

**DETERMINANTS OF CORPORATE TAX BEHAVIOUR AND CO-  
OPERATIVE COMPLIANCE: A COMPARATIVE STUDY OF THE UK AND  
COLOMBIA**

**D.PHIL IN LAW THESIS**

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## **ABSTRACT**

### **DETERMINANTS OF CORPORATE TAX BEHAVIOUR AND COOPERATIVE COMPLIANCE: A COMPARATIVE STUDY OF THE UK AND COLOMBIA**

#### **D.PHIL IN LAW THESIS**

**DIEGO QUIÑONES CRUZ, HARRIS MANCHESTER COLLEGE**

This thesis seeks to analyse the impact that operating in jurisdictions with different socio-economic and legal contexts can have on taxpayer regulation. This is done by comparing large corporate taxpayers in the UK and in Colombia using empirical qualitative methods to examine the alignment between factors at different levels that can influence corporate tax behaviour, and the premises of the co-operative compliance. The main conclusion is that the factors present in Colombia are contrary to introducing this type of regulation. This is because critically-negative perceptions of the administration -particularly of its trustworthiness- corporate tax governance weaknesses, tax-risk prone social norms, and contextual factors like a high perception of corruption create an environment adverse to this model's philosophy, which is highly dependent on interparty trust and taxpayer risk aversion and compliance-mindedness. Results from the UK show that co-operative compliance can contribute to improve taxpayer governance, strengthen risk-averse and/or compliance-minded taxation norms, and encourage perceptions of the administration that are favourable for voluntary compliance. However, the evidence also shows that operational difficulties can quickly erode taxpayer trust in the administration and on the value of collaboration, and jeopardise the progress made. This is the case with administrative business understanding, responsiveness, and providing of legal certainty while maintaining the model's legitimacy and answering demands for fair and responsible outcomes. Accordingly, this thesis proposes policy measures designed to facilitate the conditions necessary for establishing co-operative compliance in contexts like Colombia's, where shifting from adversarial, non-responsive regulation towards collaborative, responsive regulation could assist in improving voluntary compliance. Additionally, the author recommends policies for enhancing co-operative compliance's sustainability in jurisdictions like the UK, where the model is developed, but the progress it has achieved needs to be protected against the trust and compliance-eroding effects arising from the regulator's difficulties in satisfying taxpayer expectations.

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## LIST OF ABBREVIATIONS

ATAD	Anti-avoidance Directive (EU)
BEPS	Base Erosion and Profit Shifting Project (OECD)
BRR	Business Risk Review (UK)
CAP	Compliance Assurance Program (US)
CCM	Customer Compliance Manager (UK)
COL	Republic of Colombia
CSR	Corporate Social Responsibility
CRM	Customer Relationship Manager (UK)
GDP	Gross Domestic Product
DIAN	Dirección de Impuestos y Aduanas Nacional (COL)
EOI	Exchange of Information
ETR	Effective Tax Rate
FHTP	Framework for Harmful Tax Practices
G20	The Group of Twenty
HDI	Human Development Index (UN)
HMRC	Her Majesty's Revenue and Customs (UK)
HQ	Headquarters
IFA	International Fiscal Association
KPI	Key Performance Indicator
MLI	Multi-lateral Instrument (OECD)
MNC	Multinational Corporation
NAO	National Audit Office (UK)
NGO	Non-governmental Organisation
OECD	Organisation for Economic Cooperation and Development
PAC	Public Accounts Committee (UK)
PPP	Power Purchase Parity
SAO	Single Accounting Officer (UK)
SME	Small and Medium Enterprise
TCF	Tax Control Framework

UK

United Kingdom of Great Britain and Northern Ireland

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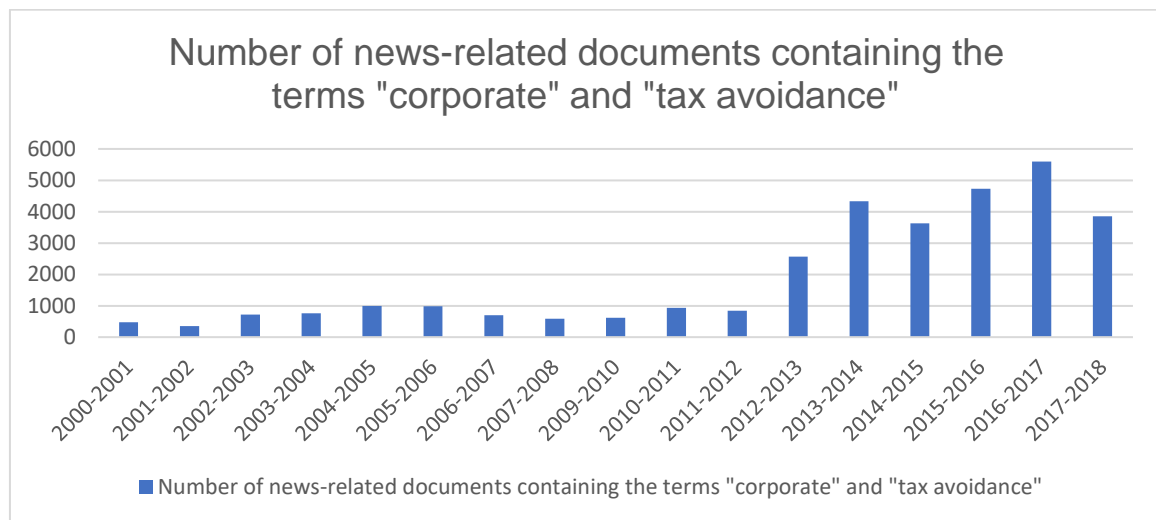
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**PART I**  
**INTRODUCTION AND THEORETICAL FRAMEWORK**

## CHAPTER 1

### INTRODUCTION

The way in which corporations approach their tax obligations has attracted a considerable amount of public interest over the past years. A news content analysis carried out by the author using FACTIVA reveals that over the past ten years, the number of news-related documents published online containing the terms 'tax avoidance' and 'corporate' anywhere in their text increased from 477 per year in 2000 to 3854 in 2017, peaking at 5595, in 2016:



*Figure 1 FACTIVA Analysis regarding the frequency of news-documents mentioning corporate tax avoidance*

Politicians and intergovernmental organisations have reacted to this surge in public scrutiny regarding corporate tax affairs by hardening their rhetoric<sup>1</sup> and by orchestrating a series of domestic and international policy measures aimed at enhancing corporate tax compliance such as the OECD/G20's 'Base Erosion

<sup>1</sup> For example, see the IMF's position as represented by Christine Lagarde: <http://www.telegraph.co.uk/business/2016/04/17/imf-to-launch-information-sharing-plan-as-world-clampdown-on-tax/> and the OECD Secretary General's position : <http://www.ft.com/cms/s/0/307c921a-6b45-11e5-aca9-d87542bf8673.html#axzz46AatSC3Y>

and Profit Shifting Plan'<sup>2</sup> and the European Union's 'Anti avoidance package' and its accompanying Directive<sup>3</sup>. The underlying message is that corporations are not fulfilling their tax obligations, at least in the way that the 'public interest' – and this term is generally not defined - would want them to, particularly in a context of austerity.

Most of the additional public attention focuses exclusively on corporate tax outcomes like effective tax rates. Different analysts and policymakers have gone further, to what could be labelled a 'procedure-centred' level and tied those outcomes to the transactional patterns or schemes believed to lead to said tax results. This is the case of the OECD and the G20, which built their BEPS initiative around identifying tax arrangements signalled as responsible for reducing corporate tax liabilities globally and their subsequent neutralisation (or attempted control).

However, an aspect that has not received equivalent attention is the interaction between corporate taxpayers and the tax administration and the impact this has on their approach to taxation and compliance. This is a critical component of the tax compliance equation. Contemporary explanatory models of taxpayer behaviour like the Slippery Slope Framework<sup>4</sup> demonstrate that the taxpayer's relationship with the administration, and its effect on perceptions of the administration's qualities is a significant determinant of compliance.

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<sup>2</sup> See <http://www.oecd.org/ctp/beps.htm>

<sup>3</sup>See [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/anti\\_tax\\_avoidance/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/anti_tax_avoidance/index_en.htm).

<sup>4</sup> Kirchler E, Hoelzl, and Wahl I, 'Enforced versus voluntary tax compliance: The "slippery slope" framework' (2008) 29 Journal of Economic Psychology 210

### 1.1. The thesis' contribution

This thesis contributes to the debate on corporate tax compliance by focusing on the taxpayer-administration relationship. The research presented here centres on co-operative compliance<sup>5</sup>, one of the leading contemporary regulatory approaches, and uses a novel approach to evaluate if this type of regulation is aligned with the variables present socially, organisationally, and at the personal level (individual corporate tax directors), which are hypothesised to influence corporate tax behaviour. The author uses this alignment (misalignment) as an indicator to measure the validity of co-operative compliance in relation to large corporate taxpayers located in specific jurisdictions. It is important to stress that the term validity is not used in this thesis in a methodological sense to describe the reliability, generalisability, or causality of the research<sup>6</sup>, but rather as a dependent variable to denote the likelihood of the regulation succeeding in its objectives.

By relying on qualitative research methods supplemented with quantitative methods examining the statistical adequacy of the criteria used by the administration to calibrate responsiveness under the UK's Business Risk Review<sup>7</sup>, this thesis analyses co-operative compliance's degree of synchrony with the regulatees' ideas about taxation, their governance structures and

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<sup>5</sup> OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance* (OECD Publishing 2013). The model's main elements are discussed in this thesis' chapter four.

<sup>6</sup> Bryman A, *Social research methods* (Fifth edition, Oxford: Oxford University Press 2016).

<sup>7</sup> For a description of the BRR refer to chapter four. Unlike other jurisdictions, where participation is entirely elective and negotiated, the UK's approach to co-operative compliance is marked by the amalgamation of non-voluntary general risk-administration procedures like the BRR and co-operative dynamics.

approaches to tax risk, and the circumstances present in the regulatory context, like administrative capabilities and political interference.

The presumption is that regulation like co-operative compliance, which is meant to increase voluntary (not enforced) compliance, can strengthen its validity if its legal framework is grounded on a thorough understanding of the regulatees' social and personal norms and the way in which these materialise in large corporations' and their tax directors' ideas about taxation, their compliance behaviour, and the taxpayer-administration relationship.

Additionally, this thesis introduces original elements by engaging in comparative work which is pioneering in its choice to examine co-operative compliance in Colombia and in the UK. This provides an opportunity to assess how an emerging market context might impact the variables associated with corporate taxpayer behaviour in relation to co-operative compliance and contrast it with the context present in developed economies. Additionally, comparing regulatees and their environment in a jurisdiction where co-operative compliance has been operating for more than a decade (the UK) with those in a jurisdiction where it has never been implemented allows for greater insight into the factors that strengthen or threaten this model's sustainability and those that could incentivise or hinder its adoption. These are important insights in a moment where co-operative compliance is expanding outside the jurisdictions that pioneered it, and where its multilateral implementation is being advocated<sup>8</sup>.

Findings suggest that the determinants of corporate tax behaviour present in Colombia are not favourable for the introduction of this type of

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<sup>8</sup> OECD, *International Compliance Assurance Programme Pilot Handbook* (OECD 2018)

regulation. Critically-low levels of interparty trust, weaknesses in corporate tax governance and in administrative capabilities, together with the presence of social norms which are tax risk-prone and/or which do not demonstrate compliance-mindedness indicate that this model should not be implemented under the current conditions because it would be unlikely to meet the parties' expectations and the model's theoretical vulnerabilities could be exacerbated.

UK results show that co-operative compliance has contributed to improved perceptions of the administration among corporate taxpayers, better corporate tax governance, and personal and social norms that are more compliance-centred and tax-risk-averse. Nevertheless, they also show that this regulatory approach creates very high expectations among regulatees and that, even in developed economies, there will be difficulties ensuring responsiveness and balancing the efficient provision of legal certainty with public legitimacy and resourcing constraints. These difficulties can erode taxpayer trust in the administration and on the model, threatening its sustainability.

Co-operative compliance might be an attractive option to alter the negative status quo in terms of taxpayer perceptions of the administration, and Colombian results do evidence improved risk awareness in corporations and a degree of alignment between the regulation and tax director personal norms. However, co-operative compliance might not satisfy expectations and could even be negative for compliance in contexts like Colombia's, unless it is preceded by policy initiatives designed to change administrative culture towards a non-adversarial approach, strengthen the administration's ability to act responsively while avoiding regulatory capture, and support changes in taxpayer

culture aimed at improving self-regulation, reducing tax risk appetite, and promoting taxpayer-administration collaboration.

The thesis presents a series of policy proposals aimed at protecting co-operative compliance from the flaws that UK interviewees identify as eroding their trust in the model, and at facilitating its introduction and operation elsewhere. These proposals, which refer to aspects like the binding nature of co-operative compliance-negotiated positions, the use of a multi-tiered system based on risk and regulatee amenability, and managing the impact of political interference, are discussed in detail in chapter nine.

## **1.2. Thesis Outline**

This thesis' structure is built around three sections: Part I, including the introduction, methodology, and the thesis' theoretical framework; Part II, dedicated to present and analyse the investigation's empirical findings, and Part III, comprising normative proposals aimed at increasing and/or preserving the validity of co-operative compliance, the thesis' conclusions, and avenues for future research.

### **1.2.1. Part I. Introduction, Methodology, and Theoretical Framework**

Chapter one introduces the thesis and chapter two focuses on its methodology. Chapter three presents a synthesis of the main explanatory models of taxpayer compliance, focusing on the expected utility model and the Slippery Slope Framework. These theories, which are associated with co-operative compliance's premises (by supporting it or representing what it departs from), were used to design the interview schedules and/or the supplementary quantitative tests and to analyse the thesis' findings.

Chapter four identifies and critically analyses the elements that differentiate co-operative compliance as a tax regulatory model. This chapter also examines co-operative compliance's goals, benefits, and the problems associated to it. Finally, it addresses the relationship between co-operative compliance and responsive regulation.

Chapter five discusses co-operative compliance programmes from various jurisdictions. This chapter is not intended as an in-depth comparative study. It is selective in its choice of jurisdictions covered and intends to provide readers with elements to differentiate the UK's co-operative compliance framework from other programmes, learn about the alternatives jurisdictions seeking to implement this model could consider, and contextualise the proposals discussed in chapter nine.

### **1.2.2. Part II. Empirical findings.**

Chapters six and seven present empirical findings from the fieldwork in the UK and in Colombia . These are organised using a thematic structure that categorises results depending on whether they are found to be positive or negative for co-operative compliance. For each variable, findings are contrasted with those found by previous researchers, particularly in the UK, since there is no previous literature for most variables in the case of Colombia. Since the UK has already experienced co-operative compliance, chapter six contains additional sections regarding interviewee assessments of specific aspects of HMRC's large business framework. Additionally, this chapter's section on the Business Risk Review (BRR) incorporates the results from the supplementary

quantitative analyses that the author conducted on the financial statements of a sample of UK large corporate taxpayers.

Chapter eight compares the findings from both samples highlighting the similarities and differences between them, associating them to the existence of a co-operative compliance programme, structural factors, and/or transnational corporate trends.

### **1.2.3. Part III. Normative proposals and conclusions**

Chapter nine draws from part II's findings and part I's theoretical framework to formulate policy "best practices" aimed at increasing and/or maintaining co-operative compliance's validity for large corporate taxpayers. While these are based on the observations from the UK and Colombia, they are also intended to be applicable in jurisdictions with similar contexts. The policies are based on the factors identified as being positively related to the observed high validity of co-operative compliance in the UK, as favourable for the model's potential validity in Colombia, and/or as options to address the factors seen to erode the model's validity in the UK or hampering its potential in Colombia.

Finally, chapter ten recapitulates the research question, summarizes key findings, normative proposals, and presents the study's conclusions. Additionally, this chapter discusses avenues for future research stemming from the aspects that were found to be elusive, inconclusive, or that were not explored because of the project's limitations.

## CHAPTER 2

### METHODOLOGY

#### 2.1. Large Corporations as a unit of study

This thesis relies on large corporations as a study unit. These organisations are a valuable study unit because a significant proportion of existing empirical research on tax compliance focuses on individuals, rather than on corporate structures, and it is corporations that are the subject of most co-operative compliance programmes. Furthermore, corporations offer fertile grounds for research regarding taxpayer behaviour because they are a space where the preferences of key individuals like tax directors and board members interact with those of other stakeholders and those of the organisation itself to produce a distinct tax culture.

Moreover, large corporations provide a good opportunity to examine the effects of structural variables on taxpayers: These organisations' transnational operation means that they are influenced by global competitive pressures, business practices, and changes in the international tax system. At the same time, they work in specific countries and are therefore faced with distinct tax administrations, social norms, and other *macro* factors that could also shape their tax culture.

Additionally, their visibility and market importance make large corporations behavioural referents for other corporations<sup>9</sup> and even other taxpayers, like individuals, who might mimic their behaviour regarding

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<sup>9</sup> Loretz S and Moore PJ, 'Corporate tax competition between firms' (2013) 20 Int Tax Public Finance 725

compliance and engagement with the authorities or differentiate themselves from it.

The author used the FAME and AMADEUS databases to select a sample of the largest 250 companies in the UK by turnover, and the SIREM database (Colombian Superintendency of Societies) for an equivalent Colombian sample. The sample selection involved a combination of purposive and convenience sampling, similar to that used in previous studies, to mail participation letters to companies across different industry sectors whose tax directors were deemed most likely to be contacted (39 sent in the UK and 24 in Colombia). As explained by Robson and McCartan<sup>10</sup>, purposive sampling relies on the researcher's judgement to build a sample that is designed to satisfy specific research needs. In this case, the project required for the sample to be composed of very large corporations, since it is this type of company which could be expected to have a tax team with the sufficient sophistication to yield the richest responses to the interviews.

Whereas smaller companies would be expected to outsource most of their tax work and have less-structured internal tax teams, very large companies would be expected to have more experience with internal tax risk control and governance systems, direct handling of the relationship with the administration, and tax directors capable of providing more information pertinent to the thesis' research question. Convenience sampling, which focuses on participant accessibility<sup>11</sup>, was used to narrow down the list of potential participants to a

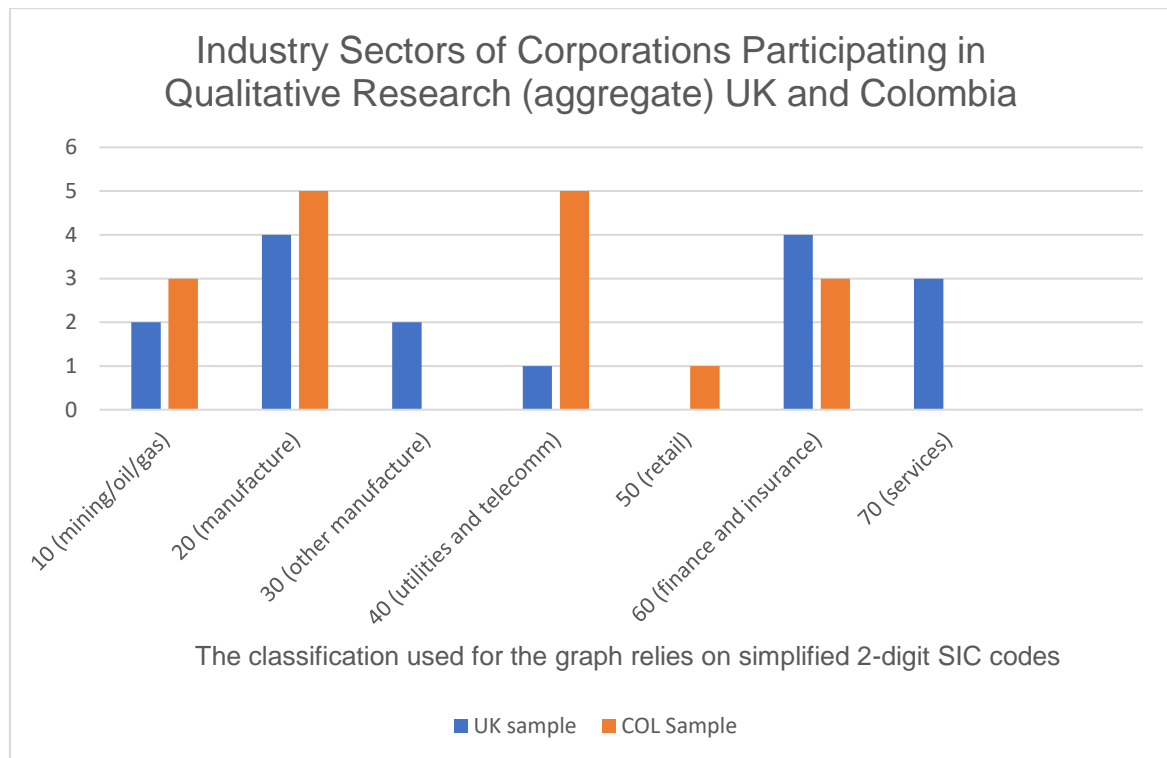
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<sup>10</sup> Colin; McCartan Robson, Kieran, *Real world research : a resource for users of social research methods in applied settings* (Fourth edition. edn, Chichester : John Wiley & Sons 2016). Page 281.

