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MASTER THESIS

Titel der Master Thesis / Title of the Master's Thesis

„Horizontal monitoring as a new type of cooperation between tax authorities and companies for increasing tax compliance in Europe“

verfasst von / submitted by

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angestrebter akademischer Grad / in partial fulfilment of the requirements for the degree

Master of Laws (LL.M.)

Wien, 2020 / Vienna 2020

Studienkennzahl lt. Studienblatt /
Postgraduate programme code as it appears on
the student record sheet:

UA 992 548

Universitätslehrgang lt. Studienblatt /
Postgraduate programme as it appears on
the student record sheet:

Europäisches und Internationales Wirtschaftsrecht /
European and International Business Law

Betreut von / Supervisor:

Dr. Dimitar Hristov

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List of Abbreviations

BEPS - Base Erosion and Profit Shifting

CCF – Cooperative Compliance Framework

DAC6 - Council Directive (EU) 2018/822, amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements

EU – European Union

HM – Horizontal Monitoring

NTCA – The Netherlands Tax and Customs Administration

OECD – The Organisation for Economic Co-operation and Development

RAM - Risk Assessment Matrix

SME – Small and medium enterprises

TCF – Tax Control Framework

WU - University of Economics in Vienna

1 Abstract

Fostering an enhanced relationship between the tax administration and taxpayer is a promising approach for transforming traditional vertical relationships into partnership based on trust and proactive cooperation. In the first chapter, I will analyze the cooperative compliance models and initiatives in different European countries. I will continue to describe how, since 2005, the NTCA in Netherlands developed a monitoring regime that has significantly altered the relationship between the Dutch tax authority and corporate taxpayers, which is considered as a model of cooperative compliance and horizontal monitoring. Effective 1 January 2019, also Austria as the second state in Europe codified horizontal monitoring as an alternative to conventional audits. In Austria the tax authority started a pilot project including several larger companies on a voluntary basis in 2011. The introduction of the new legislation effective from January 1, 2019 was a result of the positive evaluation of the trial phase. Furthermore, this scientific publication will than try to demonstrate that under HM the attitude of both corporates and tax administrators is shifting from an adversarial ‘them and us’ relationship, to a stronger relationship characterized by cooperation and trust. I will also describe the importance and way of the implementation of the Tax Control Framework for the companies that wants to participate in the Horizontal Monitoring. My personal motivation to write about this relatively new topic across many European jurisdictions is, that I am currently working in Erste Group Bank AG in Vienna on the implementation of the Tax Control Framework. Implementation of the TCF is one of the main requirements for the company in order to shift from the classical external audit to a new way of cooperation with tax authorities, which is Horizontal Monitoring. I would like to combine the theoretical knowledge that I learned during my law studies and my current LLM studies with the practical experience that I am gaining in the course of my internship in the Erste Group Bank AG.

Keywords: horizontal monitoring, pilot project, Europe, tax control framework

1 Abstrakt

Die Förderung einer verbesserten Beziehung zwischen Steuerverwaltung und Steuerzahler ist ein vielversprechender Ansatz, um traditionelle vertikale Beziehungen in vertrauensbasierte und proaktive Partnerschaften umzuwandeln. Im ersten Kapitel werde ich die kooperativen Compliance-Modelle und -Initiativen in verschiedenen europäischen Ländern analysieren. Im nächsten Kapitel werde ich beschreiben, wie die NTCA in den Niederlanden in 2005 ein Überwachungssystem eingeführt hat, das das Verhältnis zwischen der niederländischen Steuerbehörde und den Steuerzahlern erheblich verändert hat und als Modell für begleitende Kontrolle gilt. Mit Wirkung zum 1. Januar 2019 hat auch Österreich als zweiter Staat in Europa die Begleitende Kontrolle als Alternative zu steuerlichen Außenprüfungen kodifiziert. In Österreich startete die Steuerbehörde in 2011 mit mehreren größeren Unternehmen ein Pilotprojekt. Die Einführung der neuen Gesetzgebung mit Wirkung zum 1. Januar 2019 war das Ergebnis der positiven Bewertung der Testphase. Darüber hinaus wird diese Masterarbeit veranschaulichen, dass sich durch Begleitende Kontrolle, die durch Zusammenarbeit und Vertrauen gekennzeichnet ist, die Beziehung zwischen Unternehmen und Steuerverwaltern verstärkt. Ich werde auch die Bedeutung und die Implementierung des Steuerkontrollsystems in den Unternehmen, die an der Begleitenden Kontrolle teilnehmen möchten, analysieren. Meine persönliche Motivation, über dieses, in vielen europäischen Ländern relativ neue Thema zu schreiben, ist, dass ich derzeit in der Erste Group Bank AG in Wien für die Umsetzung des Steuerkontrollsystems zuständig bin. Die Umsetzung des Steuerkontrollsystems ist eine der Hauptanforderungen für das Unternehmen, um von der klassischen externen Außenprüfung zu einer neuen Art der Zusammenarbeit mit den Steuerbehörden überzugehen. Ich möchte das theoretische Wissen, das ich während meines Jusstudiums und meines aktuellen LLM-Studiums erworben habe, mit der praktischen Erfahrung aus der Erste Group Bank AG verbinden und im Rahmen dieser Masterarbeit zusammenfassen.

Schlüsselwörter: Begleitende Kontrolle, Pilotprojekt, Steuerkontrollsystem

2 Introduction

2.1 Problem definition

Traditionally, the association between taxpayer and tax authorities has been strictly hierarchical and portrayed by retrospective audits and the threat of fines as means to impose compliance. In recent years, tax administrations in many countries have put growing weight on developing relationships that are more cooperative with corporate taxpayers. Indicated to by the OECD in the year 2013 as ‘cooperative compliance’, innovative forms of interaction between tax administrations and corporate taxpayers have been introduced in numerous countries.¹

Although cooperative compliance has extent to many countries, including Netherlands, Austria, Slovenia, Croatia, Denmark, Ireland, and the US, tax administrations use considerably different measures in every country. For instance, in Dutch HM, corporate taxpayers make covenants with the local tax authority NTCA, which are official compliance agreements between the tax authority and individual corporate taxpayers. In Austria, for example a company needs to first comply with the requirements imposed by the laws and fulfill these before the beginning of the cooperative compliance relation. What is on the other hand common in every county is that the HM influences three sets of stakeholders, referred to herein as the ‘tax triangle’, encompassing tax administrators, internal corporate tax specialists and external advisors.

The “classic” relationship between a tax administration and a taxpayer contains a taxpayer that completes tax returns and reveals the minimum amount of information needed to pay the required tax. Nevertheless, the tax administration can request supplementary information about the tax declaration and, if needed, carry out further enforcement procedures. In this connection, tax intermediaries are not involved as direct parties, though they play a vital role in shaping the taxpayer’s behavior. Because of the frequency of aggressive tax planning, the OECD in the year 2008 issued a report focused on the trilateral relationships among tax

¹ OECD, 2013

authorities, taxpayers, and tax intermediaries.² It recommends forming a cooperative, relationship based on trust with taxpayers, whereby tax authorities have to demonstrate certain crucial attributes: understanding through commercial mindfulness, fairness, proportionality, transparency and openness. This methodology should lead to an accommodating, trust-based relations between tax authorities and taxpayers; that is, an “enhanced relationship”.

2.2 Research question

Numerous years after the presentation of horizontal tax monitoring in European countries the question has risen whether it works and particularly whether it is superior to traditional tax monitoring. A taxpayer may willingly decide whether to participate in horizontal tax monitoring; there is no legal requirement.

During the course of examination of the effectiveness of horizontal tax monitoring, its ‘consequences’ are judged from several points of view. I develop four indicators to quantify the effectiveness in the practice of businesses: enhanced tax compliance, more certainty on the tax position, decline in the tax compliance costs and healthier relationships with the tax authorities compared to conventional tax monitoring. In order to evaluate the global experiences with horizontal monitoring models to document what could be learnt from its local functioning and ultimately assess whether the horizontal tax monitoring model in practice yields an improvement in contrast to established old-fashioned tax monitoring.

The hypothesis is that the above-described circumstances changed the ways of working between tax authorities and taxpayers to more co-operative and compliance-oriented way, and this will influence also other European countries and companies to transform from traditional tax monitoring to horizontal tax monitoring. From this hypothesis, I deduced the research question.

² OECD, 2008

The research-question is following:

Is it likely that horizontal tax monitoring, compared to traditional tax monitoring, results in better tax compliance, greater certainty on the tax position, a reduction in tax compliance costs and a better relationship with the tax authorities? Can we expect that this new shift in cooperation will expand to other European jurisdictions?

2.3 Methodology

The master thesis portrays the HM as a new type of cooperation between tax authorities and businesses for growing tax compliance in Europe. Throughout qualitative research, I try to define this shift and find the drivers, which are responsible for it.

I used two approaches for the literature research, the first one is a backward-looking search, also known as snowball system, where I selected a few fundamental sources, and through their bibliographies, I looked for additional relevant works. This technique has its significant advantage, namely that the utmost significant and mostly cited publications can be found in a fairly short time.³ This technique was used mainly in the beginning of the literature research. However, since I aspired to remain flexible and discover new sources that have not inevitably been quoted often yet, I also applied a second research strategy - systematic search. This method consists of systematically looking for books, research publications and journals online, as well as offline.⁴ This approach was used throughout the whole research procedure, but especially in the second part, where I already knew precisely what information I was looking for.

