Tax Compliance in the Spotlight – The Challenges for Tax Administrations and Taxpayers

In this article, the authors examine the relationship between tax transparency and tax compliance. Specifically, the authors consider the opportunities and challenges brought about by the tax transparency agenda and its potential impact on tax compliance strategies.

1. Introduction

The issue of tax compliance has been receiving increased attention in the context of international taxation. Following the 2008 global financial crisis, many countries adopted austerity policies by cutting spending and raising taxes. As the need for revenue mobilization has grown in importance, facilitating tax compliance and reducing the lacunae in the oversight system have become key concerns for tax administrations worldwide.\(^1\)

The question is, therefore, how to enhance tax compliance? Based on the concept of the compliance pyramid,\(^2\) tax administrations can adopt one of the following two options.

At one end of the spectrum, tax administrations may decide to improve tax enforcement, while, at the other end, tax administrations may adjust their operations in accordance with the so-called “motivational postures” of taxpayers. Importantly, however, both approaches greatly rely on the developments realized with regard to tax transparency.

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\(^1\) For a worldwide review on the issue of tax compliance, see *Improving Tax Compliance in a Globalized World* (M. Lang et al. eds., IBFD forthcoming).


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3. The whole of government approach was initiated by the OECD at the First International Forum on Tax and Crime in Oslo that took place on 21 to 23 March 2011. It is defined as an approach based on greater transparency, gathering more strategic intelligence and improved efforts to harness the capacity of different government agencies to work together to detect, deter and prosecute these crimes. See OECD, *The Launch of the Oslo Dialogue A Closing Statement by Norway, as host, and the OECD 23 March 2011*, available at http://www.oecd.org/ctp/crime/launch-oslo-dialogue-closing-statement.pdf (accessed 10 Sept. 2017).

4. Many have already studied the topic. Sociologists and psychologists have concentrated on a number of issues including the attitudes of taxpayers, for example, D.J. Hessing, H. Elffers & R.H. Weigel, *Exploring the Limits of Self-Reports and Reasoned Action: An Investigation of the Psychology of Tax Evasion Behavior*, 54 J. Pers. Soc. Psychol. 3 pp. 405-413 (1988); E. Kirchler, *Reaction to Taxation: Employers’ Attitudes towards Taxes*, 28 J. Socio-Econ. 2, p. 131 (1999); and J. Vogel, *Taxation and Public Opinion in Sweden: An Interpretation of Recent Survey Data*, 27 Natl. Tax J. 4, p. 499 (1974); on the social representations of taxes, tax evasion and avoidance, for example, E. Kirchler, B. Maciejowsky & F. Schneider, *Everyday Representations of Tax Avoidance, Tax Evasion, and Tax Flight: Do Legal Differences Matter?*, 24 J. Econ. Psychol. 4, p. 535 (2003); on feelings of reluctance to pay, for example, Kirchler, supra, on the social identity of taxpayers and perceptions of fairness, for example, M. Wenzel, *The Impact of Outcome Orientation and Justice Concerns on Tax Compliance: The Role of Taxpayers’ Identity*, 87 J. Appl. Psychol. 4, pp. 629-645 (2002); on social norms and personality characteristics, for example, Hessing, Elffers & Weigel, supra; and on motivational postures, for example, V.A. Braithwaite, *Dancing with Tax Authorities: Motivational Postures and Non-Compliant Actions*, in *Taxing Democracy: Understanding Tax Avoidance and Evasion* pp. 13-39 (V.A. Braithwaite ed., Repr. ed. 2004). Recent attempts to integrate different factors influencing tax compliance have resulted in the development of the concepts of “slippery slope framework”, “responsive regulation” and “multifaceted approach”.
The article is structured as follows. First, the authors present the discussion around measuring the size of the tax gap (see section 2.). The authors undertake this exercise to reveal the problem of non-compliance and its magnitude. Second, the authors analyse the current opportunities for improvement of data collection, both at domestic and international levels (see section 3.). Third, the authors move on to discuss how this enhanced knowledge of the activities of taxpayers may give rise to opportunities for a tax compliance agenda, i.e. help to develop risk management strategies and compliance models (see section 4.). Finally, the authors conclude by considering the challenges that tax administrations may face in the future (see section 5.).

2. What Is the Size of the Problem?

The discussion on tax compliance starts with defining the problem. Measuring the tax gap is increasingly regarded as a necessary tool for understanding and therefore addressing tax non-compliance. At the same time, it helps to target efforts to improve and facilitate voluntary compliance.5 Depending on the data and resources available, countries tend to rely on either one of the following two most widespread approaches for measuring the tax gap: (1) the “bottom up” approach; or (2) the “top down” approach.6 Bottom up refers to the starting point on audit results or other operational information, which are then grossed up to estimate perfect compliance. In contrast, top down refers to the starting point on national accounts and other high-level data to model the tax base and estimate revenue under perfect compliance. Both provide a measure of comparison to the tax collected, thereby making it possible to estimate the size of the tax gap.