<sup>11</sup> Bryman, *Social research methods*. Page 187.

smaller list of companies whose tax directors were identifiable and whose email addresses were public or could be found using mailing software. This was necessary to ensure adequate response rates, particularly in relation to a sensitive topic.

Following responses, a final sample of 16 UK and 17 Colombian companies was selected for pilots (one per country) and final interviews. The samples include tax directors from corporations operating in various industry sectors, with a focus on the sectors prevalent among the largest companies in each jurisdiction (services and finance in the UK, mining and extractives and utility/communications in Colombia). For purposes of differentiating interviewees, each participant is assigned a “P” (for participant), a unique number and, where participants from both samples are compared, a country identifier (e.g. P1COL or P10UK). While the thesis’ ethics protocols prevent disclosure of the participant’s identities, the following graph shows the sectors present in the aggregate:



*Figure 2 Industry sectors of corporations participating in qualitative research in Colombia and in the UK*

Most (81.25%) corporations participating in the UK sample were FTSE100 constituents. The remaining were either FTSE 250-listed (6.25%) or unlisted (12.5%). In Colombia, 35.3% of the corporations were listed (50% COLCAP) and the remaining 64.7% were unlisted. Both samples included a combination of branches or subsidiaries of foreign parents (56.25% in the UK, 58.82% in Colombia) and locally-headquartered companies (43.75% UK, 41.18% Colombia).

Interviewing 16 and 17 corporate tax officers in each country was deemed sufficient to obtain the necessary data for in-depth qualitative analysis, particularly considering that most interviews lasted an hour or more, and the aggregate sample size is similar to that of other qualitative studies. For example,

Doyle, Frecknall-Hughes, and Glaister<sup>12</sup> performed 17 interviews and Freedman, Loomer, and Vella<sup>13</sup> conducted 30 interviews in total. Likewise, Hasseldine, Holland, and Van der Rijt<sup>14</sup> interviewed 19 participants across different organisations including HMRC, accounting firms and corporations being observed in their capacity as taxpayers. More recently, Freedman, Vella and Ng<sup>15</sup> conducted 30 interviews for their research on the relationship between large businesses and HMRC, and HMRC commissioned TNS to carry on research on businesses and tax strategy using 35 interviews with tax and other corporate executives.

During the interviews, participants were not asked about their companies' HMRC-assigned risk ratings in order to prevent them from feeling targeted and become defensive in case the rating was not a low risk rating. Since risk ratings are not publicized by the companies or by HMRC, the author cannot establish a direct correlation between responses regarding risk appetite and the companies' risk rating. While this introduces the theoretical possibility that the sample is not representative in terms of risk ratings and that, based on UK findings of a reduced risk appetite, the participants would be unusually low-risk, it is unlikely that this is the case because the companies displayed factors which would affect their risk heterogeneity (they belonged to different industry sectors - see below, had differences in terms of ownership (43.75% of the participants were foreign

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<sup>12</sup> Ibid

<sup>13</sup> Freedman J, Loomer G and Vella J, 'Corporate tax risk and tax avoidance: new approaches' (2009) *British Tax Review* 74

<sup>14</sup> Hasseldine J, Holland K and Van der Rijt P, 'The market for corporate tax knowledge' (2011) 22 *Critical Perspectives on Accounting* 39

<sup>15</sup> Freedman J, Ng, F and Vella J *HMRC's Relationship with Business* (Oxford University Centre for Business Taxation 2014)

subsidiaries or dual-listed and 46.25% were completely UK-centred), and their size and complexity would be expected to yield non-low-risk ratings from HMRC for several of the participants.

Additionally, based on their criticism of HMRC's risk rating, interviewees like P27 and P23 indirectly revealed that their companies have not been assigned a low risk rating (see 6.7.2.3), indicating that the sample does include taxpayers which were not assigned low risk ratings by HMRC. Moreover, the low risk views evidenced in UK responses appear to coincide with HMRC's understanding of the current trends in corporate tax behaviour, since HMRC believes that the number of large businesses who display high risk behaviour is continuously decreasing and that most large businesses are not high risk, with only a small number of this type of taxpayers adopting risky behaviours<sup>16</sup>. **The thesis' geographical scope**

This thesis compares two jurisdictions which are normally not studied together, the United Kingdom, and Colombia. This enables the analysis of the impact that operating in different socio-economic contexts (an emerging market and a developed economy) has on the tax morale and tax behaviour of corporate taxpayers and their tax directors, and, consequently, on co-operative compliance's validity (measured based on regulatee alignment with the regulatory model). The author believes that law is a social phenomenon shaped by the characteristics of regulatees and regulators, as well as their environment. Thus, variables like social norms, administrative practices and available resources, the sensitivity of regulatees to tax reputational risk, the degree of

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<sup>16</sup> HMRC Large Business compliance -enhancing our risk assessment approach, 2017. Pages 7-8.

political involvement in tax policy, and regulatee perceptions of the administration, are important for tax compliance. As Cummings, et al, point out, the comparative study of countries possessing different socio-economic and political contexts provides a rich opportunity to gain a more thorough understanding of tax compliance since ‘...attitudes toward compliance have been shown to be a function of social and cultural norms’<sup>17</sup>.

While the socioeconomic differences between the sample countries are too many to address here, the main differences likely to impact co-operative compliance’s validity are those in the social perceptions of the public authorities as trustworthy, perceptions of public corruption, and economic differences which point to lower administrative resources available in Colombia. Regarding trust, evidence from the World Values Survey shows that trust in others and trust in the civil service is considerably lower in Colombia, with only 4.1% of Colombian respondents in comparison to 30% of UK respondents stating that most people can be trusted, and the percentage of UK respondents who trust the civil service (41.6%) nearly doubling that of their Colombian peers (22.9%)<sup>18</sup>. Indeed, Colombia shares with other Latin American jurisdictions a high level of distrust in public authorities when compared to that of developed economies like the UK. Thus, for Castro and Scarstacini, Latin America ‘is a region where trust in

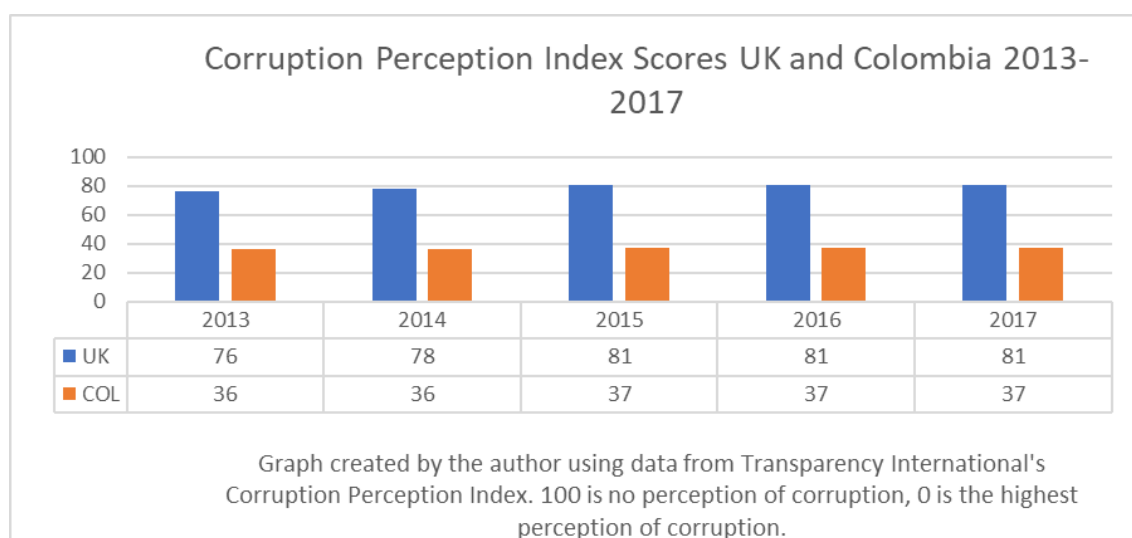
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<sup>17</sup> Cummings, R. G and others. (2009). "Tax morale affects tax compliance: Evidence from surveys and an artefactual field experiment." Journal of Economic Behavior & Organization 70(3). Page. 447.

<sup>18</sup> Inglehart, R, Haerpfer C, Moreno A, Welzel C, Kizilova K, Diez-Medrano J, Lagos M, Norris P, Ponarin E and Puranen B (eds.). 2014. World Values Survey: All Rounds - Country-Pooled Datafile Version: <http://www.worldvaluessurvey.org/WVSDocumentationWVL.jsp>. Madrid: JD Systems Institute.

government is lower than in the developed world...'<sup>19</sup>. Lower trust levels might constitute an obstacle for co-operative compliance's efficacy, since one of this regulatory model's assumptions is the existence of mutual trust between the parties.

Regarding corruption, the perception of corruption is particularly high in Colombia, whereas in the UK it is markedly low. This is evidenced by each country's scores in Transparency International's Corruption Perception Index<sup>20</sup>:



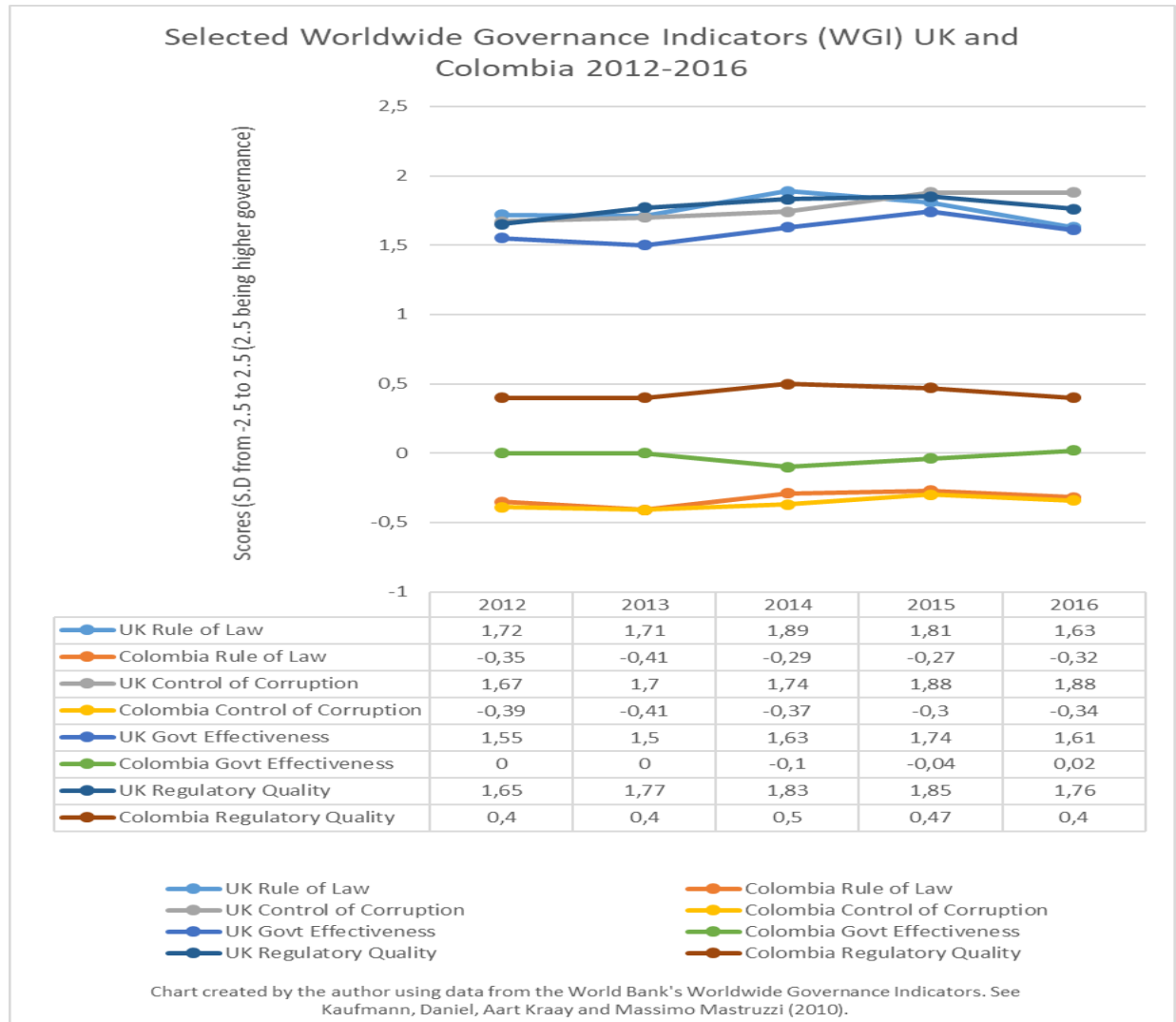
*Figure 3 Comparison of Corruption Perception Index Scores between the UK and Colombia 2013-2017*

As is discussed in chapter seven, the perception of corruption plays an important role in taxpayer opinions regarding the tax administration in Colombia, something particularly concerning for co-operative compliance, given the greater administrative discretion and interparty proximity implicit in this type of regulation. The differences regarding corruption are extensible to governance in

<sup>19</sup> Castro L and Scartascini C, 'Tax compliance and enforcement in the pampas evidence from a field experiment' (2015) 116 *Journal of Economic Behavior & Organization* 65. Page 67.

<sup>20</sup> See <https://www.transparency.org/research/cpi/overview>

a broader context, since the UK is understood to have stronger public governance structures than Colombia. The following data on World Bank Worldwide Governance Indicators illustrates:



*Figure 4 Word Governance Indicators comparative chart: Colombia and the UK 2012-2016*

Macroeconomically, Colombia is a middle-high income, emerging market, whereas the UK is a high income, developed market: The UK's GDP per capita is 3.015 times greater than that of Colombia. According to the United Nation's Human Development Index score, Colombia has a 'high' human development whereas the UK has a 'very high' human development, and Colombia has a

considerably higher income distribution inequality than the UK, measured in terms of its Gini coefficient (in 2015, Colombia's Gini coefficient was of 51.1 compared to of the UK's 33.2<sup>21</sup>). These economic differences can impact compliance because of the lower amount of resources available for the tax administration in emerging markets like Colombia.

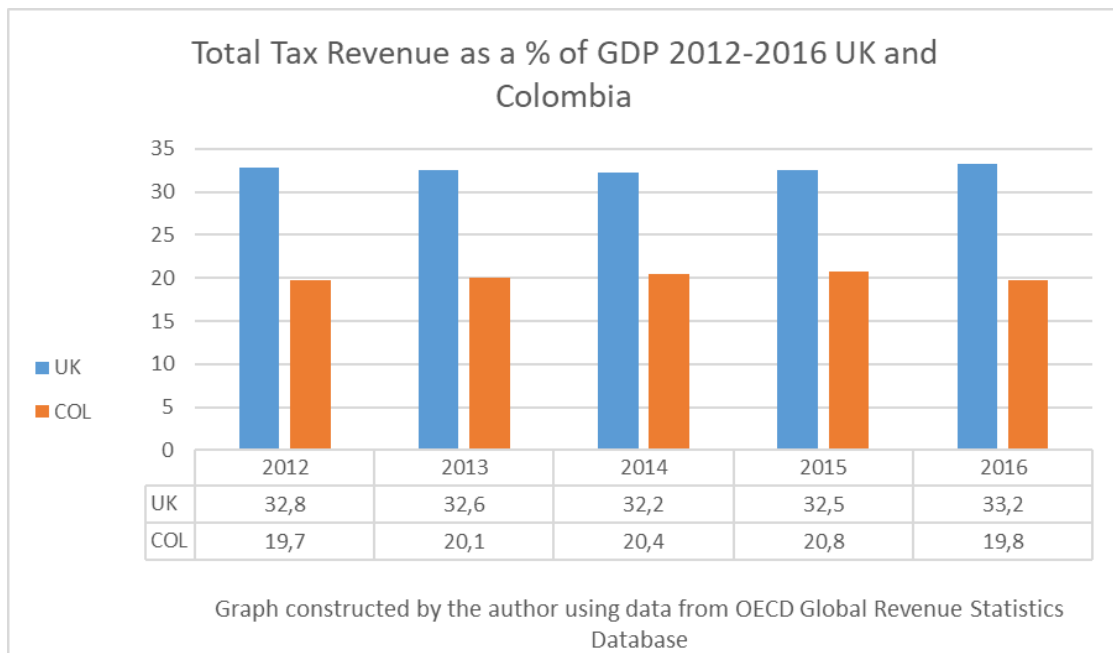
Finally, regarding revenue statistics, the UK boasts significantly lower levels of tax evasion than Colombia (10% vs. 45%)<sup>22</sup>, indicating that achieving higher compliance levels is a greater challenge in Colombia. While the UK's level of revenue collection relative to the country's GDP is higher, this is not necessarily attributable to higher corporate compliance, since the percentages of tax revenue on corporate income and profits against total tax revenue in the UK are significantly lower than those of Colombia where, as with similar emerging markets like Chile or Mexico, the low yield from personal income taxes makes the system heavily dependent on corporate taxation. Although Colombia's higher dependence on corporate taxation makes increasing corporate compliance a revenue priority, it creates pressure on the administration to increase corporate tax yields (see chapters seven and eight) and might create resistance against radical changes in regulatory approaches, like adopting co-operative compliance, out of fear of jeopardising existing

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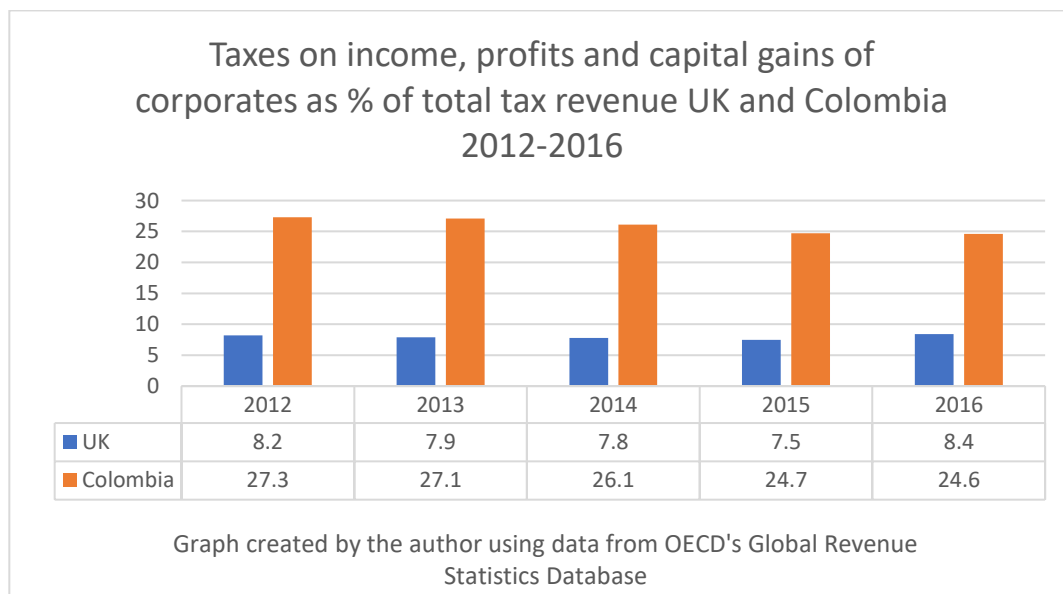
<sup>21</sup> For GDP figures: World Bank 2014 values using PPP in current international dollars. For 2014 HDI figures, UN data (<http://hdr.undp.org/en/content/human-development-index-hdi>) and for Gini figures World Bank data (<https://data.worldbank.org/indicator/SI.POV.GINI?locations=GB-CO>).