Apart from the bibliothèque of the University of Business a University of Vienna and the University of Economics in Vienna (WU), I used the literature catalogues such as ScienceDirect or ProQuest and journal databases such as LexisNexis or JSTOR where I used mainly the following key words, plural forms and synonyms to look for the relevant sources:

³ Kornmeier, 2018

⁴ Kornmeier, 2018

enhanced relationship, horizontal monitoring, pilot project, Europe, voluntary tax compliance, Dutch model, Austria, cooperative compliance, OECD, European countries, legal requirements.

Up-to-date news and information were gained from different news agencies such as Global Tax News, EU Tax News, European Commission: Taxation and Customs Union, Big4 Tax News; whereas for facts and figures, I used the statistical databanks such as Eurostat, WTO and OECD statistics and the company webpages.

Article inclusion criteria are as follows:

- topic relevance: the article must be directly connected to the issue at hand
- geographical location: the article must focus on European countries and jurisdictions
- time: the article must analyze either the pilot project analysis in the past, the current developments in the area of HM on the European level, or the future development in this area

After identification and screening of the suitable articles, books, databases and data collections, I read through them and chose the appropriate content for this scientific publication.

As in many areas nowadays, also in the area of the corporate taxation the data plays a big role in order to better understand the space for improvement and analyze the best ways for doing so. The quantitative and qualitative data available from tax auditors and employees of tax offices responsible for large-scale businesses who were either participating or not participating in the HM pilot projects was collected. Outcomes across various countries varies but in general we can say that it shows that the feedback was furthestmost positive among staff from HM companies and tax administrators directly involved in the projects, however participants from the tax administration who did not participate in the projects were hesitant and unconvinced at the beginning and stayed skeptical over the time. The acceptance or resistance vis-à-vis the paradigm transformation characterized by HM may originate from uncertainty, doubt or misrepresentation of its main objectives and strategies and from speculations, specifically by inadequately informed participants.

3 Historical background

3.1 The introduction of the Horizontal Monitoring

The cooperative compliance was firstly introduced in a more structured form in year 2005. It was mentioned and further discussed, initially in the 2008 OECD Report, Study into the Role of Tax Intermediaries.⁵ The OECD first referred to it as “a relationship that favors cooperation over confrontation, and is based more on mutual trust than on enforceable requirements” and also as “a relationship built on cooperation and mutual trust with both parties going beyond their legislative obligations”.⁶

This new way of cooperation between taxpayers and tax administrations was created on three main pillars: understanding, transparency and mutual trust. Subsequent, these three basic pillars were transformed into seven features. The first two of them disclosure and transparency ought to characterize the behavior of taxpayers and the rest five of the seven features (commercial awareness, impartiality, proportionality, transparency and responsiveness) states to the role of the tax administration inside a cooperative compliance programme. Taxpayers participating in cooperative compliance relationships must to be able to demonstrate clearly the way of their tax matter’s management. Implementation of the Tax Control Framework is an important requirement for the taxpayer to ensure an adequate level of openness and transparency. TCF needs to be implemented in such way that it is able to demonstrate whether a taxpayer is compliant and able to remain compliant with all his rights and responsibilities. On the other hand, tax administrations, must show a deep understanding of a taxpayer’s business and industry in general. The choice of the applicable compliance tools needs to be proportional and objective. Additionally, the administration must react to taxpayer’s queries in a quick and transparent way⁷.

⁵ OECD, 2008

⁶ OECD, 2008

⁷ A more comprehensive description of seven features of cooperative compliance can be found in: OECD, *supra* n. 6.

Since the moment of the initial introduction of cooperative compliance, the understanding of its main features improved, mainly thanks to the knowledge gained from the practice. In July 2013, the OECD followed up on the initial Report from the year 2008 with a new report called Cooperative Compliance: A Framework, From Enhanced Relationship to Cooperative Compliance. The reworked concept is best described by the phrase “transparency in exchange for certainty”.⁸

3.2 Cooperative compliance models in European countries

In this chapter, I will try to provide a basic overview of the various compliance models in European countries. This emphasis does not necessary mean that the cooperative compliance is just the domain of European countries. To the contrary, amongst the pioneering countries that implemented this new way of cooperation were many from the Anglo-Saxon legal system including Australia or United States, Netherlands and United Kingdom. Later also some African countries joined the club. In this master thesis, however, the author focuses only on European countries.

Austria	Pilot project HM with more than 10 businesses started in 2011 and was evaluated continuously until 2014 and, than extended to the end of June 2016. The programme design was presented in the Annual Tax Amendment Act 2018 and entered into force 1 January 2019 (Schrittwieser and Woischitzschlägerm, 2012). External stakeholders such as chamber of tax advisers, chamber of commerce and chamber of industries are also involved in this project to develop this approach further. ⁹
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⁸ OECD, 2013

⁹ Müller W. Z., 2019

Belgium	In October 2018, the Belgian tax administration's Large Enterprises Division publicized, in a Brochure ¹⁰ , the launch of a new pilot project. on cooperative compliance with initial duration for two years, referred to as Cooperative Tax Compliance Programme. The pilot launched at the end of 2018. In recent years, the General Administration of Taxes had already taken initiatives to improve service for taxpayers. There is nonetheless a demand to work (together) differently and, above all, obtain tax certainty more rapidly, where possible. The tax administration also intends to quickly get up-to-date with new tax issues. ¹¹
Croatia	In Croatia the Cooperative compliance program started in 2016 with the modifications made to the Croatian Law on Tax Administration which introduced a provision entitled "Granting of a special status to taxpayers in order to enhance voluntary tax compliance". According to this provision, tax authorities are allowed to grant a special status to the taxpayer within the extent of the voluntary tax compliance programme. The Croatian Ministry of Finance has lately issued a manual, which further specifies the conditions under which this position can be granted to or revoked to an individual taxpayer. ¹²
Denmark	The Danish tax authorities launched the pilot project in 2008. In Denmark the platform is named Tax Governance. This Danish Tax Governance program is managed from the unit for large corporate taxpayers (in Danish: <i>Store selskaber</i>) in Skat, the Danish Customs and Tax Administration. The Tax Governance program began as a pilot project from 2008 to 2011. The currently present Tax Governance program was launched in the end of 2012. So far, in 2020, approximately 30 of the

¹⁰ Finance, 2018

¹¹ Belgium, 2018

¹² Lugaric, 2019

largest Danish corporate taxpayers are taking part in this project.¹³ The basic nature is to have a continuous dialogue with these large corporations. The objective is to pre-emptively ensure that the corporations' tax arrangements and plans stay truthful to the legal obligation.

Finland In Finland the Finnish Tax Administration introduced collaborative compliance project named Enhanced Customer Cooperation in early 2013. The project was introduced by the Large Taxpayers' Unit of the Finnish Tax Administration and it ran as a pilot until the end of 2015. Since the start of 2016, the project has been a part of the permanent operations of the Large Taxpayers' Unit. Based on the interviews with tax officials, corporations participating in the Enhanced Customer-Cooperation and tax lawyers and tax consultants, the project is bringing about a cultural change in the organizational practices and ways of communicating between tax authorities and taxpayers. In general, the ECC's objective of increasing cooperation between tax administration and taxpayers has been welcomed. There were, however, some worries about the fairness towards taxpayers, efficiency in the use of human resources and the possible retrospective participation of the Tax Recipients' Legal Services Unit. In addition, since predictability was described as one of the key aspects of tax systems of the companies, many questions have been raised regarding whether the project can deliver more certainty in taxation practices.¹⁴

France In comparison to other neighboring countries, France had no formal co-operative compliance model until the year 2013. However, there were some innovative compliance programmes and approaches in place, aimed to help large taxpayers to meet their obligations and to conform to the tax rules. The main reason for the implementation of was to offer a better degree of understanding and transparency. In November 2012, France

¹³ Nigar Hashimzade, 2017

¹⁴ Potka-Soininen, 2018

revealed the formation of its own, new pilot project named “Relation de confiance”, which commenced in March 2013.^r

Germany In Germany, there is a clear perception of hierarchy of the tax administration towards the taxpayer, even more so as large companies are under ongoing examination by the tax audits, not only randomly as is the practice in other countries. Hence, no risk-based selection of taxpayers is applied. Nevertheless, in most cases there is currently a fair relationship between the tax administration and taxpayers based on mutual understanding and trust.

Even though there are not even local rules on cooperative compliance in Germany, the German Ministry of Finance has realized that, in a globalized world that we live in today and with the implementation of BEPS, tax audits also need to cooperate internationally on a global level. A high level of success can be observed in the “joint audits”. The Cooperative Compliance Model may even be widened cross-border, possibly also with the testing of systems and processes.¹⁵

The Federal States (in German: *Länder*) have taken a variety of measures with the aim to improve compliance. For instance, in 2012 Lower Saxony introduced a cooperative compliance approach for large businesses in case of tax audits.

Hungary No official cooperative compliance model. However, the recommendations of the 2008 Study were into consideration in the so-called Strategis Plan. As a part of this plan, the Large Taxpayers Directorate has been operating a client management system with devoted staff dealing with operational inquiries from large taxpayers. This ensures mutual co-operation at the tax directorate and the preservation of flexible daily relations.