A good example of the application of these methods is the United Kingdom, which relies, for example, on the top down approach with regard to VAT and the bottom up approach in respect of corporation tax.7 However, a cross-country analysis suggests that direct tax gap estimates are only undertaken by a handful of countries.8 For instance, the European Union focuses more on VAT (indirect) tax gap estimates, which have been around since at least 2009 and cover periods starting from 2000.9 This is not surprising considering that it is simply more difficult to estimate, in a reliable way, the direct tax gap than the indirect tax gap. It has also been identified that this is because direct taxes are much more complex systems compared with indirect tax regimes.10

While the tax gap estimation requires significant efforts and resources, it may be questioned whether it actually yields useful results. It can, for example, be argued that any figures so derived are inherently flawed and, therefore, that there is no merit in trying to determine the tax gap. It cannot be ignored that, in order to estimate the tax gap, the total amount of tax owed must first be ascertained. In many cases, it may well be disputable, given that the correct interpretation of tax law cannot be determined until this has been decided by the courts. For instance, the line between acceptable and unacceptable tax planning is blurred with numerous grey areas. This may have more significant implications in measuring the size of the tax gap than is often argued. This also raises the question of whether disputed amounts of tax owed should be a part of the tax gap. If the resulting measure is so uncertain, why measure it in the first place?

A first argument in favour of measuring the tax gap reflects political reality. Tax administrations need to justify the resources they are given, especially at times of crises and pressure on public finances.11 As a result, quantifying the overall scale of evasion and avoidance could help tax administrations in the political process of bargaining for resources.


10. See Fiscalis Tax Gap Project Group (FGP/041), supra note 8, at p. 23, where it is stated that: “The fact that direct tax estimations are rare in practice can be explained by the fact that reliable and comprehensive estimations for direct taxes are more difficult to perform than for the VAT. In general, due to complex taxation rules (e.g. numerous exemptions, deductions, credits, allowances) it is difficult to develop a good methodology for estimating the amounts of tax theoretically collectible. For a top down estimation of a direct tax gap, it is frequently the case that the available independent data sources on income and assets are not sufficiently comprehensive or detailed to enable a robust estimate of tax liability. In particular, national accounts data does not provide sufficient information about off-shore fraud or assets (e.g. bank deposits, shares, real estate) that taxpayers may hold in foreign countries. As a consequence, top-down estimations may only capture a part of tax evasion and will be biased downwards to an unknown extent”.


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A more convincing argument can be made in connection with the determination of trends. Even if it is accepted that the tax gap cannot be precisely measured, keeping a consistent methodology should reveal the comparative performance of tax administrations in collecting taxes. In other words, the merit lies not necessarily in arriving at an exact figure, but rather in demonstrating whether, at the macro level, the extent of tax compliance is apparently improving or deteriorating over time.12

In addition, measuring the tax gap serves as an important instrument in respect of transparency and accountability. Public reactions to tax avoidance scandals are frequently cited as the impetus behind the OECD/G20 Base Erosion and Profit Shifting (BEPS) initiative,13 which not only reinforces public interest in keeping track of the developments in the area, but also stresses the positive influence exercised by the public in the political debate. Moreover, measuring the tax gap, in absolute terms or using variations, provides a new way to assess the performance of tax administrations. While, from the perspective of the public, this could permit a more transparent accountability process, it could also help in the internal management of tax administrations, for example in setting priorities and establishing strategies.14

Overall, it should be kept in mind that, regardless of its exact size, the tax gap exists and may well be a drain on development in many countries, in particular for emerging economies. In order to ensure sustainable development and sources of revenue, tax administrations need to be more effective and more efficient. The size of the tax gap may, therefore, be a good indicator of how successful a tax administration is in gathering revenue.

### 3. Tax Transparency: Know the Taxpayer

#### 3.1. The role of information

Improving access to data is one of the core areas for ensuring improved tax compliance. Tax administrations cannot improve their effectiveness and efficiency if they do not have accurate information regarding taxpayers, their activities and the transactions that they have entered into. It is not surprising then that one of the current priorities of tax administrations is to increase access to information to reduce systemic blind spots.15 This is not the complete solution, as processing, interpreting and finally making use of all of the data available is, in and of itself, a significant challenge. However, increasing the access to information is already a significant first step. The measures for increasing access to tax information can, in general, be grouped into the following two categories: (1) domestic measures (see section 3.2.); and (2) international measures (see section 3.3.).

#### 3.2. Domestic measures

##### 3.2.1. Synergies in liaison with taxpayers

The most traditional information gathering mechanism is the tax return. However, this mechanism is burdensome for both taxpayers and tax administrations because taxpayers have the burden of filling returns, while tax administrations face the difficult challenge of overseeing a great number of returns.16 In this regard, domestic measures are generally intended to facilitate the oversight activity of the tax administration and incentivize taxpayer compliance.