<sup>22</sup> Tax evasion measured as a percentage of the GDP using the size of the shadow economy. Data from: Schneider F and Hametner B, 'The Shadow Economy in Colombia: Size and Effects on Economic Growth' (2014) 20 *Peace Economics, Peace Science, & Public Policy* 293) and Feld LP and Schneider F, 'Survey on the Shadow Economy and Undeclared Earnings in OECD Countries' (2010) 11 *German Economic Review* 109.

revenue. The following graphs created using the OECD's Global Revenue Statistics Database<sup>23</sup> illustrate this:



*Figure 5 Comparison of Total Tax Revenue as a % of GDP UK and Colombia 2012-2016*



*Figure 6 Revenue collected from taxes on corporate income, profits, and capital gains as a % of total tax revenue UK and Colombia 2012-2016.*

<sup>23</sup> <http://www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm>

Since co-operative compliance has been operating in the UK for over a decade, but Colombia has not implemented it, comparing the two countries offers the opportunity to analyse the effects that experiencing co-operative compliance has on the regulatees and on the model's sustainability.

Furthermore, considering the OECD's interest in expanding co-operative compliance as evidenced, both by its intention to facilitate co-operative compliance with robust tax control frameworks<sup>24</sup> and by the onset of the multilateral ICAP programme<sup>25</sup>, there is a need for research into co-operative compliance's validity in jurisdictions that have not experienced it, but which might consider implementing it in the future, even if exclusively for multinationals. In this respect, Colombia's recent OECD accession and the fact that many of Colombia's recent tax policy reforms have explicitly followed OECD recommendations, suggests that intra-organisation harmonisation will incentivise Colombia to embrace a regulatory approach promoted by the OECD (e.g. through the International Compliance Assurance Programme 2.0). Thus, research into the validity of this type of regulation in Colombia is topically justified.

The decision to engage in a two-country comparative analysis was also motivated by the possibility of testing the premise that, on account of its dependence on the structural elements present in the taxpayers' socioeconomic

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<sup>24</sup> OECD, *Co-operative Tax Compliance: Building Better Tax Control Frameworks* (2016)

<sup>25</sup> OECD, *International Compliance Assurance Programme Pilot Handbook* (2018)

context, 'tax morale is likely to differ across countries because of structural or cultural differences'<sup>26</sup>.

Thus, in addition to the importance of comparing a jurisdiction with an ongoing co-operative compliance program with one where it has not been implemented, the thesis' comparison between two countries with a broadly similar corporate tax regime, but which are distinct across several structural variables, offers the added value of analysing the degree to which corporate tax directors and their organisations are influenced by the environment where the corporation operates. If the patterns observed in one country are replicated in the other, then transnational trends may be present, something which would be reasonably expected given the degree of internationalisation in large corporations. The practical implication of this is considerable for tax policy formulation because the more differences displayed between country samples, the more adjustments a policy framework – like co-operative compliance- would need to succeed in different jurisdictions.

Finally, the fact that the author has practised tax law in Colombia for several years allows for greater insights into corporate taxation in that jurisdiction and was instrumental for securing an appropriately-sized sample of participants therein.

### **2.3. The choice to perform empirical research**

The decision to engage in empirical research is explained by the belief that studying the validity of a regulatory model benefits from gaining understanding

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<sup>26</sup> Alm J and Torgler B, 'Culture differences and tax morale in the United States and in Europe' (2006) 27 *Journal of Economic Psychology* 224. Page 229.

on the potential regulatees' perspective before formulating legal recommendations. The author shares the conceptualisations of law as a social phenomenon<sup>27</sup> which question the convenience of studying law in isolation from its context and its actors, and the recognition that law operates in a social context, meaning that it can be studied, not only by researching rules themselves, but also by assessing their impact on those being regulated, and the way in which regulatees influence these rules' evolution. Thus, this thesis embraces the idea that empirical legal research is valuable for finding out more about regulatory subjects and, consequently, viewing the law from angles which are sometimes neglected in legal scholarship<sup>28</sup>.

Taxation presents a perfect opportunity to carry out empirical legal research because it involves the application of legal rules to matters of an economic nature, in a highly emotionally-charged and politicised context, and the insight provided by different behavioural sciences like psychology, political science, sociology, and anthropology can assist in obtaining a holistic view. Thus, this thesis assumes that empirical approaches can contribute to a better understanding of regulatory subjects and the way in which regulation is affected by the context where it operates, and that this understanding can be combined with theory to enhance the quality and effectiveness of legal instruments.

#### **2.4. Description of Qualitative Methods**

This thesis' research design is primarily qualitative, relying on 33 one-on-one semi-structured interviews conducted with corporate tax directors – or their

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<sup>27</sup> Hart HLA, *The Concept of Law* (3 edn, Oxford University Press 2012)

<sup>28</sup> Galligan DJ, *Law in Modern Society* (Oxford University Press 2006)

equivalent- in each jurisdiction (15 interviews plus one pilot in the UK, 16 interviews plus one pilot in Colombia) carried out by the author from February 2016 to March 2017. Participants were asked about their organisation's approach to taxes, their perception regarding different aspects of the tax system, the tax behaviour and objectives of competitors and tax practitioners, their corporation's relationship with the tax administration, different aspects of the administration like its power, commercial awareness, and trustworthiness and, in the UK, key components of co-operative compliance (the BRR and CRMs). Interviewees were also asked about their professional objectives in relation to tax and about their views on the ideal taxpayer-administration relationship and the administration's objectives. The interviews were conducted in English (UK) and Spanish (Colombia), with the author translating the interviewees' responses simultaneously<sup>29</sup>. Transcripts were digitalised and coded manually using Nvivo software, with additional analyses like word frequency queries and descriptive statistics also being performed. Coding in Nvivo involved thematic nodes which were created both inductively, based on interview responses, and deductively, following themes pre-established in the interview schedules.

By relying on corporate tax directors, this investigation focuses on those who devise the corporation's strategy in relation to its corporate income tax, have a greater degree of technical tax expertise<sup>30</sup>, are in direct contact with the strategy's materialization, and normally represent the taxpayer in a co-operative compliance dialogue.

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<sup>29</sup> Interviewees were told about the simultaneous translation in advance and all of them consented to it.

<sup>30</sup> UK interviewees reported from 15 to 30 years of experience in tax matters and their Colombian peers reported an experience with tax matters ranging from 10 to 35 years.

Choosing interviews over other qualitative research methods answered to the advantages of interviews in engendering the personal proximity that would be expected to allow research subjects to feel more comfortable revealing sensitive information, and the fact that other methods like focus groups or non-participant observation would not be feasible logistically or would render limited information on this kind of topic<sup>31</sup>.

Qualitative methods are particularly useful when inquiring into phenomena regarding the behaviour of individuals (tax directors) and their organisations because of their ability to provide in-depth focus on study units. Additionally, the data obtained from the respondents can serve an inductive purpose for theory construction. Unlike research relying on surveys, this thesis' use of semi-structured interviews afforded respondents enough flexibility to introduce new variables and to suggest alternative trends and relationships that had not been considered by the author beforehand.

Additionally, in fully structured interviews, participants are placed within the strict boundaries of the question, the terms in which it is formulated, and the limited answers available. This might lead to response bias attributable to framing. Therefore, using semi-structured questionnaires enables participants to refer to the variables that the researcher is interested in but does not force them to do so under frames which might prevent them from introducing answers not previously envisioned by the researcher or that might be considered socially undesirable.

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<sup>31</sup> Freedman, J, Loomer, G and Vella, J , *Analyzing the Enhanced Relationship Between Corporate Taxpayers and Revenue Authorities: A U.K. Case Study* (Department of the Treasury Internal Revenue Service 2010). Page 115.

Certainly, it is not assumed that interview responses are free of bias or that there is a perfect correspondence between expressed beliefs and attitudes and actual behaviour. This assumption would be naïve, particularly since the interviewees are all experienced professionals that are capable of designing and administering responses, despite interviews being live and not having seen the interview schedule in advance. What is assumed is that there is a link between psychological factors and actual behaviours<sup>32</sup> and that careful analysis of an interviewee's responses can yield an acceptable, however imperfect, indication of actual beliefs, attitudes, and behaviours.

Response bias was reduced by refraining from asking tax officers direct questions about their own or their employers' tax compliance. Respondents were asked about the behaviour of their own corporation in neutral terms, letting them assign their own descriptors. Furthermore, interviewees were asked about third parties' tax morale and behaviour (the authorities, colleagues, competitors, etc.), thus directing judgment away from themselves. The use of indirect techniques like these is recommended to reduce response bias in sensitive subjects such as tax compliance, among others, by Hammar, Jagers and Nordblom<sup>33</sup>.

Moreover, including questions pertaining to respondents' perceptions regarding the tax behaviour of their peers and competitors had the objective of obtaining qualitative data on two different levels of social norms, as theorised by Wenzel: 'descriptive' social norms (what others do) and 'injunctive' norms (ideas

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<sup>32</sup> Onu D, *Measuring Tax Compliance Attitudes: What surveys can tell us about tax compliance behaviour* (2016)

<sup>33</sup> Hammar H, Jagers SC and Nordblom K, 'Perceived tax evasion and the importance of trust' (2009) 38 *Journal of Socio-Economics* 238

about what should be done)<sup>34</sup>. Thus, respondents were asked not only about what *most* corporations or tax officers do or believe, but also about what they believe those actors *should* do.

## 2.5. Supplementary Quantitative Research

While this thesis' empirical work is qualitatively focused, supplementary quantitative research was also undertaken to contrast taxpayer views about the responsiveness of the UK's Business Risk Review with the tax behaviour of UK corporations, as measured using ETR and Cash ETR proxies. The analyses were performed on a sample of 1423 UK corporations created by the author using data from the FAME database, covering the period between 2013 and 2015. The figure below reveals that the sample covered a variety of industry sectors:

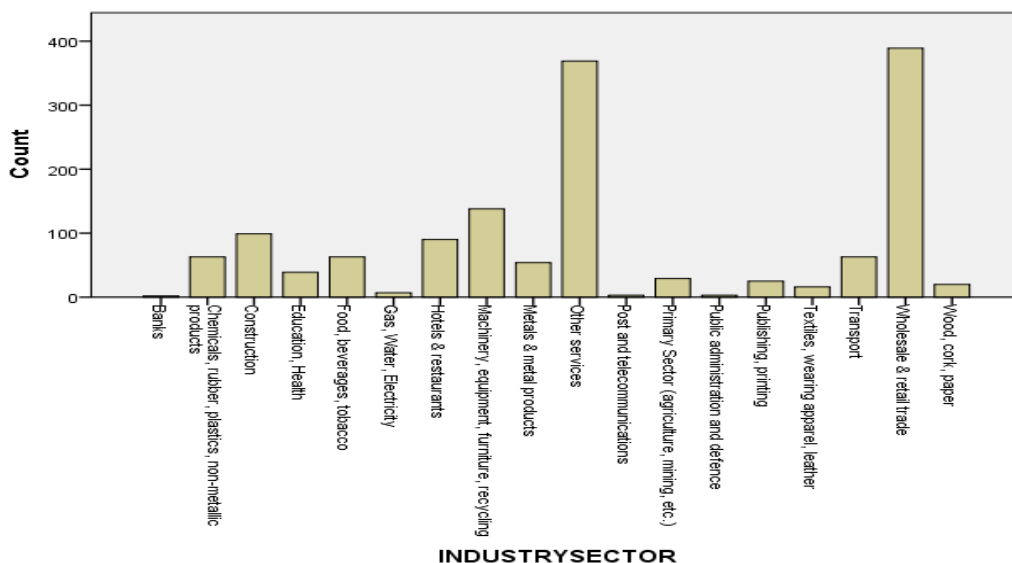


Figure 7 Frequency of UK corporations included in supplementary quantitative research segmented by industry sector

<sup>34</sup> Wenzel M, 'An analysis of norm processes in tax compliance' (2004) 25 Journal of Economic Psychology 213

Since its purpose was to complement qualitative findings, quantitative research was not used to establish causality, but rather statistical inferences<sup>35</sup> to contrast the interviewees' perceptions with actual data about the tax behaviour of large UK corporate taxpayers, as evidenced in their financial statements. Quantitative methods were used to re-examine the association between different variables used by HMRC as risk factors in the BRR and taxpayer behaviour, using effective tax rates, in their cash flow and income statement varieties, as proxies of tax compliance. These variables were analysed both year by year and longitudinally, using Dyreng et.al's<sup>36</sup> methodology. This responds to the need to account for inter-year variations attributable to economic cycles, particular business junctures, to control for the effect of changes in tax officers and tax rules, and to allow for the results to properly incorporate the effect of timing issues such as the imputation of carried over losses, deferred taxation, the execution or reversal of provisions and depreciation.

The analyses relied on a set of multiple independent variables to reduce omitted variables<sup>37</sup>, increase explanatory power, and account for different aspects used by HMRC to conduct the BRR. These include indicators commonly used in literature<sup>38</sup> like the corporation's size (by turnover and by assets); firm

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<sup>35</sup> McCartan and Robson, *Real world research : a resource for users of social research methods in applied settings*. Page 440.

<sup>36</sup> Dyreng SD, Hanlon M and Maydew EL, 'Long-Run Corporate Tax Avoidance' (2008) 83 *The Accounting Review* 61

<sup>37</sup> Gupta S and Newberry K, 'Determinants of the variability in corporate effective tax rates: Evidence from longitudinal data' (1997) 16 *Journal of Accounting and Public Policy* 1

<sup>38</sup> See Lee BB, Dobiyanski A and Minton S, 'Theories and Empirical Proxies for Corporate Tax Avoidance' (2015) 17 *The Journal of Applied Business and Economics* 21 and Hanlon M and Heitzman S, 'A review of tax research' (2010) 50 *Journal of Accounting and Economics* 127

profitability, measured using the return on equity; intensity of research and development, wage, depreciation and interest expenditure; intangible assets and inventory intensity, and liquidity. Additionally, the author devised three indicators, which proved statistically significant, to address areas contemplated by the BRR under the label of structural or inherent risk: Taxpayer's complexity, measured using a scaled indicator of the number of subsidiaries; a scaled indicator of the number of corporations in the taxpayer's corporate group, and the scaled company's age (years since incorporation).

The methods involved included descriptive statistics, bilateral correlations, and multivariate, ordinary least-squares regressions performed in *SPSS*. Following standard practice<sup>39</sup>, the data was subject to different procedures including winsorising and trimming to improve statistical significance by controlling the effect of outliers and taxpayers reporting a financial and/or tax loss<sup>40</sup>. Thus, the results were differentiated between filtered and unfiltered samples.

## **2.6. Limitations of the research**

This thesis' research design has limitations that must be acknowledged when interpreting the results. First, this thesis' geographical scope means its explanatory power is greatest in relation to the UK and Colombia and, to a lesser degree, to other jurisdictions exhibiting a similar array of variables. While results

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<sup>39</sup> See Desai MA and Dharmapala D, 'Corporate tax avoidance and high-powered incentives' (2006) 79 *Journal of Financial Economics* 145 and Armstrong CS and others, 'Corporate governance, incentives, and tax avoidance' (2015) 60 *Journal of Accounting and Economics* 1

<sup>40</sup> Minnick K and Noga T, 'Do corporate governance characteristics influence tax management?' (2010) 16 *Journal of Corporate Finance* 703

can be extrapolated to other countries, the findings' external validity is limited in relation to jurisdictions whose context is too dissimilar from those studied here.

Second, the thesis' focus on large corporate taxpayers and their tax directors means that the view of two other important actors in the co-operative compliance relationship, tax administration officials and tax practitioners, is underrepresented. While the author did consult with a limited number of individuals belonging to these groups, these dialogues were informal and were focused on contextualising corporate taxpayers' results. Thus, the taxpayers' perspectives were not directly contrasted with those of their administrative counterparts and/or of practitioners (other than the author). Since views about the administration represent an important part of co-operative compliance's panorama, it is important that the research presented here is followed up by further research focused on the administration as a study unit.

Third, bearing in mind that co-operative compliance was introduced in the UK approximately in 2010 and has not been launched in Colombia as of 2019, and that the thesis' interviews were performed during 2016 and 2017, with supplementary UK quantitative analyses covering the years between 2013 and 2015, the research does not allow for pre and post co-operative compliance comparisons. This prevents the investigation from including a UK natural experiment design with co-operative compliance as a treatment. While the door is still open for such an investigation in Colombia, in case co-operative compliance is ever launched there, not having a temporal scope beyond 2017 places limits on the findings' ability to incorporate the effect of changes in variables beyond that year.

## CHAPTER 3

### TAXPAYER BEHAVIOUR UNDER ALTERNATIVE EXPLANATORY MODELS OF TAX COMPLIANCE

As explained in chapter one, this thesis seeks to analyse co-operative compliance's validity in the UK and Colombia by examining the degree of alignment between this type of regulation and the tax morale and behaviour of potential regulatees and the characteristics present in the context where the regulation is to operate. This chapter presents the main theories that endeavour to explain which variables influence taxpayer compliance behaviour, and that will be used as theoretical frameworks to analyse the results presented in Part II.

While various explanatory models focus on different variables as determinants of taxpayer behaviour, the contemporary debate centres around two main schools representing somewhat antagonistic ways of categorising taxpayers' intrinsic motivations: The expected utility school, and what we could call the socio-psychological school. While the differences between these two are complex, they can be simplified by saying that for the former, taxpayers are rational utility-centred actors that model their compliance by trying to maximise the (pecuniary) utility of their economic operations against the probability of having non-compliance detected and penalised, whereas for the latter, compliance is influenced not only by economic return, but rather by psychological and social factors such as social norms, trust in the administration, and/or ideas regarding the tax system's fairness. The practical impact of these models for regulatory policy is that, whilst the two models are not mutually exclusive, where the regulator sees taxpayers as utility maximisers, it is more

likely to engage in vertical, enforcement-centred regulation, while regulators adopting a view of taxpayer compliance focused on psychological and social variables are drawn towards horizontal, reciprocity-based regulation like co-operative compliance.

### **3.1. Regarding the expected utility rational model**

One of the two main models for understanding taxpayer compliance is the expected utility rational model, which stems from Allingham and Sandmo's pioneering study<sup>41</sup>, and which introduced a classical economics model borrowed from the economic analysis of crime to explain compliance as a function of the taxpayer's expected utility, risk aversion and a rational calculation where the monetary benefits of non-compliance are weighed against the costs associated with the detection and punishment of said non-compliance. Under this model, taxpayers, whose primary objective is utility maximisation (pecuniary) are faced with an uncertain outcome (detection or non-detection/penalty or no penalty) and make a compliance decision based on the probability they assign to the occurrence of non-compliance detection and its cost in terms of tax plus penalties versus the cost of paying the tax fully.

The expected utility framework has arguably been the most popular model to understand compliance, but it has faced increasing criticism from those who consider it a.) To be too focused on fear of punishment, b.) To be premised on a paradigm of a rational, utility maximising, calculating individual that does not account for the heterogeneity of behaviour that has been shown to exist

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<sup>41</sup> Allingham MG and Sandmo A, 'Income tax evasion: a theoretical analysis' (1972) 1 Journal of Public Economics 323

across different taxpayers and that conflicts with the bounded rationality<sup>42</sup> explored by behavioural economics, and c.) To undervalue group or societal determinants that might be equally or more important determinants of compliance than financial utility.

While Allingham and Sandmo do concede that the model could be construed to be too pecuniary in nature and propose the incorporation of reputational cost as an additional variable<sup>43</sup>, the criticism is that there are many other taxpayer-specific and context-dependent factors, such as the quality of the relationship with the administration, which the expected utility framework does not account for and which reduce its explanatory value.