¹⁵ Härteis, 2019

Hungary implemented a client relationship management system based on staff dedicated to dealing with operational questions from large taxpayers and it started to examine the possibility of introducing a co-operative compliance programme. As at 2016, Hungary introduced under the Hungarian Law on Tax Procedures a classification system of taxpayers based on past tax compliance assessments. There are three following categories of taxpayers, trustworthy, average and risky. Various benefits are granted to trustworthy taxpayers (e.g. shorter tax audits, faster VAT refunds and lower fines), while risky taxpayers are more susceptible for penalizations (e.g. increased penalties, longer tax audits and slower VAT refunds).¹⁶

Ireland

The Irish Revenue Commissioners (Irish Revenue) has relaunched its cooperative compliance framework for large cases division taxpayers with effect from January 1 2017. Ireland initially introduced the CCF in 2005 with a view to dealing with the tax risks of large cases division taxpayers in a more efficient and operative way. However, following a review of the CCF in place, it was decided to relaunch it. The review included an examination of feedback received from taxpayers, case managers within Irish Revenue and the assessment of best international practice and other frameworks. The results of the review demonstrated that there was a lack of clarity among taxpayers, agents and Irish Revenue case managers regarding the CCF process and what was involved. It was also perceived that there was no clear distinction between taxpayers who opted into the CCF and those who didn't

The main advantages of CCF participation for taxpayers include a dedicated case manager, a reduced level of compliance interference, an annual face-to-face consultation and an annual risk review plan agreed between the taxpayer and Irish Revenue. On the other hand, taxpayers who do not participate in the CCF do not have a dedicated case manager

¹⁶ Deloitte, 2015

and are required to route queries or submissions to the Irish Revenue Commissioners through the general customer service team.¹⁷

Italy Italian Revenue Agency reorganization that took place in 2009 implemented a new large businesses division. The Risk Management Monitoring as a main feature of the reorganization it is a risk-based approach driven by a specific features of the industry sector and by any available information concerning the specific taxpayer and potentially affecting its level of compliance. This ensures that audits are focused on high risk taxpayers avoiding or minimizing disturbing enquires for non-high risk taxpayers.

In the year 2016 the Italian Revenue Agency has issued Protocol No. 54237/2016, which includes the implementing rules for the country's cooperative compliance program. The complete version of program was introduced in Legislative Decree No. 128, which was approved in August 2015.

Under the program, the large taxpayers that are taking part are eligible for a number of benefits, including the capability to agree on tax positions with the tax authorities before filing a tax return, obtaining quicker rulings, and be subject to reduced tax fines and penalties in general. Qualifying taxpayers include those with annual revenue of at least EUR 10 billion and an adequate internal revision in place to manage and control their tax risks. Taxpayers may also qualify if they took part in the pilot project launched in 2013 and have annual revenue of at least EUR 1 Billion. Permanent establishments in Italy of non-residents may also take part if the requirements are met.¹⁸

Netherlands Horizontal monitoring main model started in 2005 with to pilot projects. Since then it has been integrated in the broader compliance risk

¹⁷ Joe Duffy, 2017

¹⁸ Rübenstahl, 2018

management strategy. Essential elements of the steps taken towards a compliance agreement include Board engagement commitment (“tone at the top”) and resolving legacy issues. The Netherlands is considered one of the leading countries in the area of cooperative compliance and HM. Hence, we will have a look at the developments in this country more in the Chapter 4 – Cooperative Compliance and the Dutch Horizontal Monitoring Model

Norway A pilot co-operative compliance project started in August 2011 and lasted until December 31, 2013. The pilot included six group of companies in different branches. The pilot was based on the recommendation in the OECD 2008 Study. In addition to the pilot project, the Large Taxpayers Office in general is working based on dialogue, and most of the Large Companies have a Client Relationship Manager.¹⁹

Poland On 6 November of 2019, Poland’s President signed a law implementing a new cooperative compliance program in Poland for large corporate taxpayers (also referred to as horizontal auditing). This is a new tax institution in Poland that introduces collaboration between taxpayers and the tax authorities. The program is available to taxpayers with tax turnover of over 50 million euros, which amounts to about 2,700 taxpayers in 2019, according to Ministry of Finance data. However, the program is facultative and, in the initial pilot phase, only 20 taxpayers will be allowed to participate. The form of this cooperation will be outlined in an agreement between the taxpayer and the Head of the National Fiscal Authority.

New Polish law offers several incentives to enter into program, namely, the program provides an informal way for taxpayers to cooperate with the Head of the National Fiscal Authority; partial exemption from local tax authorities competence; preliminary tax return calculation in the form of an agreement with a forecast of tax liabilities; permanent tax auditing,

¹⁹ Jukka Pellinen, 2018

which allows for relief from interest in case of a tax return adjustment after audit; and a delay in the commencement of fiscal offence procedures.

The new program also accelerates procedures for advance pricing agreements and provides a 50% reduction of the application fee, reduces fees for binding tax rulings and opinions on the general anti-avoidance rule, and provides for relief from mandatory disclosure regime reporting for domestic transactions.

A preliminary audit is required to enter the program. The scope of the audit, as well as the agenda, must be agreed to by the head of the NFA. The audit will proceed using delegated tax office employees.

Despite these potential drawbacks, interest in the program is high and a large number of taxpayers have expressed their willingness to participate.²⁰

Portugal	No formal co-operative compliance model. However, in early 2012 a Large Business Unit was established with the goal to improve the relationship with Large business taxpayers.
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Slovenia	Official co-operative compliance model started in May 2010 with a public call for all large taxpayers to inform the Tax Administration of the Republic of Slovenia (in Slovenian: <i>Davčna Uprava Republike Slovenije</i>) about their intention with the participation in the pilot project.
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Spain	Formal co-operative compliance model: Code of Good Tax Practice. Started in 2009 with the creation of the “Large Companies Forum”. The Code of Good Tax Practice was finalized in July 2010.
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On 28 February, Spain’s Asociación Española de Normalización published its anticipated standard on tax compliance, UNE 19602. This standard is the result of various stakeholders’ work – almost all of us in

²⁰ Laskowska, 2019

the tax field – over several years, including groups of business associations, services firms, and professional associations and alike. UNE 19602 is not an obligatory legislation, law or regulation. On the contrary, a certification can be freely accepted and adopted by stakeholders. It is open to every Spanish company and group, regardless of their size. In short, UNE 19602 is a very interesting certification instrument for the control and management of tax compliance in companies and groups of any size, which will be affirmed by the Tax Administration and the Courts in case of conflict.

Sweden First co-operative compliance initiatives started in 2006 with the opportunity for the companies that could get answers in advance of filling returns in relation to certain tax issues. Formally launched in spring 2012 on a small scale by inviting 15 companies.

The so to say official Swedish cooperative compliance project was named Enhanced Collaboration (in Swedish: *Fördjupad samverkan*). Initially introduced in 2011 and later relaunched as modified initiative Enhanced Dialogue (in Swedish: *Fördjupad dialog*) in 2014. It describes how the Swedish Tax Agency proposed an initiative that carried with it international success stories from similar projects, but in the Swedish version and context met with strong resistance and is now put on hold awaiting proposed changes in the law. This chronological trajectory teases out issues that impact tax compliance among large corporations and perhaps also among ordinary taxpayers in Swedish society.

UK In 2006 HM Revenue and Customs introduced a formal co-operative compliance approach for large corporate taxpayers, based on a customer relationship with management model and using the “Tax Compliance

Risk Management framework”. In 2009 HM Revenue and Customs signed off its “Large Business Strategy”.²¹

The UK Tax Authorities’ (HMRC’s) new large business tax compliance package were published on 9 December 2015, in the form of a summary of responses to the consultation which ran from July to October and draft Finance Bill 2016 legislation. The measures, now confirmed, cover three separate but interdependent strands:

- A requirement for large businesses to publish their tax strategy as it relates to UK taxation
- A framework for co-operative compliance (in place of the voluntary Code of Practice previously proposed)
- A series of “special measures” designed to discourage persistently high risk behavior.

HMRC has explained that the measures are driven by the need to address businesses that represent a significant risk to the Exchequer, but much of what is being introduced will be relevant to all businesses. HMRC’s thinking is that the existing large business strategy has worked well for the majority of businesses, but that this needs to be reinforced to deal with those businesses who

- (i) have yet to adopt the best practice in tax compliance exhibited by the majority;
- (ii) persist with aggressive tax planning; and/or
- (iii) resist full and open engagement with HMRC.²²

²¹ OECD, Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance, 2013

²² EY G. T., 2015

4 Cooperative Compliance and the Dutch Horizontal Monitoring Model

Dutch traditional tax enforcement dates from the early 19th century and is characterized mainly by its hierarchical relationship between the tax administration and taxpayers. The Netherlands Tax and Customs Administration (NTCA) has always had wide-ranging powers in order to pursue accurate tax assessments, for example demanding taxpayers to provide tax information. We can describe the approach in general by the following sentence: „If a legal-based information request is not met, tax audits, fines and prosecutions follow”. Lack of information is one of the main issues encountered in levying the proper amount of taxes. In the 20th century, the collecting of information increasingly took up the NTCA’s capacity. It became clear that when exercising powers much more than just the hard law had to be followed, due to the expansion of the principles of suitable administrative behavior. Taxpayers could no longer be seen as subjects but as citizens entitled to right and proper treatment. Therefore, the relationship became less hierarchical and the mutual relationship between the taxpayers and the tax administration began to play a much bigger role.