In order to facilitate the oversight activity, the tax legislation of many countries tend to establish reporting obligations for third parties, in particular when they act as withholding agents.17 In such situations, the incentives for underreporting are shifted, as the third party gains nothing from underreporting, while the punishment tends to be comparatively high. In effect, this transfers the oversight burden to the third party. This raises the question of fairness, i.e. third parties are required to undertake burdensome activities in place of the tax administration without any form of compensation. On the other hand, in some tax systems, the legislator made an effort to minimize this burden. For instance, UK employers are required to pay over payroll taxes, i.e. pay-as-you-earn (PAYE) on the 19th of each month following the month for which the taxes are due.18 The delay is intended to offset the costs of collection to a certain extent. Similarly, in Poland, a withholding agent is entitled to deduct a percentage of the tax withheld.19

In recent years, technological developments have given rise to new possibilities to facilitate the oversight activity.20 In particular, the transposition of the tax reporting information to digital platforms has the potential to maximize their value by way of the cross-checking of information. For instance, the experience of Brazil with Sistema Público de Escrituração Digital (Public System of Digital Bookkeeping, SPED) enables the cross-checking of tax information provided by different taxpayers. The UK Connect21 system goes one step further; it enables not only a cross-check against the data of other taxpayers but

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15. As evidenced by Country-by-Country (CbC) reporting and the new standard of the exchange of information.
17. The importance of withholding obligations has been recognized by tax administrators worldwide. See Keen et al., supra n. 11, at p. 34.
19. In order to compensate the withholding agents for their activities, the Polish legal system permits the agents to deduct 0.3% of the tax withheld. See A. Majdanska & K. Bronżewska, National Report: Poland, in Lang et al. eds., supra n. 1.
20. Keen et al., supra n. 11, at p. 83.
also takes into account information from other sources, i.e. third-party databases.\(^{23}\)

While these measures provide tax administrations with regular access to the data of taxpayers, the measures still do not guarantee that all of the relevant information is disclosed. There are always some taxpayers who do not disclose all of their income and attempt to hide some assets abroad so that the chances of tax administrations detecting their income are smaller. However, the new standard for the Automatic Exchange of Financial Account Information in Tax Matters (see section 3.3.) may change this situation significantly, and it should be more difficult for taxpayers to hide their income.

Given the new standard, many countries have decided to initiate or enhance programmes that are intended to incentivize the disclosure of hidden assets. The objective is to provide taxpayers with an opportunity to regularize past non-compliance prior to the entry of the new standard. For instance, many countries have introduced either tax amnesties or voluntary disclosure programmes.\(^{24}\) In a sense, this fulfills the predictions of Malherbe (2011), for whom the ending of bank secrecy could give rise to generalized “last chance” voluntary disclosure programmes.\(^{25}\)

Voluntary disclosure programmes essentially offer non-compliant taxpayers the opportunity to repent and comply with their tax obligations. The design of the underlying incentives, i.e. essentially the reduction in interest and penalties, is rather delicate, as initial compliance should be retained as the most attractive option.\(^{26}\) Still, well-designed voluntary compliance programmes can be regarded as positive aspects of a broader compliance strategy.\(^{27}\)

On the other hand, tax amnesties appear to be particularly problematic. In addition to the reduction in interest and penalties, such mechanisms could also include reductions in tax liabilities, as well as waivers of civil and criminal liabilities.\(^{28}\) Consequently, in addition to being of questionable effectiveness from an economic perspective,\(^{29}\) these programmes may also give rise to serious anti-money laundering (AML) and counter-terrorist financing (CTF) concerns.\(^{30}\) From a policy perspective, tax amnesties could, in effect, permit taxpayers to avoid controversial litigation. If used on a consistent basis, this could prevent the formation of a consistent body of case law.\(^{31}\)

In addition to tax amnesties and voluntary disclosure programmes, another mechanism for encouraging compliance is connected with a change in the attitude of tax administrations to taxpayers from a confrontational approach to a cooperative one. In general, the services provided by tax administrations tend to require disclosure, while making compliance easier. Cooperative compliance programmes are further discussed in section 4.3.2.

### 3.2.2. Synergies in liaison with other law enforcement agencies

Unfortunately, taxpayers are not always willing to cooperate with tax administrations. In particular, this is the case with taxpayers who deliberately and persistently do not comply with all or part of their tax obligations. The advent of the automatic exchange of financial account information should provide tax administrations with data necessary to detect such taxpayers (section 3.3.). Nevertheless, in many cases taxpayers who evade taxes also commit other crimes or leave traces of their activities in different places. Given this, some tax administrations have decided to enter into cooperation with other government agencies to detect, investigate and prosecute those taxpayers more effectively and efficiently.

