT analysis, strengths, weaknesses, opportunities and threats are the criteria being analysed.

18. K. Bronżewska, *Cooperative Compliance: A New Approach to Managing Taxpayer Relations* (IBFD 2016), Books IBFD.

19. The programme was conducted in the period between 2015 and 2018. Currently, it is continued under the name “Co-operative Compliance”. For more details, see <https://www.wu.ac.at/taxlaw/institute/gtpc/current-projects/co-operative-compliance> (accessed 5 Dec. 2020).

The book focuses on the following main questions:

- (1) What are the potential legal constraints governing the implementation of a cooperative compliance programme, and how may they affect the design of a particular cooperative compliance programme?
- (2) What is the institutional framework required to implement the concept of cooperative compliance?
- (3) Can the concept of cooperative compliance be transplanted into the legal, institutional, political and social environment of less developed countries?

By addressing these questions, the book aims to make a significant contribution to the research on the concept of cooperative compliance.

### 1.3. Research methods

To achieve its aims, the book combines two methodologies: comparative tax law<sup>20</sup> and the theory of a legal transplant.<sup>21</sup>

The comparative method serves both as a basis for developing the definition of the concept of cooperative compliance and also for understanding potential legal constraints on the design of a cooperative compliance programme. Three cooperative compliance programmes (the Dutch, Italian and the British) are used as the basis for the comparative analysis.

The choice of jurisdictions was based on the following criteria: (i) legal tradition; (ii) the maturity of the respective cooperative compliance programmes; and (iii) their subjective scope. The selected jurisdictions represent both the common law and civil law traditions, Anglo-Saxon and Roman-German families of law and countries with relatively long experience in operating the cooperative compliance programme and those that have only recently introduced the programme. In one case, the programme only includes selected large business taxpayers, another covers almost all large business taxpayers and one country offers a form of cooperative compliance to all business taxpayers, including small and medium taxpayers. But they also share many features. The three programmes were developed by OECD member countries. This means they belong to the international organization that has been developing and promoting the concept over the

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20. E. J Eberle, *The Method and Role of Comparative Law*, 8 *Washington University Global Studies Law Review* 3, (2009).

21. A. Watson, *Legal Transplants* (Scottish Academic Press Ltd 1974).



last ten years. This also indicates that they belong to the group of relatively well-developed tax administrations. In addition, these countries are currently all Member States of the European Union, which places them in the same supranational legal framework and makes them subject to a degree of indirect harmonization.<sup>22</sup>

The order in which cooperative compliance programmes are analysed is not accidental. From the perspective of a lawmaker looking for a cooperative compliance template, the Dutch programme may be a first choice. It is seen as the most comprehensive example of a cooperative compliance programme, although it is not the oldest one. The second choice for a lawmaker could be a programme that contrasts the most with the Dutch one. As such, the Italian programme seems to be an obvious second choice in the analysis. Finally, the third programme that seems to offer an alternative type of design is the UK programme. It is one of the oldest but also was recently relaunched.

The book employs the (i) analytical;<sup>23</sup> (ii) historical;<sup>24</sup> (iii) law-in-context;<sup>25</sup> and (iv) functional<sup>26</sup> comparative methods. The analytical method aims at understanding the approach of different countries to the basic building blocks of a cooperative compliance programme. As such, each programme is evaluated in the light of its governance arrangements on the side of the tax administration and taxpayers, its legal basis and the administration of individual agreements within each of the programmes. It involves elements of a historical approach, as it puts each of the programmes in the context of its specific history. The law-in-context method was applied to explain how the programmes fit into the overall tax strategies of the tax administrations. Finally, some elements of a functional method were used to discuss similarities and differences between the programmes.

Most of the comparative discussions have a horizontal character, meaning they are oriented at comparing domestic legal and institutional

22. In the context of EU law, it may result in some concerns whether a cooperative compliance programme is a legitimate tax strategy and does not conflict with the prohibition of State aid rules under EU law.

23. P.W. Brouwer & J. Hage, *Basic Concepts of European Private Law*, 15 *European Review of Private Law* 1, pp. 3-26 (2007).

24. M. Van Hoecke, *Methodology of Comparative Legal Research*, *Law and Method* 12, p. 18 (2015), available at <http://www.lawandmethod.nl/tijdschrift/lawandmethod/2015/12/RENM-D-14-00001> (accessed 5 Dec. 2020).

25. R. Sacco, *Legal Formants: A Dynamic Approach to Comparative Law (Part I)*, 39 *American Journal of Comparative Law* 1, pp. 1-34 (1991); and R. Sacco, *Legal Formants: A Dynamic Approach to Comparative Law (Part II)*, 39 *American Journal of Comparative Law* 2, p. 343-401 (1991).

26. K. Zweigert and H. Kötz, *Introduction to Comparative Law* (Clarendon Press 1998).

developments. However, there are some elements of a vertical comparison as well.<sup>27</sup> These are applied by way of comparison between the OECD/FTA work on the concept of cooperative compliance and the three domestic cooperative compliance programmes.