Because of the bigger pressure on the monitoring capacity caused by the very complex tax system, by the end of the 20th century, the NTCA was starting to lose its control. It faced the choice either to rise and intensify the monitoring capacities substantially or to begin with a new revolutionary risk-based strategy. The NTCA chose the latter, as the traditional 100% enforcement approach was in urgent need of replacement. The loss of control was due to increase in the so to say “cloudy” tax aggressive structures used by taxpayers on one hand, and by globalization on the other. The tax inspector with focus on the national laws and regulations could no longer administer and oversee all effects and details of the increasing number of the complicated global structures, created by the tax experts specialized in the areas of international taxation and tax optimization.

From this point onwards, taxpayers were divided into numerous risk groups based on financial interest, complexity of tax matters, and last but not least their size. Different methods with different enforcement approaches have been developed for various groups of taxpayers (SMEs, large companies, high-wealth individuals). In the early 21st century, one of the main goals of the Dutch government in the area of audits and taxation was to simplify the legislation and add more responsibility for companies and individuals through self-

regulation. Trust and transparency became keywords. Subsequently, more self-regulation could be observed in Dutch society - both in the governmental and in also in the private domain. Relationships between the government and citizens, companies, or organizations become more 'horizontal'. Relationships with the NTCA have become flatter and authority has become the foundation for tax enforcement as a replacement for of force. Moreover, due to an increased need for efficiency and cost cutting, tax authorities have become aware of the necessity to work together with taxpayers. After almost two centuries of traditional tax enforcement, the NTCA followed the societal trend towards self-regulation with the shift from the classical "vertical" relationship to a new "horizontal" one.²³

4.1.1 Legislative background of the new Dutch approach

Changes and developments in the Government's approach to tax supervision were laid down in documents published in 2001 and 2005, in which the Dutch Government expressed a preference to adjust the relationship between government and society. More than in the past, one of the document states, the government is "neither willing nor able to bear all risks" and continues by stating that the management of risks and prevention of errors and mistakes is a joint duty of both government and the society.²⁴

Additional motivation for the introduction of HM relates to events in the Dutch and international business community that occurred in the early 2000s. Major international market scandals with enterprises including Enron, WorldCom, but also the Dutch retailer Ahold, shifted the attention towards the corporate governance and tightened regulations on the internal control systems and frameworks of the large companies. In the United States, this led to the introduction of the Sarbanes-Oxley Act in 2002, and the Netherlands introduced the Corporate Governance Code in 2004.²⁵

In 2005, the NTCA introduced to the public a Horizontal Monitoring project for large companies.

²³ Esther Huiskers-Stoop, 2019

²⁴ Parliamentary Documents II, 2005

²⁵ Stevens L. P.-v., 2012

The communication from the State Secretary from 8 April 2005 to the House of Representatives explained HM as follows: “Horizontal monitoring refers to a mutual trust between the taxpayer and the NTCA, the more precise specification of each other’s responsibilities and options available to enforce the law and the setting out and fulfilment of mutual agreements. In doing so, the mutual relationships and communications between citizens and the government shift towards a more equal position. Horizontal monitoring is also compatible with social developments in which the citizen’s personal responsibility is accompanied by the feeling that the enforcement of the law as of a great value. In addition, the horizontal monitoring concept also implies that enforcement is feasible in today’s complex and rapidly changing society solely when use is made of society’s knowledge”.

The relationship of trust in the SME segment is not directly aimed on the taxpayers, but on the tax intermediaries. Taking into the consideration the size of the SME segment the NTCA is trying to foster the co-operation with tax intermediaries. The primary objective is to provide assurance that the quality of tax return that the tax intermediary filed is adequate. SMEs that want to participate in the HM have to sign a statement of affiliation together with tax intermediary. Tax intermediaries verify the characteristics of the SMEs participating in HM and they assess their truthfulness and integrity.

The NTCA relies on the work the tax intermediaries carry out for their clients. One of the important principles of HM is not to duplicate works others once made. Supervision is “just” shifted to the tax intermediary’s internal quality organization. By adopting this approach, the NTCA reduced the supervisory burden for entrepreneurs who file acceptable tax returns. On the other hand is than able to devote more attention to higher-risk entities.

The NTCA rationalizes and justifies the relationship of belief with the tax intermediary by Meta monitoring which make use of information that includes the results and data from the tax intermediary’s quality assurance system.²⁶

NTCA approach to supporting the intermediaries is based largely on its strategy for improving compliance with tax law. The NTCA strategy is to get to know this group and to

²⁶ OECD, Tax Administration 2015; Comparative information on OECD and other advanced and emerging economies, 2015

be more receptive to their needs and ways of working. For this purpose, the NTCA applies the strategy called “horizontal monitoring”.

The Dutch HM model is internationally understood as a way of administrative supervision based on trust, mutual understanding and transparency between individual taxpayers and the NTCA. A business can voluntarily choose whether to join or not. The starting point is the establishment of a HM agreement, also called covenant. By signing, both parties reach agreement to collaborate based on trust, transparency and understanding in order to pursue correct tax assessments. Past tax issues must be resolved before the covenant is signed. Moreover, the internal control system of the participating (corporate) taxpayer has to meet the requirements of the TCF. The NTCA trusts the information that emerges from this system. This should therefore be seen as ‘informed trust’ as opposed to ‘blind trust’.²⁷

4.1.2 Pilot project in Netherlands

HM pilot project started in 2005 with twenty large, mostly listed companies. Most of the companies were Dutch, and, despite initial objections, the NTCA had to make relatively little effort to persuade the companies to participate in the pilot. The interest of the businesses in the pilot largely resulted from:

1. the benefits of HM as perceived by the companies;
2. commitment by high-level officials in the NTCA and the Dutch Ministry of Finance to make the pilot a success story, which was reflected by visits of high-level representatives to companies potentially interested in the pilot;
3. already existing close relationships between the NTCA and large Dutch enterprises.

In 2006, the pilot project was extended to include another twenty companies, and, following a positive evaluation in 2007, the program was rolled out to the rest of the NTCA’s Very Large Businesses segment. The evaluation of the pilots was conducted through a survey amongst corporations and members of the NTCA’s processing teams assigned to these businesses and focused on whether they experienced HM as an improvement compared to traditional “vertical” monitoring.

²⁷ Esther Huiskers-Stoop, 2019

In 2008, HM was further extended to the Medium-Sized Businesses Division and with intermediaries such as tax advisory firms also to the small enterprises. Given the significantly different shape of HM for the smallest business segment, and many medium-sized businesses.²⁸

5 Horizontal Monitoring in Austria

5.1 Pilot project in Austria

In 2008, the OECD Forum on Tax Administration²⁹ developed the theory of “enhanced relationships”, later named as “cooperative compliance”³⁰, in order to face the new challenges of globally interconnected taxation systems, such as aggressive tax models and shift of profits to tax havens. Furthermore, deeper exploration in behavioral economics and economic psychology has contributed to rethinking government patterns and has supported the development of theories such as “Good Public Governance”. The Austrian approach to “Good Public Governance” unequivocally acknowledges the importance of cooperative relationships and services.³¹

The shift from “vertical” to “horizontal” monitoring expects to encourage mutual trust and cooperation by means of impartiality, proportionality, responsiveness and awareness by the tax authorities on one hand, and openness and transparency by taxpayers on the other.³²

A pilot project on cooperative compliance commenced in 2011 and ran until the end of 2018. Austria launched HM as a pilot project in July 2011, encompassed in the “Fair Play

²⁸ Stevens L. P.-v., 2012

²⁹ OECD, 2008

³⁰ OECD, 2013

³¹ Müller E. , 2014; Ehrke-Rabel, 2014

³² Finanzen, 2012; OECD, 2008 ; Stevens L. G.-v., 2012

Initiative” introduced by the Ministry of Finance. After the pilot phase, the Austrian Ministry of Finance continued with the preparation for the long-term implementation of HM.

Following the international example, mainly the Dutch model of HM, large companies have the possibility to request supervision on an advice-giving basis in partnership with the Austrian tax and customs authorities. Throughout the developing and initial phases of the pilot project, representatives from the Austrian Chamber of Public Accountants and Tax Advisers, Austrian Economic Chamber, Federation of Austrian Industries, and the University of Vienna took part and were actively involved in the further development of the project.

Seventeen enterprises showed their interest and participated in the pilot project. The selection was based mainly on size, compliance with tax obligations and the existence of a TCF.

The scope of requirements for the eligibility for the participation was pretty narrow and only taxpayers subject to audits by large-scale undertakings and subject to audits on annual financial statements (or voluntarily participating in these audits), facing no financial criminal charges in the past years and with a TCF (in place or in preparation) could participate. These requirements limited significantly the scope of appropriate candidates from the taxpayers. The final requirement was the minimal turnover of over EUR 9.68 million in the last year.

Following admission, company management signed a declaration of intent together with the Austrian tax officials. From a legal standpoint, the relationship between companies and the tax authorities remained fundamentally unaffected.³³

As an innovation in the Austrian financial administration sphere, this project was complemented by an ongoing evaluation of every stage of the process. A new evaluation team was set up for this purpose, supported by the Institute for applied psychology from the University of Vienna. As part of the process-accompanying assessment, objective criteria for the evaluation of the project were created and further developed in order to provide

³³ Finanzen, 2012; Stiastry, 2015

politicians with a decision-making foundation as to whether the HM project should be brought into regular life or permanently discontinued.