Likewise, each of the model's variables can be interpreted differently by each taxpayer and do not fit easily into linear explanations. For example, while deterrence suggests that a higher penalty rate leads to lower non-compliance, that might not happen if the taxpayer perceives the legal system as weak/ineffective, meaning that even if non-compliance is detected, it might not be challenged or, even if challenged, it might not be penalised. Similarly, heuristic biases can affect taxpayer decisions. Thus, taxpayers might be convinced that their non-compliance will not be detected because it has never been in the past, when this has simply been an aleatory result. Additionally, taxpayers might have non-monetary motivations to comply or not comply. For example, they might intend not to comply because taxes are perceived as

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<sup>42</sup> See Pickhardt M and Prinz A, 'Behavioral dynamics of tax evasion – A survey' (2014) 40 *Journal of Economic Psychology* 1

<sup>43</sup> Allingham MG and Sandmo A, 'Income tax evasion: a theoretical analysis' (1972) 1 *Journal of Public Economics* 323

illegitimate, or because other corporations are seen as not complying (social benchmarking).

An additional area where the classic expected utility model struggles is temporality, since taxpayers, particularly sophisticated corporations, normally do not see compliance as a single-period phenomenon, but as a continuum where current decisions must be consequent with decisions taken in previous periods and are likely to impact future periods.

In terms of behavioural economics, the expected utility model's belief in perfect rationality can be questioned, since, as argued by Congdon et.al, findings suggest that 'people do not act rationally, that they are not perfectly self-interested, and that they hold inconsistent preferences'<sup>44</sup>. Thus, for Cullis, Jones, and Lewis, the taxpayer envisioned by this model is a 'caricature'<sup>45</sup> because it ignores the cognitive shortcomings that bias or bound rationality. Furthermore, for Dhami and Nowaihi, the traditional expected utility framework leads to over-predictions of non-compliance and its focus on the equivalence of losses and gains in the taxpayer equation fails to recognise the sensitivity issues (i.e. loss aversion) and reference point differences uncovered by prospect theory<sup>46</sup>.

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<sup>44</sup> Congdon WJ, Kling JR and Mullainathan S, 'Behavioral economics and tax policy' (2009) 62 National Tax Journal 375. Page 375.

<sup>45</sup> Cullis J, Jones P and Lewis A, 'Tax framing, Instrumentality and individual differences: Are there two different cultures?' (2006) 27 Journal of Economic Psychology 304. Page. 305.

<sup>46</sup> Dhami S and Al-Nowaihi A, 'Why do people pay taxes? Prospect theory versus expected utility theory' (2007) 64 Journal of Economic Behavior & Organization 171. Page 173.

Moreover, as pointed out by Alm et al<sup>47</sup>, one of expected utility's main flaws is that it wrongly assumes that the taxpayer is fully aware of its tax liabilities, so that non-compliance would be intentional. When dealing with highly complex corporate tax rules, even experts have differing interpretations of what complying with specific tax provision entails, so accidental non-compliance is a real possibility. Furthermore, the rules that corporations must apply in relation to matters like transfer pricing, tax abuse, or treaty application are by their own nature ambivalent, incorporate artificial benchmarks like the arm's length principle, and are riddled with grey areas. Thus, the notion of compliance may often be indeterminate.

Another difficulty is that the expected utility assumes that the probability of detection is constant, when in reality audits are not random and this means that a perfectly rational taxpayer would have to estimate the probability of being audited as a variable dependent on that taxpayer's economic circumstances, compliance record, and extra-legal factors like social visibility. Indeed, for large corporate taxpayers, what is normal is not random audits, but rather for tax authorities to create audit rules targeting taxpayers that have been *red-flagged*, usually because their returns deviated from sector benchmarks, being classified in a high risk category on account of their deficient tax risk management or previous compliance record, whistleblowing, third party cross-information, or being highly visible socially.

Additionally, taxpayers are unlikely to know the probability of audit beforehand, meaning there will always be an element of information asymmetry

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<sup>47</sup> Alm J and others, 'Taxpayer information assistance services and tax compliance behavior' (2010) 31 Journal of Economic Psychology 577

that renders rational calculation an impossibility. Even under co-operative compliance disclosure, what tax authorities are willing to reveal is only the framework under which they will respond to certain types of taxpayer behaviours (refer to the tiered intervention system discussed in chapter eight), but not the exact algorithms or administrative cut-off rules that are used to guide audit and enforcement strategies.

While it might be more credible regarding individual taxpayers, the idea that taxpayers act based on a calculation of the full tax and penalties times the likelihood of detection is not very accurate regarding corporate taxpayers because they know that audits are rarely successful in detecting the full extent of non-compliance and that, even when that is the case, it is by no means assured that the administration will secure the payment of full taxes plus penalties, as insufficient evidence or other circumstances may lead to a settlement or a successful challenge by the taxpayer of the administration's proposed amendments and sanctions.

When analysed exclusively from a monetary gain perspective, expected utility is also problematic for explaining the behaviour of the tax administration. Indeed, models like the one proposed by Caballé and Panadés<sup>48</sup>, where auditors gauge interventions based on the expected net revenue, fail to incorporate other factors such as the auditors' interest in auditing well-known taxpayers to send a signal to reference peers, or the fact that audits are often more intense for taxpayers that have been previously labelled as suspicious, regardless of the potential revenue involved. Additionally, auditors' efforts might change because

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<sup>48</sup> Caballé J and Panadés J, 'Cost Uncertainty and Taxpayer Compliance' (2005) 12 Int Tax Public Finance 239

of individual-specific psychological variables such as ideology, personal sympathy (or dislike) for the taxpayer, or contextual variables like political pressure.

### **3.1.1. Tuning up the expected utility model**

The standard expected utility model has seen some refinements since its inception. For example, the probability of detection is now seen as dynamic, increasing as the amount evaded increases and varying based on the fraction of the taxpayer base that is subject to withholdings<sup>49</sup>.

The model has also seen the introduction of ethics considerations in the form of the possible disutility experienced by remorseful taxpayers. Thus, a variable represents the cost of the remorse from non-compliance or, alternatively, the utility obtained from complying, whenever the taxpayer's moral code values honesty positively<sup>50</sup>. Taxpayers might comply, not only because of risk aversion and the rational calculation of tax rates, audit probabilities and penalties, but also because of their morale.

Whilst the model of expected utility was initially devised to explain individual tax decisions equating tax evasion with non-compliance, contemporary researchers have created similar models addressing corporate taxpayers and other tax behaviours such as the use of tax shelters. For example, Lin et. al rely on a rationally-calculating corporate taxpayer to create a model according to which firms strive to maximise the value of their total assets

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<sup>49</sup> Dhami and Al-Nowaihi, 'Why do people pay taxes? Prospect theory versus expected utility theory'

<sup>50</sup> Eisenhauer JG, 'Ethical preferences, risk aversion, and taxpayer behavior' (2008) 37 The Journal of Socio-Economics 45

by choosing different tax aggression settings<sup>51</sup>. Similarly, in Slemrod and Gillitzer's 'tax systems perspective', the expected utility model is refined by incorporating compliance and administrative costs, taxpayer and administrative cognitive limitations, the possibility of taxpayers engaging in tax avoidance, and policy limitations and complexities<sup>52</sup>.

### **3.2. The *Slippery Slope* Framework**

While the expected utility model tries to make sense of compliance as a function of risk, enforcement and deterrence in a context where taxpayers behave strategically seeking to maximise their utility, another strand of explanatory models focuses on non-pecuniary psychological and social variables as determinants of tax compliance. Among these, the leading contemporary theory is the 'Slippery Slope Framework', conceived by Kirchler, Hoelzl, and Wahl<sup>53</sup>.

This model, which seeks to address the perceived weaknesses of the expected utility compliance model, proposes that the interactions between taxpayers and the administration are a function of the attitudes that each one of these actors assumes towards the other. Thus, compliance is influenced by the context in which taxpayers and tax authorities interact. This context, the 'climate', ranges from a confrontational pole, the 'antagonistic climate', to a co-operative pole, the 'synergistic climate'. In an antagonistic climate, like the one that characterises jurisdictions like Colombia, where traditional vertical

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<sup>51</sup> Lin S, Tong N and Tucker AL, 'Corporate tax aggression and debt' (2013) 40 Journal of Banking and Finance 227

<sup>52</sup> Slemrod J and Gillitzer C, 'Insights from a Tax-systems Perspective' (2014) 60 CESifo Economic Studies 1

<sup>53</sup> Kirchler, Hoelzl and Wahl, 'Enforced versus voluntary tax compliance: The "slippery slope" framework'

enforcement is applied, the taxpayer-administration interaction is characterised by mutual suspicion. This generates a social distance and mistrust that can incentivise/justify game-playing attitudes from taxpayers and therefore reduce voluntary compliance<sup>54</sup>.

In contrast, under a synergistic climate, authorities adopt a client-focused approach and are consequently perceived as legitimate by taxpayers; parties show respect for each other, social distance is expected to be low, and voluntary compliance is likely to increase as an effect of compliance based on the strength of taxpaying convictions<sup>55</sup>. The notion of a synergistic climate fits comfortably with co-operative compliance, where the taxpayer-administration relationship is assumed to be amiable and collaborative, rather than antagonistic or contentious, and parties act guided by mutual trust and reciprocity. According to later refinements introduced by Gangl et.al, the synergistic climate is further divided between a service climate, associated with voluntary compliance, reason-based trust and legitimate power, and a confidence climate, associated with committed tax cooperation and implicit trust<sup>56</sup>.

An essential aspect of the slippery slope framework is its assumption that the framework's different variables are dynamic and change patterns in different contexts. Variables are expected to operate in one way in environments

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<sup>54</sup> Ibid

<sup>55</sup> See Alm and others, 'Taxpayer information assistance services and tax compliance behavior'

<sup>56</sup> Gangl K, Hofmann E and Kirchler E, 'Tax authorities' interaction with taxpayers: A conception of compliance in social dilemmas by power and trust' (2015) 37 *New Ideas in Psychology* 13

characterised by enforced compliance and in another where voluntary compliance prevails<sup>57</sup>.

The slippery slope framework is premised upon the existence of two dimensions which exert a joint influence on taxpayer compliance: the perceived 'power' of tax authorities, and the 'trust' in tax authorities. Power refers to the taxpayers' perception about the ability of the tax authorities to detect and act upon non-compliance<sup>58</sup>. Trust refers to the taxpayers' degree of conviction about tax authorities being motivated by public welfare and acting consequently<sup>59</sup>.

The power of tax authorities is not only a scale concept (low to high), but can also take different forms, since power can be seen as legitimate or as coercive. Power is legitimate when regulatees accept authority and defer to it, whereas it is coercive when regulatees feel they are being forced to act against their will.<sup>60</sup> For Kastlunger et.al, coercive power has also been defined as harsh power that combines punishment and remuneration as responses to non-cooperation and cooperation, respectively, whereas legitimate power is understood to be a form of soft power that accounts for the effect of knowledge (expertise and information), identification and legitimization in determining compliance. The different forms of power are not intended to be mutually

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<sup>57</sup> Muehlbacher S and Kirchler E, 'Tax Compliance by Trust and Power of Authorities' (2010) 24 *International Economic Journal* 607

<sup>58</sup> Kogler C and others, 'Trust and power as determinants of tax compliance: Testing the assumptions of the slippery slope framework in Austria, Hungary, Romania and Russia' (2013) 34 *Journal of Economic Psychology* 169

<sup>59</sup> Wahl I, Kastlunger B and Kirchler E, 'Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the "Slippery Slope Framework"' (2010) 32 *Law & Policy* 383

<sup>60</sup> Kirchler, Hoelzl and Wahl, 'Enforced versus voluntary tax compliance: The "slippery slope" framework'. Page 213.

exclusive<sup>61</sup>. For example, the administration might try to influence behaviour both by recurring to its tax know-how, its authority under the rule of law, and the offer of rewards or threat of punishments. In later developments, the concept of legitimate power was replaced with that of persuasive power, with the latter being characterised by service quality to increase the cooperation of 'compliance-minded' taxpayers, particularly in situations of legal uncertainty<sup>62</sup>. This provides support for the idea that co-operative compliance can increase both trust and power, thus maximising voluntary compliance.

Regarding trust, Gangl et.al introduce the differentiation between reason-based trust and implicit trust, with the first referring to trust based on knowledge and rational processing, and the second corresponding to trust generated by identification, habit, social conformity, or affection<sup>63</sup>. What separates the two is that the former is the result of a deliberate, instrumental mental calculation that pre-empts action, whereas the latter is unintended and irrational, an unconscious impulse activated as a response. As with the different types of power, reason-based trust and implicit trust can operate independently but can also coexist. These authors hypothesize that, as it increases and becomes routine, reason-based trust can transform into implicit trust. This will be revisited in relation to the UK in chapter six.

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<sup>61</sup> Kastlunger B and others, 'Powerful authorities and trusting citizens: The Slippery Slope Framework and tax compliance in Italy' (2012) 34 *Journal of Economic Psychology* 36

<sup>62</sup> Prinz A, Muehlbacher S and Kirchler E, 'The slippery slope framework on tax compliance: An attempt to formalization' (2014) 40 *Journal of Economic Psychology* 20. Page 21.

<sup>63</sup> Gangl, Hofmann and Kirchler, 'Tax authorities' interaction with taxpayers: A conception of compliance in social dilemmas by power and trust'. Page 16.

A crucial aspect of the slippery slope framework is that power and trust are considered to interact with each other so that when both dimensions are low, overall compliance is at its lowest and when both dimensions are high, overall compliance is at its highest. When the dimensions are experiencing opposite values, high compliance is still present, but focuses either on voluntary compliance (present when trust is high, regardless of low power) or on enforced compliance (present when power is high, regardless of low trust)<sup>64</sup>. In a voluntary compliance setting, the taxpayer complies willingly, exercising autonomy and is unconstrained. Conversely, under enforced compliance the taxpayer is fulfilling its duties not because they wanted to, but rather because of the threat of civil and/or criminal penalties, the perceived likelihood of their imposition and the taxpayer's risk appetite or aversion. This distinction matters because the sort of disclosure, self-regulation, and collaborative mindset expected from taxpayers by co-operative compliance is supported by deterrence, but ultimately depends on voluntary commitment.

The slippery slope framework's complexity is best captured by the notion that power and trust interact dynamically and not necessarily along a straight line. Depending on the context, changes in trust lead to changes in power, and vice versa. The directions of these changes are not univocal, so in some cases an increase in one of the dimensions might lead to a corresponding increase in the other dimension, whereas in others it might lead to a decline. Thus, tests performed by Wahl et al. reveal that strategic taxpaying behaviour (non-compliance when detection is unlikely, compliance when detection is likely)

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<sup>64</sup> Kirchler, Hoelzl and Wahl, 'Enforced versus voluntary tax compliance: The "slippery slope" framework'

changes as a function of the interaction between high and low levels of tax authority power and trust. According to these authors, strategic taxpaying behaviour is generally higher in low trust conditions than in high trust conditions and increases with high power/low trust and low power/high trust combinations. Thus, 'taxpayers exploit loopholes in the tax surveillance system, preferably when authorities act in an untrustworthy way and exert much power over them.'<sup>65</sup>

Gangl et.al<sup>66</sup> argue that implicit trust and coercive power mutually decrease each other (taxpayers who inherently trust authorities do not require fines and audits, and harsh treatment from the authorities may lead taxpayers to adopt a game-oriented approach because they feel they are not trusted), that legitimate power and reason-based trust are mutually increasing, that coercive power and reason-based trust are bridged by legitimate power, and, finally, that legitimate power relates to implicit trust through the intervention of reason-based trust.

The following pages discuss other theories that seek to elucidate taxpayer compliance decisions, and which also provide theoretical support for the analyses of co-operative compliance's validity carried out in parts II and III.

### **3.3. Taxpayer Motivational Postures**

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<sup>65</sup> Wahl, Kastlunger and Kirchler, 'Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the "Slippery Slope Framework"'. Page 399.

<sup>66</sup> Gangl, Hofmann and Kirchler, 'Tax authorities' interaction with taxpayers: A conception of compliance in social dilemmas by power and trust'

Another explanatory model focused on non-pecuniary factors is V.Braithwaite's theory of motivational postures, which categorises taxpayers based on their psychology and the way in which it leads them to interact with tax authorities.

While this theory was originally crafted with individual taxpayers in mind, the author believes that its premises are also applicable to corporate taxpayers, since these organisations also have a distinct approach to taxation encompassing both ideological and behavioural dimensions. Thus, for Braithwaite, postures are the result of a combination of multiple aspects of the regulatory subject's beliefs and have the flexibility to mould themselves as a function of the context. According to her,

'motives can combine with desires, beliefs, feelings, and values to shape a distinctive posture to the regulatory system'<sup>67</sup>

Unlike individuals, in a corporation, multiple stakeholders like the tax director or board members input their own personal norms to create a distinct organisational tax culture. Nevertheless, a corporation's tax culture does include a specific stance towards the regulator that is capable of being analysed like that of an individual regulatee.

Motivational postures attempt to explain compliance as a function of the interaction between regulators and regulatees that is marked by the level of connectedness existing between them, defined as the 'degree to which the regulator and the regulatee are of one mind on the ways and means to achieve goals'<sup>68</sup>. For co-operative compliance, this means that effective compliance

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<sup>67</sup> Braithwaite V, 'Games of Engagement: Postures Within the Regulatory Community\*' (1995) 17 Law & Policy 225. Page 225.

<sup>68</sup> Ibid. Page 226.

depends on the parties sharing the goal of achieving high levels of tax compliance and agreeing on cooperating in an exchange of legal certainty and procedural fairness for transparency and sound tax risk management as the means to achieve this. The difficulty is that, whilst both parties may agree on the need to achieve high compliance, their definition of compliance is likely to differ, and the benchmarks of what each party considers to be procedural fairness, sound tax risk management, legal certainty and transparency are probably also dissimilar.

Following Braithwaite, Murphy, and Reinhart, one of the social and psychological factors that may prove crucial in determining a taxpayer's beliefs and behaviours in relation to taxes is the way in which the taxpayer in question relates to authority in general<sup>69</sup>. According to these authors, taxpayers manifest different levels of closeness or distance to authorities. Thus, a taxpayer's motivational posture towards tax authorities is essentially a combination of a subject's tax morale and their tax behaviour in relation to tax authorities. Since a posture is a relational concept, meaning it impacts the way in which subjects interact, motivational postures regarding tax authorities would be narrower than the whole scope of a taxpayer's tax morale and tax behaviour, as these would also comprise beliefs, attitudes and behaviours towards actors other than the tax authorities, like fellow taxpayers, tax practitioners, the public, and NGOs.

The connection between Braithwaite's original motivational postures (managerial accommodation, capture, resistance, and disengagement) and corporate taxpayer behaviour in relation to co-operative compliance is

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<sup>69</sup> Braithwaite V, Murphy K and Reinhart M, 'Taxation Threat, Motivational Postures, and Responsive Regulation' (2007) 29 Law & Policy 137

strengthened by Braithwaite et.al's subsequent idea of supra-postures. According to it, taxpayers also display two supra-postures: 'resistance-cooperation', and 'dismissiveness', the first determining the taxpayer's degree of approval of the objectives and tactics of the administration, and the second referring to the legitimacy and power that is conferred to tax authorities<sup>70</sup>. Under this theory, for cooperation to take place, taxpayers would be expected to display either a committed or 'capitulative' posture, potentially coupled with the belief that taxation is morally positive. In contrast, resistant or disengaged taxpayers would be expected to be associated with negative emotional responses to taxation and to display a *supra-posture* of resistance or of dismissiveness. What remains unanswered is how to expect game-playing taxpayers to behave, since both instrumental cooperation and resistance could be possible. Additionally, a single taxpayer can display multiple postures simultaneously; for example, a corporation may be cooperative in relation to VAT, but show resistance in relation to transfer pricing compliance.