The programme comparison relies mostly on a descriptive (*de lege lata*) narrative. It describes various approaches to implementation of the concept of cooperative compliance. However, along the way, normative (*de lege ferenda*) suggestions are made as well. They mainly concern the details of how to implement the concept of cooperative compliance within a legal and institutional framework, i.e. what governs the choice of the legal instrument to implement a specific programme, how to design the scope of eligible taxpayers, how to ensure tax certainty and how to avoid a potential conflict with legal privilege. These normative suggestions address both the existing cooperative compliance programmes and potential future cooperative compliance programmes. Finally, a tax policy design for a cooperative compliance programme in less developed countries is set forth.

The examination of whether the concept of cooperative compliance could be implemented by less developed countries is presented within the framework of the theory of a legal transplant. The concept of cooperative compliance is presented as a legal transplant that – under certain circumstances – can “travel” among different legal systems.

The research for the book was based on bibliographical references, case law, statute and administrative guidelines.

### 1.4. Limitations

The book has three main limitations. The first limitation refers to the selection of cooperative compliance programmes for the comparative analysis. The second limitation involves a number of fundamental principles that were taken into account in the examination of the legal constraints in the implementation of a cooperative compliance programme. The third limitation concerns the scope of countries defined as “less developed countries”.

As stated earlier, three programmes were selected for the purposes of comparative analysis: the Dutch, Italian and the British. It would not have been

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27. A. Momirov and A. Naudé Fourie, *Vertical Comparative Law Methods: Tools for Conceptualising the International Rule of Law*, 2 *Erasmus Law Review* 3, pp. 291-309 (2009).

practical, for a number of reasons, to examine all existing cooperative compliance programmes. The most important reasons are (i) the lack of availability of the appropriate literature; (ii) language limitations; and finally, (iii) the limited scope of this book.

There are a limited number of fundamental principles against which the concept of cooperative compliance and the selected programmes have been evaluated. They were chosen with the perspective of a lawmaker primarily in mind. A lawmaker contemplating the implementation of a cooperative compliance programme is likely to be concerned with the legal underpinning of the programme (principle of legality), the personal and substantive scope of a programme (principle of legal equality), ways of providing certainty to taxpayers within a programme and the tension between the transparency that is central to the concept and the protection that stems from the principle of legal privilege. In addition, given that all three of the programmes examined in depth involve EU Member States, the EU framework was taken into account and, specifically, the potential for conflict with State aid rules was examined.

Finally, the discussion about the possibility of implementing a cooperative compliance programme in less developed countries requires defining what is meant by “less developed countries”. For research and methodological reasons, this needs to be limited to a relatively similar group of countries in terms of their legal and institutional tax systems.

Taking these factors into account, the broad category of less developed countries was narrowed, both in terms of the geographical region and in terms of the size of income. The World Bank classification is one of the most often used ranking for the categorization of countries.<sup>28</sup> It served as a basis for selection. Thus, based on a current World Bank classification of countries,<sup>29</sup> first Sub-Saharan African countries were selected. There are currently 48 countries included in this region. Next, in order to have more homogenous groups of countries, high income (Seychelles) and upper middle income (Equatorial Guinea, Gabon, Mauritius, Namibia, South Africa) were eliminated. The remaining group consists of low and lower middle-income, post-colonial Sub-Saharan African countries. Currently, there are 42 countries belonging to this category. For the purpose of this analysis, they are referred to as “less developed countries”.

28. There are also other well-known rankings developed by the IMF, the United Nations and the United Nations Development Programme.

29. Available at <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups> (accessed 11 Feb. 2017).

## 1.5. Summary

The book consists of four main parts. Part I sets the scene for the discussion of the concept of cooperative compliance. It provides a brief analysis of the history of tax administration and, in particular, economic, social and regulatory developments in the 20th and early 21st centuries. It shows the rationale for the very first cooperative compliance programmes and how they fit into the current legal and socio-economic environment. It also discusses how various programmes provided the inspiration for the OECD/FTA to develop the concept of cooperative compliance and promote its wider adoption.

Part II defines the concept of cooperative compliance. To do so, three cooperative compliance programmes – the Dutch, Italian and the British – are compared. The comparative analysis shows both differences and similarities between the different programmes. The concept of cooperative compliance is further compared and contrasted with four other tax compliance initiatives, which include (i) prompt audits; (ii) disclosure rules; (iii) tax rulings; and (iv) fora for large business taxpayers.

Part III puts the developed concept and three examples of cooperative compliance programmes into a legal and institutional framework. First, the concept is tested against certain fundamental legal principles. The principle of legality, equality and certainty and also legal privilege are evaluated as potential constraints on the implementation of a cooperative compliance programme. Due to the selection of programmes discussed and the relevance of the concept to the current European tax agenda, the discussion also examines State aid law and its potential impact on the design of cooperative compliance programmes. Next, the concept is put into an institutional framework. Essential institutional mechanisms of control and oversight are identified.

Part IV tests the claim that less developed countries may also reap benefits from a cooperative compliance programme. The concept is analysed from two perspectives: (i) as a legal transplant; and (ii) as a reform of tax administration compliance strategy.

Finally, conclusions from all chapters are brought together and presented in the form of a road map for the implementation of the concept of cooperative compliance, specifically in less developed countries. All discussions are summarized and concluded in the final chapter.



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