The HM project management team subsequently introduced and initiated the following sub-projects:

- HM - Evaluation
- HM - Communication concept
- HM - Memorandum of Understanding -
- HM - Process Guideline -
- HM - Qualification
- HM - Legal framework

5.1.1 Main goals of the Pilot project

A target-setting workshop took place on June 19 and 20, 2012. Numerous representatives of various HM stakeholders took part on this event including for example: Chamber of Economic Trustees, Chamber of Commerce Austria, Tax Advisors and Financial Management, the University of Vienna Institute for Applied Psychology: Work, Education, Economics and Institute for Applied Psychology: Work, Education, Economics.

As a portion of this event, the main goals of the HM pilot project were amended and further developed. The following main goals of the HM were considered by the legislator:

- Promotion of tax compliance:

The financial administration wants to foster an active communication with the taxpayer through customer-oriented interaction in order to promote positive behavior towards openness and transparency with the result of an advance in tax compliance.

- Legal and planning security:

Back payments of the taxes due to ex-post external audit embody hardly predictable economic risk factors for a business. A well-timed clarification of tax enquiries should result in increased planning and legal security.

- Ensuring timely and accurate tax collection:

The constant support and the mutual openness should be the prerequisites for the taxes payments to be prompt and in the correct amount ("the right taxes at the right time").

- Reduction of compliance costs:

By implementing a tax control system, company resources will no longer trace just the issues of the past, but will instead be focused on the establishment and ongoing control of the correctness of tax calculations and their timely payment.

- Employee development:

The employees of all HM stakeholders should be educated in the areas of professional ethics, trust and sovereignty and the tax departments should have wide-ranging tax law knowledge.

- Added value for businesses:

The company's image should be strengthened through its perception as a reliable partner. The implementation of the HM is perceived as an sign that the company must have complied with all the requirements, therefore also implemented a TCF, which is a guarantee for correct and on-time payment of all the tax obligations. In addition, an active contribution to corporate social responsibility should be made.³⁴

5.1.2 *Evaluated companies*

The evaluation report of the Pilot project includes companies that were in the evaluation phase and had at least one assessment year in the HM process as of the reporting date of December 31, 2015.

The list of companies that took part in HM Pilot project and are included in the evaluation report:

- Bertsch Holding GmbH
- Deichmann Schuhvertriebs GmbH
- Egger Holzwerkstoffe GmbH
- Energie Steiermark AG

³⁴ BMF, 2016

- Hornbach Baumarkt GmbH
- Infineon Technologies Austria AG
- Knapp AG
- Red Bull GmbH
- RHI AG
- Rudolf Ölz Meisterbäcker GmbH & Co KG
- Shell Austria GmbH
- Verbund AG

As a summary of the project experience and the results of the process-accompanying assessment and evaluation, it appeared that this innovative form of cooperation between the tax administration and the companies offers benefits to all those involved. For the companies the legal certainty, for the financial authorities a collection of taxes in the correct amount and on time. However, the pilot project also showed that the HM encompasses major organizational challenges and in many cases technical difficulties. These have to be answered before the implementation, so that the HM also in the permanent ongoing phase can be a model for success.

Undeniably, HM is mainly built on trust, dependence and voluntary cooperation between the two parties, on one hand the companies committed to acting openly and to develop their internal tax risk management framework, while tax authorities will hold back on conducting ex-post audits and provided non-binding guidance and interpretations on current taxation matters.³⁵

5.2 Horizontal Monitoring in Austria – the permanent phase

Given the Austrian positive experience with the pilot project described in the chapter above, there is optimism and confidence regarding the permanent phase. The Austrian government published draft of administrative tax legislation in 2018 that codified the concept of HM. Under the draft bill, effective from 1th of January 2019, HM was established as an official

³⁵ BMF, 2016

alternative to tax audits for larger corporations and corporate groups that comply with legal requirements.

The new legislation generally focuses on larger corporations. The most important requirements a taxpayer has to fulfill in order to apply for HM are:

- Qualification as an entrepreneur (Art. 1-3 of the Austrian Commercial Code)
- Revenue exceeding EUR 40 million in the two years prior to application ³⁶
- Implemented and effective tax control system or framework
- Nexus to Austria (seat, place of effective management, domicile, or permanent establishment)
- No fiscal penalty in last five years

If there are related taxpayers in Austria, they have to (in case of an Austrian tax group) mutually apply for a participation in HM. By this means, each taxpayer is obliged to meet the application requirements. The main difference to the pilot project is the focus of the permanent phase on the selected group of largest corporate taxpayers.

5.3 Tax Control Framework

The qualification as an entrepreneur, revenue, connection to Austria, no fiscal penalties in past years these requirements can be in normal case determined pretty easily and clearly. They are usually not connected with any direct activity of the company towards the implementation of the HM. Moreover, they are considered more as natural characteristics of the business, and any of them is not in itself considered as an important step towards the shift to HM. The only exception is implementation of the TCF, which is the reason why I would like to analyze this process in more detailed. An effective TCF constitutes the most crucial and time-consuming part of HM on the side of the companies. A tax advisor or an auditor must assess its implementation and effectiveness officially and therefore confirm its effectiveness and functionality. The Austrian programme recognizes the relevance of a TCF and includes very specific requirements that need to be complied with. The TCF should be able to ensure honesty in tax matters and operational measures. It should also reveal the

³⁶ Banks, other credit institutions and (re-)insurance companies are excepted from this threshold

company's ability to correctly and comprehensively calculate the relevant taxes, meet payment deadlines, recognize, and mitigate risks of a material breach of the tax rules in a timely manner. Furthermore, it should include a system for assessing tax risks, their likelihood and the financial impact. It should show what preventative and/or detective measures have been put in place to minimize tax risks and to contribute in achieving the tax control objectives. The important component of a TCF is an internal communication, accompanied by training on the topic of the elements of a TCF, assigned tasks, roles and responsibilities. Another element is an internal investigation into any breach of the guidelines, rulebooks or procedures determined by the TCF. The entire framework should be subject to regular monitoring and any identified deficiencies should be addressed and eliminated. All of these elements need to be accompanied by proper documentation, including documentation regarding identified risks and assigned control measures. As mentioned, the TCF has to be subject to an evaluation before the company can start with the cooperative compliance programme. Additionally, every third year, company already participating in the programme needs to obtain an opinion confirming the effectiveness of the TCF and the analysis of the possible lack of material changes.

TCF is usually based on an existing internal control system, or similar system that is implemented just in some parts / areas of the company, for example in the area of accounting or bookkeeping.³⁷ Due to the different objectives of these control systems, additions, extensions and improvements may be necessary.

Even if only a few new things may have to be invented and implemented in the course of the implementation of the TCF in the company, the aim of tackling the topic of tax organization with the help of a systematic and risk-oriented approach is also linked to diverse organizational challenges in a long-term process, which can be quite challenging.

³⁷ Section 82 AktG or Section 22 Art 1 of the Law on the Limited Liability Companies (GmbHG)

5.3.1 Implementation of the Tax Control Framework

The TCF comprises the sum of those measures (processes, process steps and measures) that are intended to ensure that the tax bases for the respective type of tax³⁸ are shown in the correct amount and the taxes due are paid on time and at the correct amount.³⁹

5.3.2 Internal Tax Guideline

The TCF must be implemented for all types of taxes listed in Section 153e of the Federal Fiscal Code insofar as they are relevant for the concrete company. First, the focus should be on drafting a mission statement and an internal tax guideline, which in both cases then serve as the basis for further measures.

A tax control system describes all required basic elements according to Art. 4 to 10 of the Regulation regarding the assessment of the TCF (in German: *SKS-PV; Steuerkontrollsystem Prüfungsverordnung*), whereby the level of detail of the description of the respective basic element depends on the specific operational requirements of the company. In accordance with the objective of the TCF, the focus of the documentation of a tax control system is on the basic elements "assessment of tax-relevant risks" and on the "management and control measures".

The following basic elements of and TCF should be documented in writing and should be continuously checked:

- the control environment;
- the goals of the TCF;
- the assessment of tax risks;
- the control and control measures;
- the information and communication measures;
- the sanctions and prevention measures and
- the monitoring and improvement measures.

³⁸ Section 153e, Art. 1 of the Federal Fiscal Code (BAO)

³⁹ Section 153b Art. 6 of the Federal Fiscal Code (BAO)

In this context, the existing legal and operational framework is usually laid down in the tax directive / guideline and fundamental statements are made regarding the company's tax policy, tax strategy and tax planning. The organization of the company is described, in particular the structure and process organization in the tax department. The tax guideline is focusing mainly on the organizational structure, the organizational principles, the management principles, the business purposes of individual departments in the company, as well as on the decision-making powers and responsibilities in connection with the tax obligations in the company.⁴⁰ The organization of the company can be also shown graphically by creating visual flow or organizational charts.