#### **3.4. Procedural Justice and fairness-based models**

The final section of this chapter covers theories which highlight the role of taxpayers' perceptions of fairness as a determinant of their tax compliance. Fairness, is not an unambiguous concept when viewed as a determinant of tax compliance, since perceptions about justice or fairness may refer to very different benchmarks such as distributive justice, understood as the fairness of the parameters for resource distribution; procedural justice, referring to the evaluation of the fairness of the methods by which said distribution takes place;

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<sup>70</sup> Ibid

and, retributive justice, assessing the fairness of the treatment afforded to non-compliant taxpayers.

While most research on the role of fairness perceptions in relation to compliance has focused on distributive justice and issues such as the impact that the perceived equity of the tax exchange<sup>71</sup> (public services and goods for taxes paid), or perceptions of relative tax contributions<sup>72</sup> have on taxpayers, the research that is more relevant to this thesis refers to the fairness of the taxpayer-administration relationship as a determinant of compliance. For Ahmed and Braithwaite, the procedural dimension of fairness refers to perceptions about being treated correctly in terms of the procedures and practices that guide the taxpayer's interaction with tax authorities<sup>73</sup>. Additionally, procedural fairness can be connected to Frey's concept of respectful treatment, which evaluates the transparency and clarity of administrative audit procedures as well the degree of respect granted by tax officials to the taxpayer's individual - or organisational-personality<sup>74</sup>. Thus, since this thesis is focused on the validity of a model on how the administration should relate to taxpayers, considerations about what Wenzel labels 'fairness of procedures and treatment'<sup>75</sup> are crucial. According to him, the

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<sup>71</sup> See Kim CK, 'Does fairness matter in tax reporting behavior?' (2002) 23 *Journal of Economic Psychology* 771

<sup>72</sup> Spicer MW and Hero RE, 'Tax evasion and heuristics: A research note' (1985) 26 *Journal of Public Economics* 263

<sup>73</sup> Ahmed E and Braithwaite V, 'Understanding Small Business Taxpayers: Issues of Deterrence, Tax Morale, Fairness and Work Practice' (2005) 23 *International Small Business Journal* 539

<sup>74</sup> Frey BS, 'Deterrence and tax morale in the European Union' (2003) 11 *European Review* 385. Page. 392

<sup>75</sup> Wenzel M, 'The Multiplicity of Taxpayer Identities and Their Implications for Tax Ethics' (2007) 29 *Law & Policy* 31

link between perceptions of fairness and compliance comes from the association between legitimacy, fairness, and tax morale:

Perceptions of unfairness may also reduce satisfaction with, or the perceived legitimacy of, the tax system; and this leads to resentment, resistance, and a reduced sense of moral obligation to comply with tax laws [and] people sometimes hold personal ethics and believe in social norms that they think justify or legitimize acts of tax minimization<sup>76</sup>

Previous research has argued that legitimacy is directly proportional to a compliant tax morale, so higher levels of legitimacy would serve as the basis for establishing a set of compliance-oriented attitudes and beliefs in taxpayers which should translate into compliant tax behaviours. Thus, Braithwaite and Ahmed state that a 'loss of legitimacy accompanies less moral obligation to comply, in this case reduced tax morale.'<sup>77</sup>

However, some theories regarding procedural fairness also incorporate aspects of distributive justice. Thus, according to Stalans and Lind, procedural fairness is evaluated by taxpayers along two separate dimensions: instrumental concerns and relational concerns. Regarding the former, taxpayers assess the costs of their interactions with the administration and their outcome, whereas the latter involves analysing how the taxpayers felt the administration was treating them<sup>78</sup>. While instrumental concerns would be part of the compliance equation, relational concerns primarily centred at evaluating the dignity of the

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<sup>76</sup> Ibid. Pages 32-33.

<sup>77</sup> Braithwaite V and Ahmed E, 'A threat to tax morale: The case of Australian higher education policy' (2005) 26 *Journal of Economic Psychology* 523. Page 524.

<sup>78</sup> Stalans L and Lind EA, 'The meaning of procedural fairness: A comparison of taxpayers' and representatives' views of their tax audits' (1997) 10 *Social Justice Research* 311

treatment given and conformity with social norms are seen to be more material in a taxpayer's procedural fairness judgment.

Some of the factors involved in judging an administrative process as fair are its neutrality, whether the treatment accorded to parties was dignified<sup>79</sup>, whether the authorities were professional and competent, reasonable and approachable, and whether audits were concluded and decisions produced in a timely fashion. As is discussed in Parts II and III, this last aspect is crucial for co-operative compliance. Additionally, procedural fairness has been shown to be associated with the taxpayer's belief that they are listened to by the administration<sup>80</sup>. Responses from both samples show that all these factors are seen to be important for the taxpayers' assessments of their respective administrations.

The importance of the perceptions of fairness as a determinant of tax compliance is highlighted by Bazart and Bonein<sup>81</sup>, who found that taxpayers respond to advantageous or disadvantageous inequities in tax compliance with reciprocal positive or negative behaviour. Thus, taxpayers who felt that they were being disadvantaged by inequities caused by the State or who perceive that other taxpayers do not comply could reduce their compliance. Co-operative compliance depends on reciprocity (see chapter four); thus, the concern is that positive dynamics of reciprocity like disclosure in exchange for legal certainty

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<sup>79</sup> Stalans and Lind include within this category feelings regarding politeness, respectfulness, friendliness and sympathy (ibid, Page 318).

<sup>80</sup> Murphy K, 'Enforcing Tax Compliance: To Punish or Persuade?' (2008) 38 Economic Analysis and Policy 113

<sup>81</sup> Bazart C and Bonein A, 'Reciprocal relationships in tax compliance decisions' (2014) 40 Journal of Economic Psychology 83

would only be sustainable where taxpayers felt fairly treated<sup>82</sup>. Furthermore, these authors also found that individuals adjust their tax reporting decisions to approximate them to what they perceive their peers' taxation to be, since they are particularly sensitive to horizontal inequity. In fact, the impact of the perception of horizontal inequities is said to be higher than that of vertical inequities. This highlights the fact that the success of regulatory models like co-operative compliance does not only depend on how each regulatee is treated, but also on how they perceive other taxpayers to be treated. Although interviewees in both the UK and Colombia perceived their peers to be broadly compliant, the convenience of putting in practice name and shame policies and of the zealous efforts to communicate the extent of what is perceived to be corporate non-compliance should be examined, since the deterrence element brought about by shame could be nullified by the negative reciprocal behaviour resulting from compliant taxpayers perceiving that their peers are less compliant than them. Conversely, policies oriented to communicate examples of compliance and/or of systemic fairness could enhance compliance.

Furthermore, as pointed out by Kirchler, Kogler, and Muehlbacher<sup>83</sup>, a taxpayer's evaluation of the tax system as fair or unfair depends not only on judging whether the system adheres to the principles or values that the taxpayer sees as ideal, but also to an assessment of the absolute gains or losses that the

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<sup>82</sup> As argued by Gribnau in the wider context of voluntary corporate tax compliance, reciprocity can be crucial to guide taxpayer behaviour, even in the absence of formal legal obligations. See Gribnau H, 'Voluntary Compliance beyond the Letter of the Law: Reciprocity and Fair Play' in Peeters B; Gribnau, H; Badisco, J (ed) *Building Trust in Taxation* (Intersentia 2017).

<sup>83</sup> Kirchler E, Kogler C and Muehlbacher S, 'Cooperative Tax Compliance' (2014) 23 *Current Directions in Psychological Science* 87

taxpayer experiences, and about the way in which they feel those gains or losses compare in relation to their peers or other sectors of society (relative tax burden). In the case of co-operative compliance, this suggests that taxpayers' assessment of the regulatory model as fair depends both on the model's alignment with taxpayer ideals, and on whether the taxpayer believes that participating in the programme has represented a gain equal to or better than that of its peers. Hence, it is important to note that the way in which authorities conduct themselves in their interaction with taxpayers does not only impact the way in which said taxpayers evaluate them in terms of legitimacy and fairness, but also the monetarily-quantifiable compliance burden they are subjected to. In fact, according to research performed by Eichfelder and Kegels on Belgian businesses, "a customer-unfriendly tax administration increases the average compliance burden by about 27%"<sup>84</sup>.

Finally, the analysis of the role of fairness in determining tax compliance should be open to the idea that the relationship between the two variables might not be unidirectional, meaning that, whilst perceptions of procedural and other dimensions of fairness might affect compliance, a pre-existing attitude towards compliance might be justified or rationalised with arguments about the fairness or unfairness of outcomes or procedures<sup>85</sup>. Thus, while taxpayer perceptions about procedural or distributive unfairness may erode their voluntary compliance, it is also possible that other factors could have already

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<sup>84</sup> Eichfelder S and Kegels C, 'Compliance costs caused by agency action? Empirical evidence and implications for tax compliance' (2014) 40 *Journal of Economic Psychology* 200. Page 200.

<sup>85</sup> Verboon P and Van Dijke M, 'A self-interest analysis of justice and tax compliance: How distributive justice moderates the effect of outcome favorability' (2007) 28 *Journal of Economic Psychology* 704. Page 722.

predetermined a taxpayer's non-compliance, and fairness arguments are used instrumentally to justify a posture seen as socially undesirable.

## **CHAPTER 4**

### **THE PARADIGM OF CO-OPERATIVE COMPLIANCE AND CORPORATE TAXPAYERS**

The aim of this chapter is to present the reader with the elements that the author believes characterise co-operative compliance as a distinct regulatory paradigm. To contribute to the theoretical framework against which empirical results are contrasted in Part II, and which provides foundations for the thesis' normative proposals, this chapter deconstructs co-operative compliance into its defining characteristics, advantages and disadvantages..

The chapter starts by positioning co-operative compliance within the larger genre of responsive regulation. Subsequently, it addresses each of the elements considered to be characteristic features of this type of regulatory approach and which are expected to be present regardless of the heterogeneity attributable to country-specific policies. These elements are: horizontality, voluntariness, transparency and disclosure, reciprocity, and risk-based responsiveness. Afterwards, the chapter discusses legal certainty, the role of trust, proactive regulation, and deterrence.

Finally, the chapter concludes with an overview of some of the problems like regulatory capture, selective disclosure, weak accountability, and organisational challenges, that have been identified as potential shortcomings of co-operative compliance. Throughout the chapter, co-operative compliance is analysed in reference to large corporate taxpayers and corporate income taxation, but many of the discussions presented here could be extrapolated to other fields of regulation and/or to other regulatees.

#### **4.1. Summary of co-operative compliance's main features and objectives**

In its 2008 Report on Tax Intermediaries<sup>86</sup>, the OECD, which together with Australia and the Netherlands has been one of strongest advocates of co-operative compliance, devised a series of 'pillars' that summarize what, in its view, constitutes the core of a taxpayer-administration enhanced relationship – later to renamed 'co-operative compliance' following the OECD's 2013 Report<sup>87</sup>. The pillars are split into tenets applicable to the revenue authority and those applicable to the taxpayer. For the revenue authorities, these involve: 1. Demonstrating an understanding based on commercial awareness, 2. Being impartial, 3. Being proportional, 4. Relying on disclosure to provide openness and transparency, and 5. Showing responsiveness. For taxpayers, the essential elements are: 1. Disclosure, and 2. Transparency. The fact that the pillars cover both parties corresponds to the fact that co-operative compliance, unlike other regulatory approaches, is eminently bilateral.

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<sup>86</sup> OECD, *Study into the Role of Tax Intermediaries* (Paris: OECD Publishing 2008)

<sup>87</sup> OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance*

In another source which was important in popularising co-operative compliance, the International Fiscal Association's Enhanced Relationship Project Key Issues Report, co-operative compliance is described as having ten main features: voluntary regulatee participation; the relationship is institutional (not personal); it is primarily based on expressed intentions rather than on rules, it is constructed upon trust, respect, mutual understanding, transparency and reciprocity; involves active disclosure and real-time legal certainty to maximise efficiency; is focused on the process that leads to rather than the tax outcome; incorporates mutually-agreed risk identification and disclosure mechanisms; relies on the administration being willing to disclose its views on tax positions upon request and with some degree of binding effect; respects existing rights and obligations, and focuses administrative interventions on risk identification and confirming the taxpayer's disclosures. A particular characteristic of IFA's definition is that it ties compliance with the language used in contemporary anti-abuse provisions, since it states that the correct amount of tax must 'take into account the spirit and purpose of the tax law (rather than merely the letter of the law)'<sup>88</sup>.

Accordingly, the ideal co-operative dynamic is one where the taxpayer voluntarily discloses to the administration all aspects that are material for the determination of its tax obligations, and also for enabling the administration to construct a profile of the taxpayer that allows it to calibrate its response according to criteria like the risk of non-compliance. In exchange for this transparent disclosure, the administration uses its commercial awareness to

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<sup>88</sup> International Fiscal Association, *Key Issues Report: Initiative on the Enhanced Relationship*, (2012). Pages 17-18.

provide a proportional and impartial response that encourages self-regulation and dialogue, provides the taxpayer with timely<sup>89</sup> legal certainty, allocates administrative resources efficiently<sup>90</sup>, and enhances compliance.

In terms of the enhancing efficiency, co-operative compliance has the objective of reducing information asymmetry by relying on closer contact and dialogue between the parties. The premise is that, because the corporation knows its business best, if the administration chooses a regulatory approach where parties are more distant, it would struggle with obtaining the information needed to assess compliance, whereas if the taxpayer discloses that information voluntarily, there is no struggle to obtain information and consequently collection costs are reduced.

The OECD pillars described above offers an interesting opportunity to identify some of the elements which characterise co-operative compliance, and as such, to capture the assumptions regarding regulator and regulatee behaviour that are empirically tested as part of this investigation. Thus, the design of the qualitative instruments used in this thesis takes into account the need to question whether corporations and their tax officers model their tax behaviour based on a perception of equality between themselves and the administration or not, if they are willing to be transparent and engage in disclosure, whether they see the tax administration as a trustworthy, the importance they assign to legal certainty, taxpayers' propensity to engage in

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<sup>89</sup> De Simone L, Sansing RC and Seidman JK, 'When are Enhanced Relationship Tax Compliance Programs Mutually Beneficial?' (2013) 88 Accounting Review 1971. Page 1972

<sup>90</sup> Freedman, Loomer and Vella. *Analyzing the Enhanced Relationship Between Corporate Taxpayers and Revenue Authorities: A U.K. Case Study*

strategic self-interested behaviour, and whether the reduction of costs is a guiding objective, among others. Likewise, the empirical research carried out is focused on the expectations that taxpayers have in relation to the values that should guide the administration's practices and whether these coincide with the elements signalled out in this chapter; for example, is the administration perceived as open and transparent, is it understood to be commercially aware, are taxpayers treated responsively, and is legal certainty provided to them?

To deconstruct the elements that make co-operative compliance a distinct paradigm, one of the first tasks is to understand what this regulatory approach's ultimate objective is. As with other regulatory approaches, the main objective is to enhance compliance; what changes is that co-operative compliance seeks to do this by establishing a partnership between regulators and regulatees, and the fact that the regulator seeks to fulfil multiple other ancillary objectives like increasing efficiency (both in complying and collecting), reducing tax disputes, reducing information asymmetry, or enhancing interparty trust.

Defining tax compliance is a fascinating and controversial subject; given the pressures of space, this vast topic can only be dealt with briefly here to address an issue which is crucial for co-operative compliance: what is the administration entitled to demand from taxpayers when assessing their tax compliance under this type of regulation? For the author, compliance should be understood to mean fulfilling the mandates of applicable tax laws, both in relation to formal (filing returns, information reporting, etc.) and substantive (paying tax, acting as a withholding agent, etc.) tax obligations. This coincides with the

definitions used by HMRC<sup>91</sup> and the Netherlands Tax and Customs Administration, which refer to paying the right amount of tax at the right time<sup>92</sup>, but also incorporates the dimension of formal obligations.

Given the complexity and open texture which characterise tax rules, different parties will often interpret the law differently and, consequently, disagree on what the “right tax” is. The author believes that compliance should be understood as compliance with the law as the courts would interpret it. While different jurisdictions will apply different methods of interpretation to assess the intent of the law, it is essential that the context, and not only the letter of the law are complied with. This matches the definition proposed by the IFA in its Enhanced Relationship Report<sup>93</sup>.

The importance of the principle of legality means that complying with the law should not be equated with complying with the administration’s interpretation of the law - or the taxpayer’s interpretation, for that matter. Thus, the author endorses Devereux, Freedman, and Vella’s call for the administration to enforce compliance with the law as it is, rather than what it would want it to be:

The duty of HMRC, or any tax authority, can only be to collect the tax due under the law interpreted in accordance with the accepted canons of

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<sup>91</sup> HMRC defines tax compliance risk as the risk of an ‘incorrect tax being to, or reclaimed from, the Exchequer’ (Tax Compliance Risk Management Guidance 2100). This guidance refers to the objective of risk assessments as determining whether a taxpayer is ‘capable of paying the right tax at the right time’ (TCRM3341).

<sup>92</sup> The NTCA’s Horizontal Monitoring Manual connects compliance to the taxpayer’s willingness to ‘fulfil their statutory obligations’, including filing correct and complete returns and paying the tax, all in a timely fashion. Netherlands Tax and Customs Administration, *Horizontal Monitoring Within: The medium to very large businesses segment* (2010). Page 9.

<sup>93</sup> This definition refers to the need to account for the spirit and purpose ‘rather than merely the letter of the law’. See: International Fiscal Association. *Key Issues Report: Initiative on the Enhanced Relationship*. Page 17.

interpretation. Steps taken to induce behaviour which requires taxpayers to go further than this would be of questionable constitutionality.<sup>94</sup>

Co-operative compliance is a mechanism to ensure the application of the law and reduce the likelihood of accidental or intentionally breaking the rules, not a way to reduce or increase applicable tax obligations. Thus, approaches like HMRC's, which associate the risk of non-compliance with factors like adopting an 'innovative interpretation of tax law' or being 'involved in tax planning other than that which supports genuine commercial activity'<sup>95</sup> can, if not carefully implemented, lead to a situation where compliance is wrongfully equated with the taxpayer having to share the administration's interpretation of the law, rather than an interpretation which would be approved by the courts. This would be damaging because it would encourage over-compliance and threaten the rule of law. Therefore, administrations that explicitly aim to make taxpayers' planning behaviour more conservative, as is the case with HMRC – but not most other administrations working under co-operative compliance<sup>96</sup>, must exercise care to differentiate abusive tax planning, which is illegal, from planning where the taxpayer adopts a position that the administration disapproves of, but which could prevail on appeals. Using tax planning should not be used to exclude taxpayers from co-operative compliance, unless this planning breaks the law and, is not a one-off event, and is material.

Returning to co-operative compliance's goals, for Akhand, the driving force behind co-operative compliance is increasing voluntary compliance, with

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<sup>94</sup> Devereux M, Freedman J and Vella J, *Paper 1: Tax Avoidance* (Oxford University Centre for Business Taxation 2012).Page 15.

<sup>95</sup> HMRC, Tax Compliance Risk Management guidance. Section 3330.

<sup>96</sup> E.g., the Irish Revenue acknowledges that 'tax planning is an important part of financial management for businesses' and that what matters is that the taxpayer discloses their planning strategies. See <https://www.revenue.ie/en/companies-and-charities/cooperative-compliance/drawing-up-an-action-plan.aspx>

the reduction of compliance costs as an auxiliary objective<sup>97</sup>. For De Simone et.al, what co-operative compliance seeks is primarily to solve tax disputes in a timely fashion<sup>98</sup>. Freedman, Vella, and Loomer described co-operative compliance in the UK as oriented towards improving administrative resource allocation, reducing compliance costs and, interestingly, shaping taxpayer behaviour by making taxpayer behaviour less aggressive<sup>99</sup>. This last goal can relate to co-operative compliance's reliance on taxpayer administrative profiling and the use of conditionality and the threats/rewards of achieving or maintain a desired profile to influence regulatee behaviour. Finally, for Job et.al, co-operative compliance was designed with goals that included acquiring a greater understanding of taxpayer behaviour, encouraging compliance, establishing a differentiated penalty system to diminish disputes and their accompanying costs, enhancing procedural fairness and strengthening taxpayer's rights<sup>100</sup>.