The primary example of inter-agency cooperation is the exchange of information. Given that tax crimes are recognized in many jurisdictions as a predicate offence to money laundering,\(^{32}\) it is not only tax administrations that may have the relevant data. Currently, financial intelligence units also gather information in the format of the Suspicious Transaction Reports (STRs) received from responsible parties.\(^{33}\) Given this, the OECD has recommended that tax administrations should have the fullest possible access to STRs. This may require amending the legislative

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23. Cerioni, supra n. 7.
27. OECD, supra n. 24, at p. 7.
28. Baer & Borge, supra n. 26, at p. 5 for a definition.
29. Baer & Borge, supra n. 26, at p. 55:
30. Even voluntary disclosure programmes, can be quite attractive in terms of data collection, from a policy perspective, it is paramount to design the programmes taking into account other higher ranking concerns with the risk of abuse by criminals for the purpose of moving funds. An issue of particular relevance is that some of these programmes, explicitly or in practice, exempt the full or partial application of AML and CTF measures. The Financial Action Task Force (FATF) has already recognized several instances where this might be the case, for example, when the programmes exempt financial institutions from the requirements to conduct full customer due diligence on taxpayers and verify that the funds or other assets being declared or reprinted are from legitimate sources. As a result, the FATF set out four basic principles that should be applied when implementing voluntary disclosure programmes: (1) effective application of AML and/or CTF preventive measures; (2) the prohibition from exempting AML and/or CTF requirements; (3) domestic coordination and cooperation; and (4) international cooperation. See FATF, *Best Practices Paper: Managing the Anti-Money Laundering and Counter-Terrorist Financing Policy Implications of Voluntary Tax Compliance Programmes (FATF 2012)*, available at www.fatf-gafi.org/media/fatf/documents/reports/BPP%20VC.pdf (accessed 7 Sept. 2017).
32. It is the result of the FATF *International Standards of Combating Money Laundering and the Financing of Terrorism and Proliferation* (FATF Feb. 2012) [hereinafter: the FATF Recommendations] regarding the legal framework in respect AML and/or the countering of the financing of terrorism. According to the list of designated offenses under the FATF Recommendations, tax crime should be included in the definition of the predicate crimes in respect of money laundering or terrorist financing.
33. Under FATF Recommendation 20 ‘If a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to terrorist financing, it should be required, by law, to report promptly its suspicions to the financial intelligence unit (FIU)’.
frameworks and providing the operational structures and procedures that could facilitate the maximum effectiveness of the use of STRs.\textsuperscript{34}

Many agencies have decided to move towards more advanced modes of cooperation. They have established joint investigation teams, created inter-agency centres of intelligence and organized secondments of personnel between agencies. One of the most well-known examples is from Australia. The Serious Financial Crime Taskforce (SFCT) and the Project Wickenby appear to embody "the best practices" in how task forces should be formulated to effectively and efficiently realize their objectives. The SFCT is intended to counter the highest priority of serious financial crimes, for example international tax evasion and criminality related to fraudulent phoenix activity, trusts and superannuation. A closely related idea was previously and successfully implemented by way of the Wickenby Project. The primary focus of that project was dealing with offshore tax evasion and crime. The results of this special task force are impressive. According to official data, as at 30 June 2015, such cooperation had resulted in the conviction and sentencing of 46 individuals and the recovery of over AUD 985 million in outstanding revenue.\textsuperscript{35} This included AUD 608 million in cash, AUD 372 million from increased voluntary compliance and AUD 5 million in recovered assets.

Among the most recent examples of a special task force, the Croatian Ured za suzbijanje korupcije i organiziranog kriminaliteta (Croatian State Prosecutor's Office for the Suppression of Organized Crime and Corruption, USKOK) and Tax Cobra as developed in the Czech Republic should be noted. USKOK is part of the Croatian criminal justice system, working under the auspices of the State Attorney’s Office, but also with the Croatian tax administration and financial intelligence unit.\textsuperscript{36} The Czech Tax Cobra only focuses on tax evasion and tax frauds. It comprises the Unit for Combating Corruption and Financial Crimes, the General Financial Directorate and the General Directorate of Customs. It cooperates both on a state and a regional level. According to the data provided by the Czech Ministry of Interior, after only 18 months in existence, CZK 4.1 billion has been secured due to this cooperation.\textsuperscript{37}

The analysis of existing trends strengthens the idea that different agencies are not only making the effort to improve the access to the information, but are also trying to work together to realize better results. Cooperation between various agencies appears to be a new upcoming trend on the compliance agenda.


\textsuperscript{35} Australian Taxation Office (ATO), Project Wickenby Has Delivered (accessed 7 Sept. 2017).

\textsuperscript{36} S. Hodžić, National Report: Croatia, in Lang et al. eds., supra n. 1.

\textsuperscript{37} D. Nerudová & J. Tepperová, National Report: Czech Republic, in Lang et al. eds., supra n. 1.