Moreover, the implementation of a compliance program serves to maintain trust in the company. It includes combating and preventing money laundering as well as preventing fraud and corruption; it also covers security-related aspects. It should comply with all international regulatory requirements and compliance standards. The detailed description of the following areas is considered as sufficient for the implementation of the compliance programme:

- Guarantee that the responsibilities in the accounting and taxation areas are clearly defined and checked regularly;
- rely on legitimate tax reduction instead of tax avoidance;
- comply with the internal transfer pricing directive on rules and responsibilities in accordance with the requirements of the OECD;
- define standards and constant controls in all relevant processes to identify and prevent possible illegal or unethical practices. Use suitable technical and administrative systems for this;
- identify, stop and report all suspicious transactions related to terrorist financing, misuse of sensitive information, market manipulation and insider trading;
- maintain business relationships only with properly identified, suspicious customers and their owners, from whom the company representatives also understand their respective business model;

⁴⁰ see Section 11 Art. 1 of the Regulation regarding the assessment of the TCF (in German: *SKS-PV; Steuerkontrollsystem Prüfungsverordnung*)

- identify, regulate and / or disclose all potential conflicts of interest;
- comply with strict guidelines to prevent corruption and bribery, as well as the payment and acceptance of bribes and kickbacks;
- take precautions to protect and protect the employees, assets and reputation;
- offer the customers, business partners and visitors a safe and healthy environment;
- encourage all employees to anonymously express concerns as part of a whistle-blowing program (including an external platform) and to take appropriate action in the event of violations while respecting the rights of the individual;
- regularly organize compliance training for our employees and
- the accounting and taxation provides a clear picture of the financial and earnings position.

5.3.3 Risk assessment

After outlining the basic points that were mentioned above, in the Tax Guideline. The further step is usually the risk-assessment to gain the basic understanding of existing situation and to identify the processes with the biggest risk-potential. The scale and complexity of the businesses in scale and therein the volume of their tax obligations, means that inevitably risks will arise. It is important ensure that where risks do arise, they are identified, evaluated and managed proactively. The risk assessment purpose is to assess how big the risks are, both individually and collectively, in order to focus management's attention on the most important threats and opportunities, and to lay the groundwork for risk response. Risk assessment is all about measuring and prioritizing risks so that risk levels are managed within defined tolerance thresholds without being over controlled or forgoing desirable opportunities.

The tax risks and how they are covered, must be presented in a comprehensible manner, with a reference to the respective process description. This documentation will usually be in the form of a risk-control-matrix, in which, based on the respective process, the risk that arises and the measures provided to cover it are shown and described. Processes that have no or low risk potential can be omitted.

In accordance with Section 153b Art. 6 of the Federal Financial Code as amended by the Annual Tax Law of 2018 (in German: *JStG; Jahressteuergesetz*), the TCF is derived from the analysis of all tax-related risks. The risk assessment must be carried out in accordance

with Section 6 Art. 1 of the Regulation regarding the assessment of the TCF (in German: *SKS-PV; Steuerkontrollsystem Prüfungsverordnung*) using a systematic procedure for identifying, analyzing and evaluating of the risks. As part of risk identification, so-called risk sources, i.e. the risky tax-relevant processes, are to be collected. The process is surveyed in the form of interviews, workshops and evaluations of the documentation and information provided by the company. In any case, the company representatives and the (senior) employees of the company entrusted with the tax function must take part in the interviews and workshops (tax department). However, it should be noted that the tax risks are not only hidden within the directly tax-relevant processes that usually take place in the tax department. Rather, many tax risks are already triggered in the upstream operational business processes such as accounting, controlling etc.

5.3.4 Risk assessment process

The first step of the process can be described as the identification of the risks. The risk (or event) identification process precedes risk assessment and produces a comprehensive list of risks (and often opportunities as well), organized by risk category (financial, operational, strategic, compliance) and sub-category (market, credit, liquidity, etc.) for business units, corporate functions, and capital projects. At this stage, a wide net is cast to understand the universe of risks making up the enterprise's risk profile. While each risk captured may be important to management at the function and business unit level, the list requires prioritization to focus senior management and board attention on key risks. This prioritization is accomplished by performing the risk assessment.

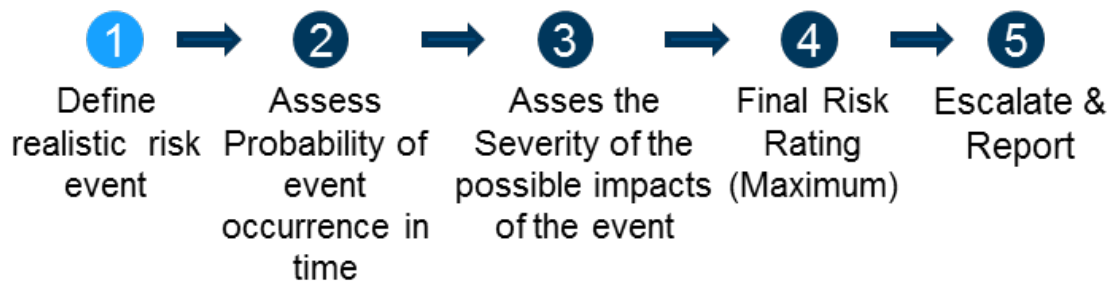
Second phase is the development of assessment criteria. The first activity within the risk assessment process is to develop a common set of assessment criteria to be deployed across business units, corporate functions, and large capital projects. Risks and opportunities are typically assessed in terms of impact and likelihood. Many companies recognize the utility of evaluating risk along additional dimensions such as vulnerability and speed of onset.

5.3.1 Risk scaling

Following the risk assessment process, the assessment of the potential risks is considered as the next phase of the implementation of the TCF. Assessing risks consists of assigning values to each risk and possibility of occurrence using the defined criteria. This may be

accomplished in two stages where an initial screening of the risks is performed using qualitative techniques followed by a more quantitative analysis of the most important risks.

Following the identification of the risks with the biggest risk potential and the development of the assessment criteria, the next step is to assess the potential risks in the risk scaling process. This sequence of five steps is commonly used in this phase of the implementation:



A matrix is a two-dimensional array; an array made of rows and columns. In risk management, the risk matrix is a mean to visualize these two dimensions in order to display the ranking of a risk. A risk matrix is simple graphical tool. It is made of the consequence of a risk when occurring and the likelihood of a risk to occur.

A Risk Assessment Matrix (RAM) is a tool, helps to determine which risks, need to develop a risk response for the mitigation of possible unwanted impacts. The first step in developing a RAM is to define the rating scales for likelihood and impact. In a qualitative analysis, likelihood or probability is measured using a relative scale. These scales are very dependent on the specific industry, laws, regulations, and details of the project.

The following formula is applied to determine the final “value of the risks:

$$Risk = Probability * Consequence$$

The number of columns and rows in a risk matrix can be different depending on how much refined the risk assessment shall be. To build the risk matrix, divide likelihood and consequences into steps. For a 3x3 matrix, the likelihood could range from 'unlikely', via 'possible' to 'likely'. Consequences of a risk could range from 'minor' via 'significant' to 'critical'. Within such a risk matrix, all the risks are displayed and categorized according to the risk class they belong to. The colors like a traffic light help to easily set priorities for the company to take action and implement the suitable controls and checks to mitigate the risk potential of these processes.

The graphics shows the possible risk scaling outcomes. The risk of each relevant process is the combinations of the risk occurrence probability and the possible impact / consequence of the evaluated process.

Risk Event Occurance Probability		
Unlikely (Event could occur in over 5 years)	Possible (Event could occur in foreseeable future 1-5 years)	Likely (Event could occur within 12 months)
Significant	Critical	Critical
Important	Significant	Critical
Important	Important	Significant
Minor	Minor	Minor

**Critical risk and all regulatory risk
exceed the Risk Acceptance level**

The results of the risk assessment process then serve as the primary input to risk responses whereby response options are examined (accept, reduce, share, or avoid), cost-benefit analyses performed, a response strategy formulated, and risk response plans developed.

5.3.2 Risk types

Risk is the loss resulting from inadequate or failed: processes, people, systems or external events. Realistic risk event scenario can result in a multiple negative impacts on the

⁴¹ The Risk Scaling Matrix: Used to grade the severity of risk according to the combination of the possibility of occurrence and the impact

company. There are three main categories of the impacts for every company: financial, reputational or legal.

The financial risk is the danger or possibility that shareholders, investors, or other financial stakeholders will lose money. Corporations may also face the possibility of default on debt they undertake but may also experience failure in an undertaking the causes a financial burden on the business. There are multiple types of financial risks for example: credit risk, market risk, operational risk or liquidity risk.

The second category, the reputational risk is the potential loss of financial capital, social capital and/or market share resulting from damage to a firm's reputation. This is often measured in lost revenue, increased operating, capital or regulatory costs, or destruction of shareholder value. Reputational risk is consequential of an adverse or potentially criminal event even if the company is not found guilty.

The third and last category are the legal risks. Basel II classified legal risk as a subset of operational risk in 2003. This conception is based on a business perspective, recognizing that there are threats entailed in the business-operating environment. The idea is that businesses do not operate in a vacuum and that, in the exploitation of opportunities and their engagement with other businesses, their activities tend to become subjects of legal liabilities and obligations.⁴²

One of the primary reasons why legal risk is associated with operational risk involves fraud, since it is recognized as the most significant category of operational loss events and considered a legal issue as well.⁴³ These, however, do not mean that legal risk is only confined to this conceptualization because it can be defined in broader way. For instance, there are specific sets of legal risks that are defined by the EU Law. In 2005, the European Central Bank declared the development its own legal risk definition to help "facilitate proper

⁴² Chapman, 2011

⁴³ Moosa, 2007

risk assessment and risk management, as well as ensure a consistent approach between EU credit institutions."⁴⁴

5.3.3 Implementation of the controls and checks

Following the risk identification process the controls and checks are implemented to mitigate the risks that were discovered during the risk assessment phase. In documentation of processes and controls, the focus should be on efficiency (controls addressing the same objective not being performed multiple times) and completeness (all risk and control objectives being addressed). This can best be done by looking at the key processes end-to-end from the business transaction to the accounting entry across departments and interfaces.