#### **4.1.1. Co-operative compliance under Coglianese and Mendelson's regulatory approach analysis**

Using Coglianese and Mendelson's catalogue of essential characteristics of a regulatory approach involves determining co-operative compliance's target, regulator, command, and consequences<sup>101</sup>. Whilst co-operative compliance is

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<sup>97</sup> Akhand Z, 'How compliant are the large corporate taxpayers? The Bangladesh experience' (2015) 13 eJournal of Tax Research 581. Page 582.

<sup>98</sup> De Simone, Sansing and Seidman, 'When are Enhanced Relationship Tax Compliance Programs Mutually Beneficial?'. Page 1972.

<sup>99</sup> Freedman, Loomer and Vella. Analyzing the Enhanced Relationship Between Corporate Taxpayers and Revenue Authorities: A U.K. Case Study.

<sup>100</sup> Job J, Stout A and Smith R, 'Culture Change in Three Taxation Administrations: From Command-and-Control to Responsive Regulation' (2007) 29 Law & Policy 84. Page 90.

<sup>101</sup> Coglianese C and Mendelson E, 'Meta-Regulation and Self-Regulation' in Martin Cave Robert Baldwin, and Martin Lodge (ed), *The Oxford Handbook of Regulation* (The Oxford Handbook of Regulation, Oxford University Press 2010). Page 3.

theoretically suitable to different segments of taxpayers, its target generally refers to larger corporate taxpayers, who are seen as having the level of complexity to justify a constant, close interaction with the administration, the resources to be able self-regulate efficiently and provide the information required by the administration, and the revenue potential (*materiality*) to warrant dedicated, specially trained, tax administration personnel. Whilst meta-regulation means that self-regulation is encouraged, the administration remains the main regulator, since the taxpayer regulates internally in accordance to the parameters commanded by the administration and the latter is expected to monitor the former's conformity or deviance, with the possibility of escalating interventions or excluding the taxpayer from the programme altogether<sup>102</sup>.

In terms of the regulator, co-operative compliance assumes that the regulator is the tax administration, generally relying on a specialised division such as a large taxpayers' unit. While corporations can adopt 'best practices' suggested or commanded by peers, NGOs, and industry organisations, these are guidelines and are normally not considered legally enforceable. Nevertheless, co-operative compliance's emphasis on self-regulation means that extra-legal guidelines can play an important role. For example, corporations are likely to rely on tax control frameworks and strategies devised by non-governmental entities such as consultants and industry organisations, provided these are recognised as standards that would contribute to the taxpayer being assessed by the administration as being 'low risk' or capable of self-regulating adequately.

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<sup>102</sup> Braithwaite J, 'Meta Risk Management and Responsive Regulation for Tax System Integrity' (2003) 25 Law & Policy 1

Under co-operative compliance, the regulator is expected to adopt a different working environment: Shifting the focus towards taxpayers self-enforcing or adopting a more proactive stance is not enough. The regulator is expected to treat taxpayers horizontally and invest in improving the quality of treatment to generate trust. The relationship sought shares the elements of the synergistic climate explained in chapter three, that is, voluntary compliance, high levels of trust, and a service-oriented approach. Indeed, co-operative compliance seeks to distance itself from the “cops and robbers” regulatory approach, where taxpayers are treated as suspicious utility maximisers that need to be aggressively enforced.

Nevertheless, when non-compliant outcomes occur, and once participants have been given a chance to explain the occurrence, co-operative compliance can also incorporate coercive elements, provided they are carefully targeted at preserving deterrence and controlling those taxpayers that are stubbornly non-compliant and represent the smallest fraction of the regulated population under the compliance pyramid<sup>103</sup>. Moreover, theoretically one could envisage a scenario where an antagonistic climate is present ab initio, but where co-operative compliance is instated as a policy instrumental to shifting towards a synergistic climate. This could be the case in jurisdictions like Colombia.

Regarding its command, while co-operative compliance has a clear goal which is enhancing compliance, it focuses on supporting taxpayers to reach that end; namely, on the processes and practices that reduce the risk of non-compliance. Thus, co-operative compliance normally assesses the quality of a

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<sup>103</sup> Braithwaite, 'Meta Risk Management and Responsive Regulation for Tax System Integrity'

taxpayer's tax risk control framework and the way in which said framework operates in the determination of tax positions and managing tax obligations.

The focus on instructions regarding sound management of tax risk is based on information asymmetry and the idea that the taxpayer is in the best position to adapt its business to applicable laws. According to Coglianese and Mendelson 'Management-based commands seek to give targets enough flexibility to take advantage of their superior information about how to solve problems they create.'<sup>104</sup>

Thus, co-operative compliance expects that taxpayers will reach an acceptable end position (i.e., compliance) by following a series of procedures designed with that objective. Notwithstanding this procedural focus, co-operative compliance can also include what Coglianese and Mendelson label 'the avoidance of general outcomes'<sup>105</sup>, for example, not engaging in tax-reducing strategies or tactics which contradict the spirit of the legal provisions they are based on.

Co-operative compliance attempts to improve compliance by enabling the taxpayer to be a part of the process of constructing regulation, not by law-making, but rather by shaping the way in which law is effectively implemented. Viewed as a regulatory paradigm, co-operative compliance does not limit itself to black-letter law, since it involves all the administration's practices to direct regulatee behaviour. As argued by Gribnau,

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<sup>104</sup> Coglianese and Mendelson, 'Meta-Regulation and Self-Regulation'. Page 4.

<sup>105</sup> Ibid.

Regulation encompasses legislation, but is not restricted to legal instruments. Regulation is a multidisciplinary field that is by no means restricted to governing by rules<sup>106</sup>

Finally, regarding its consequences, co-operative compliance combines positive and negative consequences: Regulatees are incentivised by positive consequences like improving their goodwill with the regulator, obtaining greater legal certainty, and enjoying lower compliance costs via a reduction in disputes and the intensity of administrative interventions. Simultaneously, unlike what is often perceived by the public, co-operative compliance attracts negative consequences for regulatees who fail to abide by the regulator's commands. Uncooperative behaviour can result in regulatees being denied access to the programme, having co-operative compliance's benefits reduced, or fully revoked. Additionally, even if allowed to remain in the programme, regulatees are expected to face the full, ordinary, consequences of non-compliance (payment of back taxes, interests and, where warranted, the imposition of different types of penalties) whenever non-compliance is detected and cannot be neutralised within the programme.

#### **4.2. Co-operative compliance and responsive regulation**

Co-operative compliance can be included in the genre of responsive regulation. As described by Wenzel<sup>107</sup>, responsive regulation is premised on allowing regulators to use a variety of techniques and tactics to interact with regulatees, depending on their characteristics, so regulation is tailored and not homogenous. Responsive regulation believes that regulatees should be able to

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<sup>106</sup> Gribnau H, 'Taxation, Reciprocity and Communicative Regulation' (2015) 20 *Tilburg Law Review* 191. Page. 203.

<sup>107</sup> Wenzel, 'The Multiplicity of Taxpayer Identities and Their Implications for Tax Ethics'

self-regulate, provided the right balance of persuasion and dissuasion. Moreover, responsive regulation functions dialogically, relying on the regulator-regulatee interaction to construct the principles underlying the regulatory scheme.

Under this type of regulation, made prominent by Ayres and Braithwaite<sup>108</sup>, the regulator should approach each regulatee in a different manner, designed to respond to their behaviour in terms of past and/or present compliance and/or structural factors which signal potential compliance or non-compliance. The objective is to increase administrative efficiency by allocating more resources to regulatees who are more likely to fail to comply, leaving the remaining resources for assisting and meta-regulating compliance-prone regulatees. Thus, according to HMRC, the BRR, which is part of the UK's co-operative compliance framework, intends 'to classify taxpayers as Low Risk or non-Low Risk so that HMRC can target resources on those taxpayers who represent the greatest risk...'<sup>109</sup>.

Responsive regulation presumes regulatees to be predominantly oriented towards compliance and voluntary cooperation. Gracia and Oats explain:

[in] responsive regulation...regulators begin by assuming that regulatees are cooperative, but if this proves not to be the case, regulators respond with escalating punitive strategies until cooperative compliance is achieved.<sup>110</sup>

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<sup>108</sup> Ayres I and Braithwaite J, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press 1992)

<sup>109</sup> See HMRC. 2017. Page 5.

<sup>110</sup> Gracia L and Oats L, 'Boundary work and tax regulation: A Bourdieusian view' (2012) 37 *Accounting, Organizations and Society* 304. Page 305.

This view of regulatees has been popularised by the 'regulatory pyramid', pioneered by V. Braithwaite and J. Braithwaite, where most compliant taxpayers sit at the base, with reduced numbers of less compliant taxpayers representing the pyramid's upper layers<sup>111</sup>. While the original pyramid has been adapted to have more of an oval shape regarding corporations, where most of the population is said to be at a middle point between compliance and non-compliance<sup>112</sup>, the idea remains that only a minority of subjects will require the maximum level of coercive administrative intervention.

Hence, the regulator under co-operative compliance relies on a combination of enforced regulation, meta-regulation, and self-regulation to deal with taxpayers with varying levels of perceived risk of non-compliance. High-risk taxpayers are enforced directly, whereas lower-risk taxpayers are given more space to self-regulate, with the administration assuming different levels of monitoring and meta-regulation, depending on evaluations of the quality of the regulatee's self-regulation and its outcomes<sup>113</sup>. Thus, co-operative compliance seeks to improve upon the traditional, 'command and control' paradigm, which is based upon a low degree of regulatee autonomy and a high level of regulatory control, and shift towards less interventionist policies that allow for some regulatee discretion<sup>114</sup>.

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<sup>111</sup> See Braithwaite, 'Meta Risk Management and Responsive Regulation for Tax System Integrity' and Braithwaite V, 'Responsive Regulation and Taxation: Introduction' (2007) 29 *Law & Policy* 3

<sup>112</sup> Freedman J, *Responsive Regulation, Risk, and Rules: Applying the Theory to Tax Practice*, vol 44 (2011). Page 633.

<sup>113</sup> Hasseldine J, Holland K and Van der Rijt P, 'Companies and taxes in the UK: Actors, actions, consequences and responses' (2012) 10 *eJournal of Tax Research* 532

<sup>114</sup> Coglianese and Mendelson, 'Meta-Regulation and Self-Regulation'. Page 2.

Co-operative compliance's reliance on combined self-regulation and administrative regulation has the potential to reap the benefits attributed to both types of regulation, but also entails problems. For example, self-regulation offers proximity, meaning that regulation is endowed with the regulatee's insider knowledge of its own business and organisation, thus reducing the costs of information asymmetry between the regulator and the regulatee. Additionally, because the regulation being applied is endogenous in origin (it emanates from the regulatee and its industry), it does not face the same legitimacy issues as an externally-devised regulation and is consequently potentially easier to accept by the regulatee<sup>115</sup>. However, relying on the regulatee's own understanding of regulation and its own control procedures means that the system is more vulnerable to regulatory capture.

An additional responsive element of co-operative compliance is maintaining constant dialogue and disclosure between regulators and regulatees. This allows the regulator to permanently update its understanding of the regulatee's profile and of the tax challenges it faces and that requires the administration to provide distinct responses accordingly. While a responsible exercise of administrative discretion is needed to prevent arbitrariness and/or damage to the rule of law, responsiveness enables the regulator to operate dynamically and may enhance taxpayer trust in the administration.

Thus, co-operative compliance can be placed within responsive regulation's framework because a.) It prompts tax authorities to react differently

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<sup>115</sup> Ojo M, 'Co-operative and competitive enforced self regulation: The role of governments, private actors and banks in corporate responsibility' (2011) 19 Journal of Financial Regulation and Compliance 139. Page 141.

to dissimilar types of taxpayers (compliant or deemed “low-risk” regulatees are treated with a light touch and only monitored to ensure continued compliance, mid-risk taxpayers face more inspection and interventions aimed at improving compliance such as training and threats of punishment, and uncooperative taxpayers are treated with intrusive enforcement, fines and penalties aimed to shock them back into compliance); b.) It presumes that most taxpayers are compliant-minded and should be able to self-regulate without the need of actual enforcement but just the threat of it, and c.) Co-operative compliance is based on a horizontal, dialogue-based relationship where there is mutual feedback that allows for customising the administration’s approach to a given taxpayer, instead of applying a ‘one size fits all’ regulatory strategy.

### **4.3. Deconstructing co-operative compliance’s elements**

#### **4.3.1. Trust**

Given co-operative compliance’s reliance on voluntary compliance (enforced compliance is left as a response to non-cooperative taxpayers and for the preservation of deterrence), taxpayers are expected to cooperate based on intrinsic motivations and not exclusively legal coercion. One of these motivations is trust between regulators and regulatees. Here, trust can be understood as the feeling that another (person or institution), will act as is expected of them in accordance to a given standard. Trust is not only about predictability, since someone could be expected to act deviously and not be deemed trustworthy, but also an issue of whether the other party can be expected to conform to specific norms.

As a regulatory strategy based on improving taxpayer-administration interaction and enhancing certainty, co-operative compliance is heavily

dependent on a mutual feeling of trust that is manifested in two dimensions: the *procedural* and what could be called the *substantive*.

Procedural trust examines how the parties conduct themselves when interacting with each other. For Torgler,

‘The way people are treated by the authorities affects their evaluation of these authorities and thus their willingness to co-operate’<sup>116</sup>.

Applying Tyler and Blader’s Group Engagement Model to co-operative compliance, judgments about procedural fairness and trustworthiness are fundamental to explain, and might be more important than distributive justice, in establishing attitudes leading to cooperative behaviour<sup>117</sup>. Thus, procedural trust under co-operative compliance involves a judgment on the quality of the treatment the parties give each other and focuses on feelings of civility, mutual respect, and the parties’ ability to be sympathetic to the other’s position. Because co-operative compliance asks parties which would traditionally see the other as an adversary to come together in a ‘partnership’, it is essential for these subjects to feel that there are rules that will govern interactions and that they will be respected.

Moreover, co-operative compliance also necessitates interparty trust regarding each party’s commitment to their respective substantive obligations. For the administration, this means expecting the taxpayers to be compliance-minded, *prima facie* honest, and willing to disclose all material information, even if not required to do so legally. This does not mean that the administration trusts

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<sup>116</sup> Torgler B, 'Tax morale in Latin America' (2005) 122 Public Choice 133. Page. 136.

<sup>117</sup> Tyler TR and Blader SL, 'The Group Engagement Model: Procedural Justice, Social Identity, and Cooperative Behavior' (2003) 7 Personality and Social Psychology Review 349

taxpayers blindly, since this would be contrary to the model's responsiveness. However, it does mean that, unless there is evidence to the contrary (e.g. the taxpayers' failure to provide assurance about their internal tax control frameworks) they should not be treated as suspicious.

It is important to address the notion of justified trust. One of the consequences of the global climate of public outcry about unfair or inadequate corporate taxation mentioned in chapter one is that the concept of co-operative compliance, which was originally rooted on mutual trust and reciprocity, has changed towards a model where collaboration remains, but taxpayers must prove to the administration that they are worthy of being trusted - note that this is different from the understanding that the trust placed on taxpayers is conditional<sup>118</sup> on their behaviour -.

The shift towards 'justified trust', which attempts to improve the model's public legitimacy, has a positive element in encouraging taxpayers to increase their tax risk awareness and the quality of their tax governance to demonstrate a robust tax control framework<sup>119</sup>. This can be beneficial for voluntary compliance and increase co-operative compliance's efficiency, particularly in countries like Colombia, where taxpayers' approaches to risk are often not structured. However, the additional demands placed on taxpayers can be understood to carry the connotation that they are not a trustworthy party in principle, and this would contradict the interviewees' expectations of mutual

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<sup>118</sup> Goslinga S, Van der Hel-van Dijk, L, Mascini, P, and Van Steenbergen, A, 'Introduction to Tax and Trust' in Goslinga S, Van der Hel-van Dijk, L, Mascini, P, and Van Steenbergen, A (eds), *Tax and Trust: Institutions, Interactions, and Instruments* (Eleven Publishing 2018). Page 19.

<sup>119</sup> OECD, *Co-operative Tax Compliance: Building Better Tax Control Frameworks*

trust, reciprocity and horizontality, thus harming the model's validity. Additionally, the fact that the administration is not held to the same standards - it does not have to justify taxpayers' trust in it- creates a notion of one-sidedness which contradicts the idea of reciprocity, worsening the taxpayers' perception of the relationship as procedurally fair<sup>120</sup> and limiting the model's validity.

From the taxpayers' perspective, the administration is expected to preserve confidentiality and provide legal certainty in exchange for their disclosure and to treat them fairly, tailoring its responses to the taxpayers' specific circumstances and behaviour. The trust required by co-operative compliance is mutual because reciprocity entails that even if one party trusts the other, unless both parties view the other as trustworthy, the administrative paradigm would not be expected to function properly<sup>121</sup>.

Trust is also particularly important for co-operative compliance because there often is a dedicated administrative officer intermediating between the taxpayer and the administration, and the proximity between these point of contact officers and their peers in the corporation's tax teams gives rise to a personal relationship that is emotionally charged and whose perceived quality is likely to be highly influential for voluntary compliance<sup>122</sup>.

According to Van der Hel-Van Dijk and Siglé, interparty trust is expected to be nurtured by the authorities by giving taxpayers evidence of fair treatment:

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<sup>120</sup> See Murphy K, Tyler TR and Curtis A, 'Nurturing regulatory compliance: Is procedural justice effective when people question the legitimacy of the law?' (2009) 3 Regulation & Governance 1.

<sup>121</sup> Pickhardt and Prinz, 'Behavioral dynamics of tax evasion – A survey' page 3.

<sup>122</sup> Murphy, Tyler and Curtis, 'Nurturing regulatory compliance: Is procedural justice effective when people question the legitimacy of the law?'

'By giving taxpayers consistent, objective and fair treatment, it is expected that taxpayers will reciprocate with improving their own behaviour'<sup>123</sup>. Moreover, as explained by Scholz and Lubell, trust 'emphasizes expected benefits of cooperation'<sup>124</sup>, meaning that where trust is present, co-operative compliance would be expected to be seen as more beneficial by taxpayers. Consequently, the existence of lower trust levels might constitute an obstacle for co-operative compliance's efficiency.

The interaction between trust and co-operative compliance resembles the byzantine discussion of the egg and the chicken, since mutual trust is generally understood to be a prerequisite for functional co-operative compliance, but, simultaneously, it can be argued that implementing co-operative compliance can nurture trust where a confrontational 'cops and robbers' paradigm used to prevail. This will be discussed further in parts II and III.

#### **4.3.2. Certainty**

A second characteristic fundamental for co-operative compliance is its focus on providing certainty to the parties. For taxpayers, the programme is meant to increase certainty regarding the treatment of the tax positions they adopt and, consequently, increase the predictability of tax expenses. For the administration, co-operative compliance is intended to enhance certainty in relation to the tax positions that the taxpayer has agreed to adopt and to the level of tax risk said taxpayer represents; this is expected to translate into more predicable tax

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<sup>123</sup> Van der Hel-van Dijk L and Siglé M, 'Managing compliance risks of large businesses: A review of the underlying assumptions of co-operative compliance strategies' (2015) 13 eJournal of Tax Research 760. Page 770.

<sup>124</sup> Scholz JT and Lubell M, 'Adaptive Political Attitudes: Duty, Trust, and Fear as Monitors of Tax Policy' (1998) 42 American Journal of Political Science 903. Page 399.

collection figures and a better picture of the resources to allocate to traditional enforcement (audit and challenge), meta-regulation, assisting self-regulating taxpayers, and managing disputes.

Certainty's prominence in the hierarchy of corporate values makes it one of the main driving forces behind taxpayers' willingness to engage in co-operative compliance and voluntarily disclose their tax affairs. De Simone et.al, describe the exchange as one involving disclosure in return for timely resolution of uncertain tax positions and the commitment from the administration to not challenge the positions that were agreed during the process. According to them,

By entering the program, there is an understanding that the taxpayer will disclose significant uncertain tax positions to the tax authority in return for a timely resolution of these positions...<sup>125</sup>

As will be discussed later in this chapter, achieving full material disclosure is not guaranteed and the administration's commitment to the positions it agreed may be ineffectual if the agreement itself is subject to administrative or judicial review and/or if the applicable legal system does not provide adequate safeguards to protect legitimate expectations. Therefore, proving that taxpayers are being transparent in their disclosures and being able to fulfil the parties' expectation of certainty are both aspects that can determine the validity and sustainability of a co-operative compliance programme.