3.3. International measures
Collecting domestically available information can go a long way in the effort to close systemic data blind spots. However, given the existence of base erosion and profit shifting, it is common sense that avoidance and evasion have a strong international dimension. In this regard, the ability to collect international information is crucial to adequately assess domestic taxation, not only for sophisticated MNEs, but also for internationally active small and medium-sized enterprises (SMEs).

The advent of the Global Forum,\textsuperscript{38} under the auspices of the OECD and the G20, has proven to be the most important development in the implementation of the effective exchange of information. Following the 2009 reform, the Global Forum became a key aspect in implementing the internationally agreed standards for the exchange of information.

In a first step, the international commitment to exchange information on request effectively included tax haven jurisdictions within the scope of the exchange of information for tax purposes. Later, the United States enacted the Foreign Account Tax Compliance Act (FATCA).\textsuperscript{39} This legislation establishes a 30% gross withholding tax on certain US-source payments that are made to foreign financial institutions, unless these financial institutions agree to perform specified due diligence procedures to identify and report information regarding US persons that hold accounts with them to the US Internal Revenue Service (IRS).\textsuperscript{40} As a result of the FATCA, many countries decided to collect and exchange the required information. This has been realized on the basis of bilateral intergovernmental agreements.

The success of this initiative appears to have given rise to an international move towards the automatic exchange of information, which is now perceived as the most appropriate way to effectively deal with offshore tax evasion. This has been implemented by the OECD, under the auspices of the G20 leaders, with the title of Standard for Automatic Exchange of Financial Account Information (the “Common Reporting Standard”, CRS). One of the main obstacles relates to its practical implementation, which requires significant adaptation efforts by the jurisdictions involved. In particular, developing countries may prioritize tax reforms differently and may, therefore, postpone the implementation of the Standard.\textsuperscript{41}

The effective implementation of the Standard also requires adequate information technology (IT) infrastructure, which can be relatively expensive, and properly trained.


\textsuperscript{39} US: Foreign Account Tax Compliance Act (FATCA).


and skilled human resources. In addition, the issues of confidentiality and data protection may raise some concerns. All in all, implementing the Standard is perceived to be highly complex and demanding significant legislative changes.\(^4_2\)

The implementation of the Standard is monitored by the Global Forum. The body conducts peer reviews of the legal and regulatory framework of countries with regard to transparency and the exchange of information in tax matters, and the implementation of the Standard in practice. Recently, the OECD has proposed that countries that do not meet the objectives set should be identified as non-cooperative jurisdictions with regard to tax transparency.\(^4_3\)

These developments have been supported by the implementation of a multilateral platform for exchange of information and assistance in the collection of taxes. While articles 26 and 27 of the OECD Model\(^4_4\) and UN Model\(^4_5\) retain their relevance, they have become secondary to the more effective Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAC).\(^4_6\) This instrument serves as legal basis for several of the most recent developments, such as the CRS and the Country-by-Country (CbC) reporting under Action 13 of the OECD/G20 BEPS initiative.\(^4_7\)

Even if the challenges for implementation of the current developments have not yet been fully resolved, there are other new developments that should be noted in this context. That is the case with the Joint International Taskforce on Shared Intelligence and Collaboration, previously the Joint International Tax Shelter Information and Collaboration (JITSIC), remodelled in 2014 and then again in 2016. The prototype of this forum was established in 2004 as the Joint International Tax Shelter Information Centre. The new format of the forum emphasizes the need for collaboration and cooperation. It is intended to provide better possibilities for tax administrations to exchange information and undertake collaborative casework.\(^4_8\) In contrast to other international fora, the JITSIC heralded a more dynamic and operational cooperation between countries. It is rooted in the notion of an “enhanced” exchange of information that should enable, in appropriate cases, operational collaboration through bilateral or multilateral audits. Tax administrators may thereby gain a unique possibility to exchange their views and experience regarding the latest developments in tax compliance measures.

4. What Action Should Be Taken?

4.1. A number of approaches

Only after obtaining the appropriate data can a tax administration decide on how to adjust its operations and which measures should be applied to which taxpayers. With this information, international experiences reveal that tax administrations have different approaches at their disposal. For instance, they can allocate taxpayers into segments, according to their size, and distinguish between certain sectors, depending on the relevance to the economy of the country in question, for example oil and gas, and mining. Tax administrations may also seek to follow the enforcement pyramid and adopt different approaches, depending on a taxpayer’s compliance behaviour. In addition, the data collected may be used to guide the restructuring of a tax administration’s internal affairs and to identify priority situations according to the level of compliance risk. Sections 4.2. and 4.3. now explore, in greater depth, the options available to tax administrations in seeking more efficient operations.