The design and creation of the control processes is of course linked to already existing procedures. Where possible, the procedures will be placed in the IT environment, mostly because automated controls are more efficient and more effective than manual ones. This especially applies to procedures targeting risks in routine processes. For non-routine processes, such as mergers, acquisitions, IPOs or refinancing, an organizational, procedural approach is the more obvious route to take.

New and/or modified control procedures are implemented, but not before agreeing on priorities in consultation with management and setting a schedule for improvement. Key controls and obvious control gaps are first addressed, enabling an initial effort to generate major progress. Communication with all the employees and departments is crucial in this phase. If necessary, employees must be informed, instructed and trained. It goes without saying that the role of IT in this phase is also important for the successful implementation of an effective TCF.

The proposed implemented solution should be able to deliver the answers to the following questions:

- How do your controls mitigate your risks?
 - Central strategic overview of tax risks with illustration of effects of mitigating actions and activities is available.

⁴⁴ Reccah & Emilia, 2016

- Have controls been performed and documented in a timely manner?
 - Automation to support that delegated controls are easily performed, documented and reported.
- Are you in control?
 - A reporting dashboard with monitoring of tax controls is available⁴⁵

6 DAC 6 Directive opening doors for a common cooperative compliance system on taxation in Europe

On the 25 May of 2018, Council Directive (EU) 2018/822, amending Directive 2011/16/EU (“DAC6”) as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, was adopted. BEPS Action 12 on mandatory disclosure became a hard-law, which raises numerous questions, especially in respect of the role of taxpayers and the intermediaries.

6.1.1 DAC 6 Mandatory disclosure as an ex ante mechanism for the risk reduction

Since Directive 2011/16/EU (DAC1) entered into force with the automatic exchange of non-financial relevant information for tax purposes, the standard of transparency has started to rise, expand and stretch. Financial information exchange was also incorporated into the standard (DAC2, 2014/107), followed by rulings (DAC3, 2015/2376/), Country-by-country reporting (DAC4 2016/881), Anti money laundering standards (DAC5, 2016/2258), and, finally, DAC6 closed the circle by imposing mandatory disclosure of certain aggressive tax planning structures. Mandatory disclosure is supposed to act as an ex-ante mechanism to discourage potentially aggressive tax planning and to fight the tax avoidance and tax evasion.

DAC6 is based on two pillars: the automatic exchange of information and mandatory disclosure. Thus, it goes beyond the main idea of BEPS Action 12, which was intended to prevent the intermediaries (tax planners, tax advisors, banks) of tax structures that take advantage of international taxation “gray” areas and loopholes from using the system in order to avoid or substantially reduce the payment of taxes. Consequently, DAC6 broadened the scope of data that has to be exchanged, because most of those tax aggressive

⁴⁵ KPMG, 2017

arrangements and schemes have cross-border element and, in order to have a non-discriminatory tax system that information has to be shared between all the countries affected. This is part of the open and transparent culture: the more information and data one Member state is willing to share, the more transparent it is considered and, as a result, the more dependable it becomes for other Member states and for its own citizens. These days, all tax systems have to rely on a mutual trust, cooperation and openness. Nevertheless, trust based on cooperation is only achieved by showing a transparent government structures that complies with globally accepted rules and standards.

6.1.2 Development of the new EU-wide common tax compliance system

Mandatory disclosure obligations of this kind of information and in this magnitude might increase the mistrust of tax intermediaries, who are a crucial part of every modern tax system. The intermediaries will face a new kind of problem and will have to find a balance between giving the best advice to their clients and saving the most of the taxes for them and on the other hand between complying with the recently implemented disclosure obligations. This creates a need to reconsider tax relationships and in some cases, the professional privileges such as client-attorney privilege or the banking secrecy will be challenged, in some countries even abolished. Taxpayers and intermediaries (tax advisors, attorneys and banks) will need to cooperate closely: the taxpayer will have to consult its position on the risks of certain schemes and operations, and will have to approve potentially aggressive tax methods. In essence, both sides will have to design their fiscal strategies together as partners, building a reasonable interpretation of tax relevant laws and regulations. The impact of the newly implemented DAC6 disclosure rules is the introduction of tax compliance in Europe for a tiny part of the whole system: cross-border aggressive structures.

6.1.3 Cooperative compliance as the future of tax systems in Europe

Widening tax transparency standards could result in the tax authorities knowing everything about their taxpayers. However, and according to General Data Protection Regulation, tax-relevant information cannot be freely accessed. This situation should make us think about the following:

- is a good and trustworthy tax administration one that knows absolutely everything about us without having to ask us to access our own personal information?;

- is it necessary to give taxpayers more access to their own data, since the amount of information tax authorities holds makes it almost impossible to cheat?

Cooperative compliance-inspired systems are only efficient if there is trust between the actors (administration-taxpayers-intermediaries). The implementation as of TCF as was described in detail in the Chapters above is an important way how to find balance between giving the tax authorities too much data and on the other hand, have the necessary trust from the tax authorities because they can rely on the checks and controls implemented by the TCF. Although most of EU Member states tax systems are not based on compliance mechanisms, it seems to be the future trend.⁴⁶

7 Change in the relationship between the tax authorities and taxpayers

It is obvious that the new idea of the HM has the right objectives, mainly the improvement of the relationship between the tax authorities and the taxpayer through ensuring the legal certainty and deepening of the tax compliance. However, the long way to reach these objectives is full of challenges and obstacles that need to be overcome.

First, the core question is, if this new approach fits the public law principles that governs the relationships between the tax administrators and the taxpayers. The main characteristics of the public law is the characterization of the subject as non-equal. The HM is disturbing this status-quo by shifting the relationship to an equal position of the counterparts, which is not at all typical in the public law domain. Does this mean just the shift in the cooperation between these two different types of subjects or are also the core grounds of the relationship changing?

After evaluation of the perception of the project by the NTCA in Netherlands, the Committee responsible for the implementation of the project considered the choice of the term “Horizontal Monitoring” unfortunate, mainly from the legal perspective. Because of the position of the state, the government and the tax authorities itself it is the statutory duty to

⁴⁶ Serrat, 2018

levy taxes and the further legal relations based on this state power monopoly cannot be considered as constituted based on equality with the citizens. It is important to emphasize that the tax administrator and the taxpayers does not have the same equal position, even if the name of this institute can indicate so.

The so-called enhanced relationship approach does not change the position of either party and is not related in any matter to their legal rights and obligations. The new cooperation is focusing much more on the behavioral changes of the parties.

The focus and the objective of the HM is to achieve a new level of legal certainty and reduce the compliance obligations and burdens associated with taxation. The aim is not to reduce or limit the right to levy taxes of the tax authorities. Furthermore, the agreements under this new type of cooperative relationship are also not providing the taxpayer with the more favorable treatment, but is much more focused on giving the taxpayer a more certain and faster solutions concerning the tax matters.

Because of the superior position of the tax authorities, they will always have the decision power regarding the final implementation of the tax regulations and this concept will not in any case be changes or challenged under the HM. However the main difference will be the in the way of how the final understanding of the law will be reached. The taxpayer will have a possibility to be actively involved and contribute to the process of the interpretation and application of the laws and regulations, by explaining their decisions and steps to the tax authorities along the way. This way the businesses will be able to discuss and adjust their tax positions even before performing the relevant taxable events. Already the knowledge and experience from the pilot projects in many countries showed the increase in the transparency and trust in tax matters, the tax administrators have a much better insight into the taxpayer's risks and operations and therefore much better understanding of these.

To conclude, it seems that the relationship between the tax administrations and taxpayers under the HM will also in the future be based on the principles and rules of the public law and characterized as a relationship on an unequal footing, with the difference in exercising and using of the powers of the participants within this relationship.⁴⁷

⁴⁷ Karoline Spies, 2014

7.1 Taxpayer's role as a trusted partner

As already analyzed above the new type of cooperative compliance does not change or shift the legal position of the taxpayer to more equal. This shift must be perceived much more in terms of behavioral change and change in the treatment of the taxpayer, comparing to the traditional “vertical” relationship. In the former model of cooperation, the taxpayer was in the position of the potential fraudster, thus controlled by the tax authorities. The new approach is based on the mutual trust and understanding, with openness and transparency on both sides.

Therefore, the taxpayer would have a much higher level of legal certainty in the tax positions, as the view of the tax authorities would be available to them in advance. Moreover, the openness for a much closer relationship, the open communication about the tax matters in advance, the possibility and willingness of the tax administrators to better understand and analyze the business positions would result in a deeper participation of the taxpayer in the process of interpreting the law.⁴⁸

Bear in mind that in classical “vertical” relationship, the tax authorities must interpret the tax positions of the taxpayer alone. Under HM, the taxpayer has a unique opportunity to proactively discuss the complex tax matters with the tax administrators (for example on a quarterly basis) and to obtain a valuable binding opinion on the uncertain tax positions. This is a completely new way on how to reach the final interpretation of the laws and regulations.

The legal certainty is very beneficial for the taxpayer in many ways, for example, it reduces the administrative burdens and minimize the issues to be resolved by the court of law. We must say that the change will not be easy. One of the biggest challenges of this new cooperation will be the existence of a traditional barrier of mistrust that will be hard to overcome.