On a separate note, co-operative compliance does not guarantee an increased degree of legal certainty whenever the tax rules being interpreted are fraught with ambiguity, contradictions, or gaps. For co-operative compliance to

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<sup>125</sup> De Simone, Sansing and Seidman, 'When are Enhanced Relationship Tax Compliance Programs Mutually Beneficial?'. Page 1972.

be most effective at reducing uncertainty, the parties need to be able to reach a clear understanding of applicable laws and then agree on how to apply said interpretation to a situation. Thus, initiatives like furthering the role of principles in tax interpretation or improving the quality of tax rule drafting can contribute to successful co-operative compliance, notwithstanding the fact that for complex issues of artificiality and avoidance, where detailed rules are present, these mechanisms might not be as effective and that they require a technically-adept judiciary to adjudicate<sup>126</sup>.

Co-operative compliance provides an arena for dialogue and the means to guarantee that once an agreement has been reached it will be respected, but it cannot enable the administration to change legislation or to settle a conflict definitively, since those roles are reserved to the legislature and the judiciary, respectively. Therefore, unless the parties can agree on the content and interpretation of the law, the promise of certainty might not be more than a mirage.

The difficulties with certainty should not be underestimated in relation to large corporate taxpayers because these taxpayers are the target of increasingly complex tax rules and rely on sophisticated structures that are likely to make it impossible to agree on an interpretation of the law with the administration. Furthermore, if the parties agree, but the law remains unclear, it might be impossible to achieve the level of assurance promised by the policy model. In these instances, the taxpayer would have to trust the administration to refrain from challenging situations where the law is unsettled, to provide unilateral relief

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<sup>126</sup> See Freedman J, 'Improving (not perfecting) tax legislation: rules and principles revisited' (2010) *British Tax Review* 717. Page 727.

(for example, in the UK, in the form of extra-statutory concessions), or to use its position to lobby the legislature and/or the executive<sup>127</sup> to change applicable tax rules.

#### **4.3.3. Voluntariness**

Unlike the traditional command and control model, founded on the historical tradition of submission by the citizen to the *imperium* of the State and its agencies, co-operative compliance does not rely primarily on the imperative nature of the law to command the taxpayer's compliance. Instead, co-operative compliance is premised upon the idea that taxpayers cooperate with the authorities out of their own volition. As suggested by Langham, Paulsen, and Härtel's planned behaviour theory<sup>128</sup>, this focus on the taxpayers' intention to cooperate voluntarily means that co-operative compliance can harness the power of intrinsic motivations to bolster tax compliance.

The idea that most taxpayers are compliant-minded and just need the administration to assist them in complying is at the core of the co-operative compliance paradigm and has been signalled by commentators to be present in the different co-operative compliance programs implemented around the world. For example, according to Whait, Australia's programme:

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<sup>127</sup> For example, in Colombia the Executive frequently exercises its prerogative to produce Decrees, which are secondary rules that supplement laws.

<sup>128</sup> Langham J, Paulsen N and Härtel CEJ, 'Improving tax compliance strategies: Can the theory of planned behaviour predict business compliance?' (2012) 10 eJournal of Tax Research 364

appears to advocate a 'hands off' approach for most taxpayers due to the assumption that most are compliant and only need education and service provision to help them to comply<sup>129</sup>

This is closely connected to what Murphy calls the 'accommodative model of regulatory enforcement', a regulatory approach that separates itself from traditional deterrence and where authorities

tend to be more oriented toward seeking results through cooperation rather than by coercion, and prefer to see themselves as service providers rather than as strict law enforcers<sup>130</sup>

Voluntary collaboration is not mutually exclusive with taxpayers believing that there are legally enforceable obligations to comply with under fear of punishment. Co-operative compliance can, and should, coexist with a degree of coercion and vertical enforcement because this is necessary to prevent an erosion of existing compliance and reduce existing non-compliance. Taxpayers have a choice in what they disclose and how they engage the administration, and it is expected that if the conditions are right, regulatees would decide to collaborate. The consequence of this assumption is that coercively-imposed compliance is seen as a last-resort scenario and is meant to take place only in those instances where taxpayers have proven to be disengaged or openly resisting compliance.

Voluntariness should not be confused with altruism, since voluntary cooperation might be motivated by self-interest, both of a pecuniary, or non-pecuniary nature. A taxpayer might cooperate with the tax authorities because they believe that will contribute to society's welfare, because they respect the

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<sup>129</sup> Whait RB, 'Let's talk about tax compliance: Building understanding and relationships through discourse' (2015) 13 eJournal of Tax Research Page 149.

<sup>130</sup> Murphy, 'Enforcing Tax Compliance: To Punish or Persuade?'. Page 116.

administration, are concerned about their reputation, and/or simply because they believe that this will result in a greater provision of public goods and services for them (and not only for their peers). Thus, cooperation is not entirely incompatible with a rational agent, utility-maximizing explanation of tax behaviour. However, the taxpayers' motivation for participating in co-operative compliance can be an important factor in determining the sustainability of this regulatory approach, because the more extrinsic the motivations, the less likely regulatees are fully committed, and the more likely they will engage in strategic behaviour like selective disclosure.

The assumption that most taxpayers are willing to collaborate voluntarily and self-regulate can be seen as part of a broader trend in regulation that encourages the creation of standards for regulatees to auto-enforce, and which is not exempt of criticism. As argued by Tuck, the State has not stopped believing in regulation or adopted the view that citizens and corporate entities should not be subject to disciplinary power; instead, the regulator has realised that it can discipline subjects by making them police themselves, while creating the illusion of parity between the regulatee and the regulator<sup>131</sup>. Thus, it could be argued that whenever a regulatee participates in a co-operative compliance program that requires the taxpayer to devise and implement a tax risk control framework that satisfies administrative standards, what is taking place is not the taxpayer reclaiming power, but rather having power imposed on to it in the subtle form of norm conformity. Indeed, concepts like that of 'justified trust' indicate that

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<sup>131</sup> Tuck P, 'The Changing Role of Tax Governance: Remaking the Large Corporate Taxpayer into a Visible Customer Partner' (2013) 24 *British Journal of Management* S116. Page S121.

the taxpayer is trusted but trusted to act within the boundaries of the standards set by the regulator, boundaries which, if anything, are increasingly narrow.

That said, because large corporate taxpayers are sophisticated regulatees who employ and contract equally sophisticated tax directors and external advisors, it is likely that the disciplinary power embedded in self-regulation standards and meta-regulation is accepted consciously by these taxpayers, in a dynamic where the corporation participates and does what is necessary to appear compliant, but does so with its own strategic interests in mind, being willing to withdraw and/or resist whenever the programme is no longer seen to be beneficial.

#### **4.3.4. Collaborativeness**

Another one of co-operative compliance's main features is, *collaborativeness*, a relational concept that refers to the intention or attitude with which the parties are expected to approach each other. Unlike other regulatory strategies, where regulatees are pitched against the regulator as adversaries, co-operative compliance believes in the idea of a partnership between the parties.

The philosophy is that for compliance to increase, the taxpayer-administration relationship should be dictated by collaboration instead of confrontation. Thus, the administration acts as a facilitator instead of an authoritative enforcer. Likewise, the taxpayer is not presumed to be a potential deviant, trying to elude compliance at the first opportunity, but rather a taxpayer client or *customer*<sup>132</sup>, who seeks to engage with the administration voluntarily.

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<sup>132</sup> Ibid

According to Van der Hel-Van Dijk and Siglé, this implies a shift from a strategy focused on punishment, to one centred on preventing harm, and from coercion to conciliation<sup>133</sup>.

As Burton highlights<sup>134</sup>, co-operative compliance is based both on interparty trust, and on the belief that parties can operate as partners in relation to common goals, regardless of whether their ultimate interest might be shared. This means that co-operative compliance assumes that taxpayers and authorities can work together despite their seemingly opposite objectives of reducing the tax burden and maximising revenue collection because a common goal is constructed from something that benefits both parties, even if this entails different obligations and rights for each party. For example, both parties might agree to reduce compliance costs and increase legal certainty, even if taxpayers have to disclose uncertain tax positions and accept a possibly less-than ideal interpretation of the law, and if it commits the administration to providing one-on-one support to the taxpayer, treating the tax position in a particular way, and waiving any subsequent challenge, even if this entails foregoing the possibility to collect more revenue if the administration would have maintained its position and prevailed following litigation.

Interestingly, co-operative compliance's *collaborativeness* can sometimes lead to the mistaken belief that there will be no disputes, when disagreements regarding tax positions are likely to be present because of the

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<sup>133</sup> Van der Hel-van Dijk and Siglé, 'Managing compliance risks of large businesses: A review of the underlying assumptions of co-operative compliance strategies'. Page 761.

<sup>134</sup> Burton M, 'Responsive Regulation and the Uncertainty of Tax Law—Time to Reconsider the Commissioner's Model of Cooperative Compliance?' (2007) 5 eJournal of Tax Research 71

complexity of the transactions undertaken by large corporates and the open-texture and difficult interpretation of applicable rules. As argued by Frecknall-Hughes and Kirchler,

there will inevitably be areas of tax reporting where the amounts to be entered in the tax returns are subject to uncertainty and hence to an overt process of negotiation with the tax authorities.<sup>135</sup>

However, under co-operative compliance, instead of having the taxpayer waiting to see if the administration discovers an uncertain tax position and challenges it, the parties disclose material positions and try to pre-empt conflict so that it can be averted through negotiation, minimise its scope, or at least agree to disagree and allow the judiciary to adjudicate it. Thus, *collaborativeness* means that when differences arise, these will be dealt with in a manner that prevents their escalation, with disclosure and negotiation preceding and, ideally, preventing litigation.

It is important to stress that co-operative compliance's non-adversarial ethos should not be equated with a renunciation of deterrence or abandoning the employment of coercive enforcement tactics, since these are necessary to penalise non-cooperative taxpayers and to incentivise cooperative taxpayers to remain being compliant<sup>136</sup>.

#### **4.3.5. Horizontality**

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<sup>135</sup> Frecknall-Hughes J and Kirchler E, 'Towards a General Theory of Tax Practice' (2015) 24 *Social & Legal Studies* 289. Page 296.

<sup>136</sup> See Lederman L, 'Report for the European Association of Tax Law Professors 2015 Congress "Tax Penalties as Instruments of Cooperative Tax Compliance Regimes"' (European Association of Tax Law Professors Congress).

The next element to be discussed is *horizontality*, understood as the positioning of the taxpayer and the administration on an equal footing, with each party being given reciprocal obligations.

Where a more command and control, hierarchical approach to the administration-taxpayer relationship would see the latter as a subject of the former<sup>137</sup>, co-operative compliance sees taxpayers as equal partners in a horizontal relationship, whose objective is to achieve full tax compliance whilst preserving the highest degree of efficiency and legal certainty.

As noted by Gribnau<sup>138</sup>, co-operative compliance is part of a wider trend in regulation where traditional models focused on enforcement and authority are substituted for ones where a more symmetrical view of the two parties and voluntary compliance prevail. This is not a phenomenon isolated to tax, since it entails a change in the political philosophy of the State that finds parallels in other areas of public law: the passage from a 19<sup>th</sup> Century State focused on defending the rule of law by maximising the administration's prerogatives and commanding subjects, to the idea of a partnered or levelled relationship between the regulators and regulatees as equal stakeholders.

Co-operative compliance's horizontality can be accommodated within Feld and Frey's notion of tax compliance resulting from a 'psychological contract'<sup>139</sup>. Under this theory, taxpayers are willing to pay taxes voluntarily,

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<sup>137</sup> This might be, for example, the case in the context of regulation of criminal behaviour.

<sup>138</sup> Gribnau, 'Taxation, Reciprocity and Communicative Regulation'

<sup>139</sup> Feld LP and Frey BS, 'Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation' (2007) 29 Law & Policy 102

even in excess of the public goods they receive, provided they sense that the State is fair and legitimate in its behaviour, including that of the tax administration, and consequently consider it a partner. As was explained earlier in this chapter, co-operative compliance can entail the creation of a 'personal relationship' between regulators and regulatees that is heavily charged with emotions. One of these, feeling that the other party is an equal, strengthens the taxpayers' intrinsic motivations to comply. Feld and Frey explain:

the psychological tax contract presupposes that taxpayers and the tax authority treat each other like partners...If tax administrations treat taxpayers as inferiors in a hierarchical relationship instead, the psychological tax contract is violated, and citizens have good reason not to stick to their part of the contract and to evade taxes<sup>140</sup>

When connected to existing research on conditional cooperation, co-operative compliance's horizontality can be seen as incentivising compliance because taxpayers are able to identify the administration as an equal 'contributor'<sup>141</sup>, based on its reciprocating taxpayers' disclosures by revealing its own interpretation of uncertain tax positions and matching taxpayers' commitment to implement agreements with its own promise not to challenge positions that have been cleared in the co-operative dialogue.

Horizontality should not be confused with the State becoming the underdog in the regulatory relationship; it can be argued that the State has become more and not less powerful as a consequence of the expansion of the fields it regulates and which it did not control in its traditional liberal version, concerned only with external and internal security and the enforcement of the

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<sup>140</sup> Ibid. Page 104.

<sup>141</sup> Aguirre B and Fontes Rocha F, *Trust and tax morale in Latin American and Caribbean countries* (2010). Page 7.

rule of law. The State now believes that the exercise of that augmented power may be just as or more effective if it is aided by regulatees that, in exchange for a more dialogic relationship, are willing to comply without the need to be coercively forced to do so.

Co-operative compliance's horizontality does not translate into legal equality, since the monopoly of taxation means that the State is the only party capable of creating and enforcing tax obligations, and the administration is endowed with multiple powers to forcefully execute the obligation if cooperation is not forthcoming. However, the objective is to not have to resort to these powers. For Gribnau, legal asymmetry:

...pervades the relationship between tax administrations and taxpayers, as the former has considerable unilateral powers to determine its legal relationship with citizens, particularly as to the tax liability of taxpayers. Despite the asymmetry, the tax administration should take citizens' demands and interests seriously. Indeed, tax administrations depend on taxpayers' compliance to fulfil the assigned tasks, thereby incentivising these administrations to enhance compliance.<sup>142</sup>

#### **4.3.6. Transparency**

Transparency, understood as openness between the parties, is a crucial component of co-operative compliance, since it justifies interparty trust and is necessary to defend the model against public legitimacy issues. Transparency requires the taxpayers' full disclosure of all aspects that are material for the administration's profiling of the taxpayer, and/or for discussing any uncertain tax positions. For the administration, transparency commands openness regarding all the applicable procedures, the rules that are followed in determining participation and exclusion of taxpayers, the criteria for categorising taxpayers

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<sup>142</sup> Gribnau, 'Taxation, Reciprocity and Communicative Regulation'. Page. 192.

into different groups subject to differential administrative responses, the way in which taxpayers' tax positions are interpreted, and whether the administration will accept or challenge these positions.

From an economic perspective, co-operative compliance's transparency is focused on dealing with the information asymmetry between the parties. On the one hand, the administration has less information than the taxpayer regarding their governance and risk controls, their business models, their finances, and their tax positions; on the other, the taxpayer is uncertain regarding what the administration knows about them, the enforcement strategies it will adopt, and often about the way in which it will interpret applicable tax rules. In a rational setting, this lack of information clouds both actors' ability to make calculated decisions. Thus, disclosure enables both parties to make better decisions by bridging the information gap. The benefit of enhanced taxpayer disclosure has been modelled by De Simone, Sansing, and Seidman, according to which co-operative compliance is positive for the administration because greater taxpayer disclosure reduces the administration's information-acquiring costs, thus allowing for the detection of uncertain tax positions that would not have otherwise been discovered if audit costs were too high<sup>143</sup>.

The degree of transparency required for co-operative compliance goes beyond revealing a corporation's tax strategy or control framework, since it also involves revealing every detail that could be material in the assessment of a particular tax position. Thus, the quantity of information being disclosed might be even larger than what would be discovered as evidence within the context of

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<sup>143</sup> De Simone, Sansing and Seidman, 'When are Enhanced Relationship Tax Compliance Programs Mutually Beneficial?'

a traditional tax dispute. As argued by Boer and Gribnau, this duty to disclose extends beyond what participants are required to reveal legally and might even conflict with ordinary limitations such as the attorney-client legal privilege<sup>144</sup>.

As is addressed later in this chapter, the commitment to transparency brings with it possible abuse from taxpayers engaging in selective disclosure and might force the administration to reveal information regarding its enforcement strategies and/or about the negotiations that are being conducted with other taxpayers in a way that could weaken deterrence. Similarly, as has been the case in Sweden, where strong confidentiality laws threaten to make all the negotiations and working papers public<sup>145</sup>, whilst transparency between the parties is a necessity within co-operative relationship, it might not be equally beneficial in relation to the public, since the loss of confidentiality could deter corporate participation. As argued in Part III, the difficulty lies in balancing confidentiality and legal certainty with accountability and public legitimacy.

#### **4.3.7. Focus on Tax Risk**

Another key component of co-operative compliance is its focus on tax risk. Tax risk is crucial for responsiveness because the administration uses its assessment of a taxpayer's risk of non-compliance to calibrate the type and magnitude of its interventions. When taxpayers are judged to be higher risk, the administration assumes an interventionist approach, actively reviewing the

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<sup>144</sup> Boer K and Gribnau, H, 'Legal Aspects of Behaviourally Informed Strategies to Enhance Tax Compliance' in Goslinga, S, Van der Hel-van Dijk, L, Mascini, P and Van Steenberghe, A (ed) *Tax and Trust: Institutions, Interactions, and Instruments* (Eleven Publishing 2018)

<sup>145</sup> See Björklund Larsen L, 'SWEDEN: Failure of a Cooperative Compliance Project?' <<http://www.diva-portal.org/smash/get/diva2:1074077/FULLTEXT01.pdf>>.

taxpayer's positions – i.e. auditing-, and using its powers to challenge and penalise non-compliant taxpayers. When the risk is assessed as lower, the administration regulates prudentially, monitoring or overseeing (meta-regulating) the taxpayer's self-regulation under what is presumed to be a compliant tax governance strategy. This shift towards prudential regulation fits squarely within a broader movement in regulation towards the regulator assisting in the creation of regulatee endogenous control structures and the reduction of regulatee risk appetites that has been taking place for the past decades, but which has intensified following 2008's financial crisis<sup>146</sup>.

Regulating regulatee risk management works effectively in co-operative compliance schemes because of the possibility for the regulator to understand the taxpayers' profile following an initial disclosure and for negotiating with them appropriate changes in their risk appetite and controls in subsequent dialogues. As argued by Gribnau<sup>147</sup>, this entails the use of communicative regulation, which involves persuasion and negotiation in the dialogue that occurs between the taxpayers, who voluntarily disclose their tax positions and their tax risk control mechanisms, and the authorities that respond to this disclosure by alerting the taxpayer about the need to change those practices or by giving them assurances that those positions and/or governance structures which have been disclosed and have been found to be suitable, will not be challenged.

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<sup>146</sup> OECD, *Risk and Regulatory Policy: Improving the Governance of Risk* (OECD 2010)

<sup>147</sup> Gribnau, 'Taxation, Reciprocity and Communicative Regulation'

As explained by J.Braithwaite<sup>148</sup>, contemporary tax regulation is designed to operate within the context of a risk-conscious society. Hence, approaches like co-operative compliance must be understood considering the concern they demonstrate towards managing the risk of taxpayers engaging in non-compliant behaviour, broadly understood to encompass different behaviours such as evasion, abuse, and failing to comply with formal requirements such as filing the appropriate forms and supporting documentation.

As a risk-reactive paradigm, co-operative compliance is characterised by the adoption of a two-pronged risk management system that acknowledges the existence of risk and the importance of regulatee internal systems to manage it, but also implements a further tier of risk management aimed at controlling and improving those taxpayer risk control systems. This meta-risk management<sup>149</sup> means that the administration's role shifts from directly managing external risk to managing external risk indirectly by focusing on monitoring the taxpayer's own risk management system. The co-operative element lies in the parties collaborating for the regulator to steer the regulatees' tax risk management procedures towards the provision of compliance assurance.