4.2. How to structure operations?

As noted in section 2., estimating the tax gap may assist tax administrations in understanding deficiencies in tax systems. Having this information should provide tax administrations with a better insight regarding the priority areas for adjusting their internal structure and operations as well as for targeting and addressing certain high-risk issues. This is the first step for the development of an appropriate risk management strategy and a compliance risk management programme.

A risk management strategy is a methodology adopted by tax administrations for determining the most efficient allocation of resources. It is a tool that should support the tax administration in realizing its objectives.\(^4_9\) The introduction of such a strategy is an answer to the need for more flexible actions in light of growing demands, reductions in budgets and restrictions on hiring new personnel or to acquire new technical support.\(^4_9\) In order to achieve its objectives, a risk management strategy should cover all of the critical functions and processes of the tax administration. It should take into account not only internal, but also external risks and opportunities. As a result of a risk management strategy, the tax administration should be able

\(^{42}\) Id., at para. 5.


\(^{44}\) Most recently, OECD Model Tax Convention on Income and on Capital (26 July 2014), Models IBFD.

\(^{45}\) Most recently, UN Model Double Taxation Convention between Developed and Developing Countries (1 Jan 2011), Models IBFD.

\(^{46}\) Convention on Mutual Administrative Assistance in Tax Matters (25 Jan. 1988) (as amended through 2010), Treaties IBFD.


\(^{50}\) Id., at p. 7.
to decide what is important for the purpose of tax compliance and how to address major tax compliance risks. Compliance risk management programmes were developed as a consequence of risk management strategies. These programmes can be defined as structured processes for identifying, assessing, ranking and dealing with tax compliance risks. In contrast to risk management strategies that are intended to efficiently allocate the resources of tax administrations, risk management programmes emphasize understanding and influencing taxpayer behaviour, although these strategies still provide guidance on the most efficient allocation of scarce resources by selecting the highest risk cases for auditors. Consequently, compliance risk management programmes reflect the need to adopt different measures for different taxpayers. Traditionally, such a strategy is presented as a compliance pyramid that indicates how the regulatory response from a tax administration correlates with the compliance attitude of a taxpayer. The pyramid approach recognizes the fact that most people are willing to comply and that only a small minority are engaged in deliberate and determined evasion.

Risk management strategies and compliance risk management models have been on the agenda of leading international bodies since at least 2004. Both the OECD and the European Union have developed comprehensive models that tax administrations can follow. From a high-level perspective, both models emphasize the importance of taking into account the specific operating context of a particular tax administration and devising a strategy to identify, analyse, assess and prioritize risks. Based on these steps, adequate treatment operations can be determined, planned and implemented.

There are many examples of risk management strategies that have been adopted by tax administrations worldwide. The most recent strategies take advantage of existing technologies. One of these is the “studi di settore” (“sectoral study benchmark”). This Italian method is based on software provided by the tax administration. Under the method, each taxpayer is required to calculate its estimated gross revenue according to the “studi di settore” that relates to its activity. The estimate is based on the data imputed by the taxpayer describing the physical and economic characteristics of the activity carried out, such as the number of employees, the dimensions of the premises, etc. The software presents some intelligent features, as it also calculates indexes that signal possible incoherence or irregularity in the data imputed by the taxpayer. The estimated revenue constitutes a benchmark with direct implications on tax audit risk management by the tax administration, i.e. taxpayers reporting below the benchmark have a greater probability of being audited. While compliance with the benchmark does not grant immunity from auditing, it is perceived by tax inspectors and taxpayers as a situation free of risk.

Regardless of what risk management strategy or compliance risk management model the tax administration decides to implement, it needs data to adjust its operations and be more efficient and effective.

4.3. How to facilitate compliance?

4.3.1. Acknowledging the differences

Considering the compliance pyramid, in addition to taxpayers who decide not to comply, the remainder of taxpayers are either compliant, willing to be compliant or require increased attention and control. Tax administrations usually develop different strategies for each of these groups based on their specific characteristics. It is, for example, often the case that there is a separate strategy for SMEs (see section 4.3.2.) and for large business taxpayers (see section 4.3.3.)

4.3.2. Strategies for SMEs

SME is a category that encompasses very diverse companies. This is why developing a strategy that is intended to improve tax compliance of this segment poses considerable challenges for tax administrations. In many countries, SMEs have been found to be the least compliant component of the taxpayer population and, therefore, a target for many tax administrations. This may be particularly prevalent where the income of SMEs is not subject to third-party reporting to the tax administration and/or where it is difficult for the tax administration in question to directly verify the income with third parties, thereby making it easy for SMEs to conceal income. There is also the risk that expenses that are set off against business income may be overstated by taxpayers so as to reduce their tax liability, which may be complicated by poor quality or non-existent books and records. For these reasons, it is acknowledged that auditors need a set of tools to indirectly measure taxable income of such taxpayers.