There are valid concerns in the scientific community about the lack of change in the parties' position. Openness, transparency, and business and timely awareness is expected from the tax administration also under the “traditional” relationship. However, it is obvious that the

⁴⁸ Karoline Spies, 2014

difference between the new Horizontal relationship and the traditional vertical relationship has to do with the parties interact and behave in relation to each other. From the practical point of view, a positive change is expected.⁴⁹

To confirm this theory I would like to mention a one concrete example from the Australian implementation of the HM programme. In the survey conducted, the taxpayers states as the main benefits:

- Reduction in the number of disputes;
- The tax matters are discussed on the appropriate level and with the right people from the Tax administration and
- Increase in the certainty of tax matters and in the closure of the tax returns.

In conclusion, the taxpayers perceived as the main benefit the certainty in the tax matters and the process of resolving the issues in openly and timely matter.

7.1.1 Advantages for the taxpayer

From the perspective of businesses, there are also advantages:

- Improved tax certainty: Co-operative compliance delivers a platform for discussing any tax issues with the tax administration on a regular basis. It can substantially reduce the need to make provisions for uncertain tax positions and unexpected tax liabilities.
- Better and easier tax risk management: Tax issues are better integrated in the taxpayer's process and underpinned by a tax control framework.
- Lower compliance costs: The taxpayer is less exposed to administrative penalties, can file and settle tax returns quicker, and may require less help from tax intermediaries. In addition, the number of disputes that involve extra costs should be lower.
- Better dialogue: Tax audits are more focused and carried out in real time or even prospectively. The dialogue with the tax administration is also substantially improved.

⁴⁹ Karoline Spies, 2014

- Corporate Social Responsibility: Taxpayers may benefit from reputational gains. Company's stakeholders will perceive the enterprise as a more reliable partner and a good corporate citizen. Shareholders and institutional investors will have greater confidence in the returns from investments.
- Better investment climate: An improved relationship between large taxpayers and the tax administration will encourage foreign direct investment as MNEs can achieve certainty about the tax treatment of their investments and the rate of after tax returns they will achieve.

7.1.2 *Potential disadvantages for the taxpayer*

- Co-operative compliance is, in most cases, limited per jurisdiction. A multilateral co-operative compliance approach, where there is an agreement between a taxpayer and two or more revenue bodies, is not yet widely established. However, a number of revenue bodies are more and more seriously considering the multilateral co-operative compliance approach and in that, way they are looking at using intermediates to support them with cross-border co-operative compliance programs.
- Taxpayers may be put at a competitive disadvantage if, within the scope of co-operative compliance, it decides to eschew tax planning that other taxpayers continue using.
- While entering in a co-operative compliance agreement increases certainty, it is not meant to reduce the amount of taxes paid.
- Termination of co-operative compliance agreement by either side may lead to reputational and other risks. In most cooperative compliance programs, it is unclear on when and how a taxpayer can exit the program and for instance, what the revenue body will do with the information they have obtained during the program.⁵⁰

7.2 Tax administration position

Regarding the legal position, the same conclusion is valid for the tax administrations. They will still act according to the public law principles from the superior position. The change is

⁵⁰ EY, 2014

more in the area on how the powers granted to them by the laws and regulations will be exercised.

The results of the survey conducted by the OECD that included the countries that have already implemented some kind of co-operative compliance models in which HM is an integral part show that most countries have adopted them as part of their risk compliance management in order to achieve improved behavior of the taxpayer. Compliance risk management is described *as systematic process under which the Tax Administration makes substantiated choices on which instruments could be used to effectively stimulate compliance and prevent non-compliance based on the knowledge of the behavior of all taxpayers and related to the available administrative capacity.*

As a result, the change in behavior in terms of scale of tax planning or avoidance undertaken is expected. Moreover, the active participation in the process of the law interpretation and deeper insight into the business matters of the taxpayer would lead to much better prediction of the tax positions of the taxpayer.⁵¹

7.2.1 Attractiveness of the cooperative compliance for the governments

From the perspective of governments co-operative compliance programme are attractive:

- Improved tax compliance: Co-operative compliance provides a country with a competitive edge. It facilitates compliance by providing timely advice on tax issues. It affects the behavior of a broad group of taxpayers for whom tax certainty is a tangible benefit of the programme.
- Secured revenue base: Because of improved tax compliance, in the longer-term the revenues paid voluntarily will increase. In the near term, settlement of legacy disputes, which is a first step in establishing the new relationship, will deliver significant yield.
- Improved certainty: Open discussion on tax positions means less risk of incorrect tax assessments and less need to use legal remedies; the number of open years of assessment is kept to a minimum, which in turn makes revenue forecasting more reliable.

⁵¹ Karoline Spies, 2014

- Better compliance risk management: As part of a risk based compliance strategy, co-operative compliance helps the tax administration to focus its limited resources on high-risk cases and taxpayers.
- Savings in resources by reducing the scope of audits: Thanks to transparency and full disclosure, the tax administration may get a better understanding of current issues that the taxpayer faces. As a result, the tax administration can reduce the scope of audits and keep the cost down.
- Improved capabilities: With co-operative compliance the tax administration may improve its commercial awareness, develop better understanding of how MNEs' manage their business and the control systems they rely on to ensure that their accounts and returns are accurate.

7.2.2 Challenges of the implementation to be considered by the revenue body

- When implementing a co-operative compliance program, revenue bodies may want to consider the following challenges:
- What benefits should be offered to co-operative compliance participants, e.g., greater certainty, less frequent audits, possible materiality limits, open discussion of areas of risk, reduced penalties on behavioral grounds etc.
- Whether implementation of co-operative compliance requires a change of tax legislation. In this respect, it should also be taken into consideration that more and more taxpayers are looking at multilateral co-operative compliance approach, where the cooperative compliance is not limited to just one country. However, country-specific tax legislation may limit the same approach in different countries.
- Need for the revenue body to be open and transparent about its core values and approach to a co-operative compliance process as well as need to disclose some of the detailed rules and procedures. This will include standard working programs, based on legislation, ethical rules and core values and operating systems, including written guides to contribute to an unambiguous and predictable way of working.
- Specifically, revenue body officers (and the revenue body in general) will have to protect themselves against allegations of special treatment of taxpayers within a co-operative compliance regime. The revenue body will have to be able to show that tax is applied fairly to all, with no inappropriate concessions to co-operative compliance taxpayers. There are opportunities to clearly publish settlement criteria, and to have

open, transparent and robust governance procedures for settlements, including a potential role for parliamentary scrutiny.

- Potential resource implication as involvement of a second (or even more) pair of eyes will be required to assure decisions are not made by one individual and minutes of every meeting will be mandatory, and the content will need to be signed off by the taxpayer and the revenue body.
- Setup of training programs and programs of regular contact between experts to enable tax officers to learn together and to learn from each other.
- Make sure that field auditors are aware of the co-operative compliance regulations and not only the tax officers.
- Implementation of a formal rotation system to reduce the risk that tax officers lose their independence and professional attitude.
- Implementation of a monitoring system that is used to measure the quality of work done and provide insight in the way the taxpayer has been treated also in comparison to other taxpayers.
- Clear instructions should state how you select taxpayers you would like to invite to cooperate. The focus should be on the larger taxpayers to make it as cost-efficient as possible.
- How do you start a co-operative compliance program? Would it, for instance, be a task for the revenue bodies to “audit every single number” of a taxpayer for a certain period to make sure, it feels comfortable with the TCF? Moreover, if the taxpayer has passed the test how will the revenue body make sure the taxpayer stays “ok”?
- Agree on ways to measure the achievements and the “success” of a co-operative compliance program from external and internal perspectives.⁵²

⁵² EY, 2014

8 Conclusion

The lack of transparency has been regarded to be an important facilitator for tax evasion and tax avoidance. The main objective of the cooperative compliance programme that is based on sound Tax Control Framework that supports the trust is transparency and understanding, required from both taxpayers and the tax authorities participating in the HM.

The taxpayer receives advance certainty and by discussing and resolving cases earlier, it is possible to avoid costly and time-consuming audits and controls from the tax authorities. A taxpayer should provide the tax administration with proper information, if necessary outside the legal obligations and in return, for a much higher level of legal certainty.

Horizontal Monitoring contains issues with regard to the level of taxpayer protection and certainty. The HM depend heavily on one hand on the proper functioning and capacities of the tax administration and on the other on the willingness of cooperation and quality of the TCF on the side of the taxpayer. These are perceived as the crucial elements in order to make the implementation of the HM a success.

The results of the pilot projects in various European countries showed that the HM is perceived very positively by the participants either on the side of tax administrators or on the side of companies. The implementation of the TCF increases significantly the tax compliance and improves the general management of the tax matters within the companies. Moreover, a lot of processes relevant to tax, accounting, and bookkeeping departments are automatized and digitalized in the course of the implementation of the TCF, which has a positive and innovative impact on the company.

The paradigm shift from control and command relationship to more equal cooperative relationship is connected with the change of the mindset in the managements of the companies and even more in the change of the mindset of the tax officials.

I conclude that there is a huge opportunity that lies in the implementation of a HM within the tax systems of the European countries. Accordingly, I strongly believe that the Austrian concept of Horizontal Monitoring will be a survivor in the Austrian Tax system.

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