The general trend is to embed taxation into the business process, thereby ensuring that tax reporting obligations are incorporated into or serve as business management tools. This should not only reduce the compliance costs of SMEs, but should also increase tax compliance. As a
result, tax administrations should move from a traditional case-by-case approach to a more system-based approach. This process may be facilitated by the use of new technologies. With the uptake of mobile devices or machine-to-machine communication, it is now possible to integrate tax compliance into the systems businesses use to make and record transactions.

The United Kingdom is a good example of a country that has decided to make use of new technological developments and reshape its compliance strategy accordingly. HMRC’s plan is to ensure that, by 2020, individuals and business "will be able to register, file, pay and update their information at any time of the day or night, and at any point in the year". Ultimately, the HMRC intends to collect and process information affecting tax as close to real time as possible. Taxpayers should, therefore, no longer have to wait until the end of each tax year before knowing how much tax they should pay. They should also be provided with a complete financial picture of their tax affairs in their digital account.

It is, however, necessary to remain vigilant to avoid implementation problems. Even though the experience of Brazil with SPED is, in many ways, an example of success (see section 3.2.1.), the system is considered to be rather complex and involves significant implementation costs that are borne by taxpayers. For reasons of economy of scale, these costs tend to be more burdensome for SMEs.

Developing countries also contribute to the toolkit of innovative technological solutions at the disposal of tax administrations. For instance, the Kenya Revenue Authority (KRA) decided to access mobile payment data and to influence the compliance of taxpayers at the transactional level. Currently, mobile payment is used by approximately 90% of the population in Kenya, not only to make peer-to-peer payments, but also as a broader "branchless banking" platform. The KRA recognized this as an opportunity for improving tax compliance. The mobile application is used not only for tax payments, but also provides data on mobile transactions. In this way, the service of third parties is used to gather information on the transactions of taxpayers. The tax administration then translates the data into information regarding tax liabilities. The mechanism has several advantages, as it facilitates the tracking and monitoring of taxpayers, the identification of non-filers and nil-filers, the expansion of the tax base, the pre-filing of tax returns, the creation of audit trails, and the payment of taxes. In addition, it cannot be ignored that, due to reduced interaction between the taxpayer and the tax administration, the measure may contribute to counter-corruption and reducing the opportunities for bribery.

In general, the use of new functionalities provided by IT developments, for example the rise of "big data", advanced analytics, cloud and mobile computing, and the role of social media, provides opportunities for tax administrations to focus on the peculiarities of different categories of SMEs, thereby seeking to promote tax compliance together with improving certainty regarding tax positions, ensuring low cost of compliance processes and confidence that the correct amount of tax is being paid. From a system perspective, this approach ensures the taxpayer that other SMEs are also paying their fair share of tax while, at the same time, improving the transparency of the services provided by tax administrations. In particular, taxpayers are usually invited to view and provide feedback on the accuracy of data or other aspects, which not only helps to avoid errors, and increase operational efficiency and compliance, but also improves the relationship between tax administrations and taxpayers and builds a feeling of joint responsibility for the system.

4.3.3. Strategies for large taxpayers

The importance of large business taxpayers to the economy is undisputable. This group of taxpayers may represent up to 80% of collected revenues. Such businesses are highly diverse with regard to their operations, financing and planning arrangements, and the volume of the transactions that they undertake. The most innovative and widespread strategy to handle this complexity is "cooperative compliance".

The concept of cooperative compliance emerged as an effort of the OECD, which presented the concept as a way to mitigate aggressive tax planning and to facilitate tax compliance by large taxpayers. Referred to at the time as enhanced relationship, it represents a move from a retrospective and primarily repressive control to a cooperative relationship between tax administrations and taxpayers that is much more likely to involve the discussion of the tax treatment in real time or even prospectively. It is intended to deliver quality compliance, which means payment of the tax due on time in an effective and efficient manner. At the heart of the concept is a simple exchange of transparency for certainty. The taxpayer undertakes to be wholly transparent with regard to the tax positions it has adopted in its return and the transactions that are likely to give rise to a tax risk. The taxpayer does not limit this disclosure to the information that is required by the administrative provisions of the tax law and does not seek to invoke legal privilege to prevent access to documents that may be relevant to the determination of a tax liability. In return, the tax administration agrees to offer the tax-


61. Schoueri & Galendi Jr inom, supra n. 21, at p. 2.


63. Alink & Van Kommer, supra n. 52, at sec. 5.3.


payers early certainty regarding the tax treatment of the taxpayer’s business transactions.

When speaking of cooperative compliance, the OECD explained that:

the recommendations in this report have the potential, if fully implemented, to reduce the demand from large corporate taxpayers for aggressive tax planning and to give revenue bodies much better information about aggressive tax planning and therefore the opportunity to devise more effective responses. If the demand can be reduced, the supply of aggressive tax planning would also fall. In this way, the Study Team believes revenue bodies can best respond to the promotion of aggressive tax planning by tax intermediaries. More generally, the implementation of the Study Team’s recommendations should lead to a more constructive relationship between revenue bodies, taxpayers and tax intermediaries. 69

The concept of cooperative compliance was, however, known even earlier. In 2000, Australia adopted the concept based on cooperation between tax administration and large taxpayers, with improved tax compliance as the ultimate objective. 68 Since then, cooperative compliance programmes have been adopted in one form or another in almost 30 jurisdictions worldwide. 69 Although they share many features, there are also some important differences. Some programmes have been implemented through a specific statutory framework, while others have been conducted within the existing legal framework, supplemented in some cases by formal agreements with participating taxpayers. The scope of the cooperative compliance arrangements, in terms of the tax issues that are covered, also varies.

One of the cooperative compliance programmes most recognized worldwide is that of the Netherlands. The cooperation between the tax administration and the taxpayer is based on the “covenant”, i.e. the agreement that enshrines the principles of the programme and the process of its operation. 68 It is intended to facilitate tax compliance by those taxpayers who are willing to be compliant. It does so by assigning a client coordinator to a taxpayer to assist the taxpayer in dealing with its tax obligation. The taxpayer is expected to report and consult with the client coordinator on all of the tax risks identified. Tax compliance should be facilitated by the adopted comprehensive tax control framework. One important feature of the Dutch programme is that it provides the possibility to resolve outstanding legacy issues before entering into the programme, which is expected to enable working in real time. 69 What is important is that participation in the Dutch programme does not remove the taxpayer’s right to disagree with the tax administration regarding the correct tax treatment of a transaction. 71 However, it appears that, in recent years, the programme has lost its attractiveness for both the tax administration and taxpayers in the Netherlands. Specifically, it has been criticized by taxpayers as burdensome, and the tax administration has slowly resorted to vertical monitoring tools.

Interestingly, at the same time, the concept of cooperative compliance is being adopted by emerging economies. Russia and Kazakhstan are only two examples of its most recent application. It will be interesting to see whether, in countries struggling with lack of trust in the system and perhaps even with limited capacity, cooperative compliance will bring about change and help to improve the relationship between tax administrations and taxpayers.

In these countries, the concept brings an opportunity of improved effectiveness and efficiency with regard to the use of the resources of the tax administrations.

Russia initiated cooperative compliance as a pilot in 2012, and in 2015 the pilot was moved to a regular programme. 72 Kazakhstan adopted cooperative compliance only in 2015 and is still only running it as a pilot. 73 A characteristic feature of both programmes is that their first participants were state-owned companies, which may be evidence of a lack of trust in the system. In addition, with regard to the Kazakh pilot, to date, no information has been published. The lack of transparency around the programme may raise some doubts, as it is questionable as to how a relationship that features trust, mutual understanding and transparency can be based on secrecy.

5. What Comes Next and the Challenges Ahead

This article explores developments regarding tax compliance. In times of increased attention to tax loopholes, the authors argue that a major revolution is silently happening on a broader scale in connection with the new possibilities for transparency. The authors indicate how the ability of tax administrations to collect data has dramatically increased in recent years, both at domestic and international levels. The authors also discuss how this information can be used as a guide for more targeted and efficient operations by tax administrations.

In general, it appears that these opportunities have been supported by developments in the technological as well as legal infrastructure. Much domestic and international exchange of information is only possible due to fairly recent IT developments. The cross checking of data and the integration of platforms are other examples of data treatment enabled by technological developments that are now available to tax administrations.

66. OECD, supra n. 64, at p. 6.
71. This is the principle “agree to disagree”. See OECD, supra n. 64, at p. 52.
73. X. Yeroshenko & T. Balco, National Report: Kazakhstan, in Lang et al. eds., supra n. 1.
At the same time, the developments of the legal infrastructure have also been making more and better information available to tax administrations. Examples include the end of bank secrecy, the development of standards of automatic exchange of information, for example CbC and CRS, and the recognition of tax evasion as a predicate offence to money laundering. These developments together dramatically increase the potential for tax administrations to restructure their activities and pursue more effective and fair relationships with taxpayers. It is in this connection that the rise of risk management strategies and cooperative compliance programmes are discussed. It is to be welcomed that, due to IT developments, special tax compliance programmes addressing SMEs have also been developed.

However, the positive effects of these developments should not be taken for granted. The scenario of increased opportunities brings with it greater complexity, for instance dealing with the very large amount of information available using the latest technological developments, implementing the integration of platforms, working in interdisciplinary teams with other law enforcement agencies, interacting on a regular basis with international tax administrations with different languages and cultures, detecting patterns and areas of interest for risk assessment purposes, and building constructive relationships with taxpayers. These are only a few of the new challenges faced by tax administrators, which could potentially hamper the effective realization of the potential discussed in this article.

These challenges suggest to the authors that the next bottleneck for tax administrations will be human resources and capacity building. Recent initiatives by key international organizations suggest that this issue has already been recognized.