The association between tax risk control frameworks and co-operative compliance means that this type of regulation relies on taxpayers which have enough autonomy, resources, and responsibility to devise and implement an internal tax risk management system. This presupposes that taxpayers a.) Are aware of tax risk, and b.) Seek to control it. Under these premises, which may

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<sup>148</sup> Braithwaite, 'Meta Risk Management and Responsive Regulation for Tax System Integrity'

<sup>149</sup> Ibid

be inaccurate because certain taxpayers lack the level of governance required to correctly identify risk and because other taxpayers are fully aware of risk but embrace it and the administration is not supposed to be adversarial, except when facing recalcitrant taxpayers deemed unable to manage tax risk satisfactorily and who are not responding to cooperation. The question arising is how would co-operative compliance react to a scenario where a significant portion of taxpayers do not fall under one or more of the premises mentioned above, or where taxpayers devise tax risk systems which appear to root out accidental or evasive non-compliant behaviour, but which fail to deter abuse because of differences in the understanding of the concept of tax risk or because of a deliberate attempt to deceive the administration.

#### **4.3.8. Proactiveness**

Another distinguishing feature of co-operative compliance is its focus on proactive, per opposition to reactive administrative action. Whilst responsiveness dictates that the regulator's behaviour is modelled after the regulatee's behaviour and characteristics, co-operative compliance is not reactive, since the administration does not wait to see if the taxpayer complies and then decides on a course of action, as would be expected under a traditional command and control approach. Instead, the taxpayer and the administration are expected to interact and reach mutually satisfactory solutions in real time, before the taxpayer executes any tax position, and before the authorities undertake unilateral actions such as audits or challenges. Thus, in its consultation on the Business Risk Review, HMRC stresses that 'CRMs<sup>150</sup> also

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<sup>150</sup> Compliance Relationship Managers

identify emerging tax risks and resolve tax disputes in real time.’<sup>151</sup> and that low risk taxpayers are those who, among others, ‘give advance warning of any significant or potentially contentious voluntary disclosures’<sup>152</sup>

Co-operative compliance programmes can involve reviewing tax positions before the tax year, during the tax year, or after it. What matters is that, regardless of whether the economic transactions have already taken place, any associated uncertain tax positions are discussed with the authorities before they have been adopted so that the parties have an opportunity to agree on how to treat it, or alternatively identify the matters in dispute and prepare for the tax controversy that will ensue in case the position upon which there is disagreement ends up being adopted. This represents efficiency gains for both parties as well as an improved environment in terms of legal certainty.

However, it is important to note co-operative compliance’s limitations regarding proactiveness. First, market dynamics mean that it might not be possible to discuss an uncertain tax position before its economic foundations have materialised. This is the case for day to day operations that, unlike corporate reorganisations, mergers and acquisitions or other large transactions, are not necessarily planned with sufficient anticipation, or for one-off, extraordinary transactions that were not planned but which are time sensitive (e.g. speculative windfalls or crisis-management transactions). Second, co-operative compliance’s proactiveness might be difficult to translate into reality whenever tax rules and regulations change too quickly for the parties to analyse

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<sup>151</sup> HMRC, *Large Business compliance -enhancing our risk assessment approach* (2017). Page 5.

<sup>152</sup> *Ibid.* Page 8.

a tax position in advance, or so slowly that the parties would take too long to have the elements to have a reasoned discussion and the taxpayer is forced to move ahead with the transaction in absence of an agreement or final position from the administration.

#### **4.3.9. Deterrence**

It is often believed that co-operative compliance entails an abandonment of deterrence in favour of an amiable relationship between the taxpayer, who is expected to self-regulate, and the administration, who is expected to negotiate or settle with the taxpayer. As will be discussed in Part III, this belief leads to the model being criticised as being 'too friendly' and prone to having the administration co-opted by taxpayers that are given preferential treatment.

Co-operative compliance should not be understood to forego deterrence, since the administration retains the faculty to impose penalties and coercion needs to be used in relation to recalcitrant taxpayers so that otherwise compliant taxpayers do not see their motivation to comply eroded because they perceive the administration to be weak or because they think that they are being disadvantaged in relative terms. The difference with a traditional coercive approach is that penalties and enforcement are not seen as a generalised, first-instance regulatory mechanisms, but rather as secondary or last-resort tactics reserved for non-cooperative taxpayers, or for those that, under the guise of cooperation, fail to disclose the true nature of their tax position.

The view of coercive enforcement as a second-line mechanism is linked with responsiveness and the regulatory pyramid described earlier in this chapter.

For example, Whait<sup>153</sup> describes the responsive regulation approach behind Australia's Cooperative Compliance Model as a mixture of deterrence measures and other compliance tactics which are escalated, depending on the taxpayer's attitude and their context. According to this author, the hierarchy of administrative responses put into practice by this model begins with the general premise of self-regulating taxpayers who are willing to cooperate voluntarily; from there, it escalates to assisted self-regulation for taxpayers who comply but do not do so fully autonomously, and finally switches onto active enforcement for those taxpayers exhibiting the least compliant-minded indicators.

Deterrence does not necessarily originate from the authorities. For J.Braithwaite<sup>154</sup>, market competition will assist in self-enforcement because potential non-compliant taxpayers and tax practitioners are deterred by the threat of being denounced by their compliant peers and facing the corresponding costs of shaming and penalties. However, it is unclear whether denouncing non-compliance would be the prevalent reaction from compliant taxpayers, or whether they would adopt the non-compliant behaviours they perceive their peers engage in, particularly if they sense that those behaviours have not been detected by the administration or have not been penalised.

Even where there is a functional partnership between a cooperative taxpayer and the administration, it is likely that certain disagreements regarding tax positions persist because of differences in the interpretation of the law. In these cases, it is to be expected that administrative challenges will take place

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<sup>153</sup> Whait, 'Let's talk about tax compliance: Building understanding and relationships through discourse'.

<sup>154</sup> Braithwaite, 'Meta Risk Management and Responsive Regulation for Tax System Integrity'

and that in some instances the dispute will move to the judiciary and/or to international arbitration. Under co-operative compliance, having disputes does not have the same negative effect on the relationship as in a traditional enforcement model, since parties are presumed to understand that there will be differences and disputes, but that these will not derail the relationship since they will be dealt with technically and loyally.

#### **4.4. Co-operative compliance's shortcomings**

Having examined co-operative compliance's main features, its objectives, and its relation to responsive regulation, this section addresses some of the difficulties associated with this regulatory approach.

Many of the problems associated with co-operative compliance are related to its emphasis on self-regulation because of the possibility of a conflict between the regulatee's private interests and public interest. Corporations, being for-profit vehicles, are likely to experience an internal clash between the desire to maximise after-tax utility - and consequently minimise taxes - and wanting to comply fully with the law. As argued by Ojo,

knowledge of a particular industry does not necessarily imply that the incentives of the self-regulator are projected in the right direction to enable such a regulator regulate more effectively<sup>155</sup>.

Other challenges are related to the difficulty of changing from an adversarial to a collaborative approach, the resources needed to maintain customised, real-time relationships, the provision of legal certainty, and maintaining the balance

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<sup>155</sup> Ojo, 'Co-operative and competitive enforced self regulation: The role of governments, private actors and banks in corporate responsibility'. Page 142.

between efficiency, interparty trust, legal certainty, and public accountability and legitimacy.

#### **4.4.1. Corruption and regulatory capture**

One of the main problems arising from co-operative compliance's reliance on self-regulation is aligning regulatee interests with public interest. When these interests are unaligned, it is possible that taxpayers exploit their proximity with the administration and co-operative compliance's horizontality to engage in 'regulatory capture', with self-regulation overpowering enforced regulation and rendering governmental action moot. This is concerning because the benefits of regulatee-regulator proximity (greater business and organisational know-how from the organisation that is self-regulating) can be overshadowed by exploitative regulatees who lead the regulator to believe that the business' reality is different than what it actually is and that the corporation's tax positions and risk control frameworks are adequate, when they might not be, so that the regulator incorrectly assumes that it should not intervene.

Furthermore, the close relationships constructed between taxpayers and the administration over a dialogic procedure like co-operative compliance might lead to an undue emotional attachment between the parties, particularly when the same individuals have been representing each party for prolonged periods of time. If this happens, the relationship can de-institutionalise and either break down because of personal enmities, or risk regulatory capture if the parties are too close. Excessive closeness can weaken the regulator's impartiality, deterrence, enforcement, and oversight. In the worst-case scenario, it might facilitate corruption. The fear is that co-operative compliance might set the stage

for an inappropriate *rapprochement* that could end up with the authorities and the taxpayer colluding to disregard applicable rules and regulations<sup>156</sup> by exploiting inter-party proximity and the discretion afforded to the administration. As argued by Pickhardt and Prinz: ‘...cooperation between taxpayers and authorities is valuable only up to the point where cooperation becomes rather conspiracy or corruption’<sup>157</sup>

Regulatory capture is concerning in any type of setting, but it is particularly worrying in the context of emerging markets like Colombia, where administrations can display comparative weaknesses in terms of resourcing, and where controls against corrupt practices are sometimes inadequate.

The interaction between creative compliance<sup>158</sup> and co-operative compliance is at the core of the debate regarding co-operative compliance and regulatory capture: Since regulatees adopting an overly formalistic view of law use creative compliance to resist control by complying with the letter of the law but not its substance, regulatory policies like co-operative compliance, viewing regulatees as mainly compliant-minded, seem to conflict with creative compliance at face value. The issue is not that co-operative compliance cannot account for non-compliant taxpayers, since the model assumes that there is a minority of taxpayers that are non-compliant and will require a more coercive response from the authorities. The real difficulty is discerning which of those taxpayers considered to be compliant are actually creatively complying and

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<sup>156</sup> Job, Stout and Smith, 'Culture Change in Three Taxation Administrations: From Command-and-Control to Responsive Regulation'

<sup>157</sup> Pickhardt and Prinz, 'Behavioral dynamics of tax evasion – A survey'. Page 4.

<sup>158</sup> See McBarnet D, 'Whiter than White Collar Crime: Tax, Fraud Insurance and the Management of Stigma' (1991) 42 *The British Journal of Sociology* 323

exploiting the relationship to receive its benefits whilst still adopting schemes that disregard the purposive elements of the law.

Finally, a difficult balance in relation to regulatory capture and co-operative compliance is providing taxpayers with dedicated staff from the administration that are knowledgeable about their industry, who can efficiently solve their queries, and who can gain taxpayers' trust, but still maintain the technical independence necessary to protect the rule of law and identify whenever the taxpayer is trying to game the system. This issue is revisited in chapter eight.

#### **4.4.2. Selective disclosure**

An issue associated with the regulatory capture and creative compliance is selective disclosure. When disclosing selectively, taxpayers abuse co-operative compliance by revealing only those tax positions that are less uncertain or less material in a bid to appear compliant and reduce the chances of having their high-risk positions audited. This phenomenon also covers taxpayers that refrain from disclosing aspects of their structure and/or behaviour that would lead to a higher-risk profile or which would otherwise prevent or limit their participation in co-operative compliance programmes.

Assuming that co-operative compliance's reliance on voluntary disclosure affords taxpayers more opportunities to hide valuable information about their tax affairs than non-participating taxpayers, one question is whether a participant's partial disclosure is more harmful than having no participation altogether. De Simone et.al argue that incomplete disclosure from participants in a co-operative compliance program may not be as damaging as to justify exclusions from the

programme, since the pay-offs for the administration that arise from the taxpayer reporting some of their positions (i.e. avoiding devoting resources to unnecessary audits) might be enough to justify continued engagement.

According to these authors,

the tax authority's decision not to expel firms that fail to disclose all uncertain tax positions is rational when the tax authority achieves higher payoffs within the program, even though the understanding that the taxpayer will disclose all uncertain tax positions is not fulfilled in equilibrium...<sup>159</sup>

Furthermore, borrowing from game theory, it is possible that participating taxpayers are less likely to try to cheat than their peers who are not participating because they know that, as long as the programme is not finite and they are not in the last period of its operation, they will have to participate in future rounds and if they cheat, the other 'player', the administration, might discover them and stop cooperating, thus eliminating the possibility of deriving sustained benefits from the co-operative relationship.

As argued by Posner, provided that the parties in the co-operative compliance relationship are able to know if the other 'player' cheated in their past dealings, 'players may refrain from cheating in the hope that they will develop a reputation for not cheating - both within an existing relationship and generally among others in the society'<sup>160</sup>. Because taxpayers who are under a traditional tax enforcement relationship do not know with certainty if the administration will audit them in future periods (they might suspect so, but generally they cannot be sure), they might feel more tempted to engage in non-

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<sup>159</sup> De Simone, Sansing and Seidman, 'When are Enhanced Relationship Tax Compliance Programs Mutually Beneficial?' Page 1974.

<sup>160</sup> Posner EA, 'Law and social norms: The case of tax compliance' (2000) 86 Virginia Law Review 1781. Page 1786.

compliance because they do not necessarily have the same concern for preserving their status as 'good' players in the tax 'game'.

For this game theory premise to work, the parties need to possess the ability to know if the other party cheated, and this might not be the case in a context where there are information asymmetries between them. That said, the greater number of enforced disclosure requirements, such as country by country reports, and the increased amount of third-party reporting within and across jurisdictions theoretically reduces said asymmetry, particularly in relation to multinational corporations.

Selective disclosure might arise without a strategic motivation behind it. This is attributable to differing definitions of compliance, particularly regarding tax avoidance. Thus, there might be a cognitive dissonance at play between the regulator and regulatees because what the former understands to be non-compliance or uncertain/high-risk could be understood as compliant or certain/low risk by the latter. When the parties do not share a definition of compliance –or at least do not label the same behaviour as compliant or non-compliant-. In this case, co-operative compliance's premise that the parties can enhance compliance by collaborating in an exchange of disclosure for legal certainty, is in jeopardy, regardless of any deliberate intention by the taxpayer not to be transparent.

Thus, it is important for the administration to recognize that co-operative compliance entails the possibility of taxpayers mistakenly thinking that they are complying and that certain positions or factors do not need to be disclosed, and the possibility that other taxpayers use partial disclosures to try to game the

system. In the latter case, the administration could be seen by taxpayers as a game player and this means that they might react to the conduct of the administration during the co-operative exchange. In the words of Posner,

the government is a player in the game in the sense that people will adjust their behavior in response to its behavior, and the government should anticipate these adjustments when setting its policies<sup>161</sup>

For example, being straightforward in discussing tax positions and treating the tax positions as was agreed during those discussions would generate a positive signal that could increase the taxpayer's trust in the administration and create an incentive for behaving in a cooperative manner.

While co-operative compliance's horizontality and its emphasis on voluntary disclosure do provide opportunities for selective disclosure, this does not mean that initiatives that follow this type of approach cannot be protected against exploitation. As is proposed in Part III, access to co-operative compliance can be made conditional on passing strict reviews of the taxpayer's conduct, their governance, and their overall fit with this type of regulation. If these reviews include thorough investigations and rely on third party information and administrative information in addition to taxpayer-provided data, it is possible to reduce the pool of taxpayers with tendencies to engage in gaming before they engage in selective disclosure. Additionally, by investing in highly-trained officials that are dedicated to participating taxpayers, the administration has a better chance of reducing information and resource asymmetries and detecting selective disclosure.

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<sup>161</sup> Ibid. Page 1799.

Nevertheless, since it is likely that there will be instances of selective disclosure that materialise before the administration can address them, it is necessary to devise adequate procedures to either exclude or condition the participation of taxpayers who are caught engaging in it, to socialise detected cases among all the staff in the administration who is working in co-operative compliance so that they learn from them and apply this know-how in their own engagements, and impose specific penalties to the taxpayers that are caught cheating so that internal stakeholders are deterred from imitating them and so that external stakeholders do not see the model as facilitating deviant behaviour and the policy's legitimacy is not affected<sup>162</sup>.

#### **4.4.3. Equality before the law**

An area that is often controversial in relation to co-operative compliance is its impact on equality before the law. One of the frequent criticisms made against co-operative compliance is that it breaches equality by introducing a regulatory system that provides participants with a more favourable engagement with the administration than that available to the generality of taxpayers.

Because co-operative compliance models are built on the basis of efficiency, understood as enhancing compliance with the lowest costs possible, they generally focus only on a subset of large taxpayers that are deemed to be sufficiently material for the administration (in terms of revenue potential and/or systemic influence) to justify spending limited resources on sustaining an enhanced relationship with them. Thus, co-operative compliance is often offered

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<sup>162</sup> For an analysis about how penalties for failure to disclose affect co-operative programmes see Osofsky L, 'Some Realism About Responsive Tax Administration' (2012) 66 Tax Law Review

only to a small portion of the taxpayer base, which normally coincides with the large corporate taxpayer segment. While this means that most taxpayers are effectively excluded from co-operative compliance and must remain under a traditional vertical enforcement paradigm which can be understood as being disadvantageous procedurally speaking, this does not signify a breach of the principle of equal treatment under the law.

The reason for which there is no breach of equality is because there are material differences between large corporate taxpayers and other taxpayers that justify a dissimilar tax treatment. Indeed, large corporate taxpayers are normally subject to different tax rules than other segments of taxpayers (e.g. country by country reporting, transfer pricing rules, special digital taxes or anti base erosion taxes, single accounting officer rules, group losses and group financing rules, etc.), meaning that their compliance needs are particular and require the intervention of specialist staff. Additionally, large corporations have complex governance structures and other features such as multiple internal stakeholders and market significance that also justify a different administrative approach.

Co-operative compliance's self-regulation and voluntary disclosure elements entail practical difficulties regarding smaller enterprises and individuals because these would not be likely to have at their disposal the necessary resources to create and maintain robust internal tax control frameworks, assess their tax positions proactively, disclose them and discuss their appropriateness with the authorities. Similarly, extending co-operative compliance's scope to these taxpayers would mean that the administration could not commit to maintaining dedicated agents for each taxpayer, as is usually the case with large businesses, and this would harm the efficiency and inter-party trust expected by

the model. Additionally, having to sort out the demands for legal certainty from a very large base of taxpayers would delay the provision of legal certainty in a way that would render co-operative compliance ineffectual and would create difficulties in terms of scrutinising administrative discretion and ensuring systemic coherence in the agreements reached with different taxpayers.

Provided that participation is elective and conditional, implementing co-operative compliance might lead to further segmentation between participating and non-participating taxpayers, even among a particular segment such as large corporations. This too, might engender a perception of inequality, even though the difference in treatment could be legally justified by participating taxpayers satisfying the requirements for access to the programme, which are meant to be objective and should be publicised in advance, and as a quid pro quo in exchange for the additional disclosure provided by participants. Ironically, advancing the collaboration between participating taxpayers and the administration entails the risk of creating a rift between those taxpayers that do have the opportunity to participate in the program and those that do not, and may create subgroups that either want to exploit the program or who justify their resistance to tax authorities by referring to their exclusion from the programme. For Wenzel, the risk of targeted rapprochement is a 'fragmentation of taxpayers in terms of subgroup identities, who then see themselves in opposition to each other and to the tax system as a whole.'<sup>163</sup>

A separate issue regarding equality before the law is the potential for the agreements or the interpretation disclosed by the administration following a co-

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<sup>163</sup> Wenzel, 'The Multiplicity of Taxpayer Identities and Their Implications for Tax Ethics' Page 45.

operative compliance exchange to breach equality by providing a taxpayer with a decision that is different to the ones given to other taxpayers in an equivalent position. The concern here is that co-operative compliance's dialogue-centred structure and the promise to provide timely legal certainty, plus the presence of taxpayer-dedicated administrative officials, create a space for the administration to exercise its discretion in a way that leads to the administration committing itself to interpretations of the law that are less uniform and possibly more advantageous than what they would be under traditional regulatory approaches.

On this note, part of what should be analysed is the fact that agreements or interpretations reached following a co-operative compliance disclosure and dialogue represent an opportunity for taxpayers to participate in the process of giving meaning to laws via administrative interpretation, a process of rule construction, that is not available under traditional vertical enforcement. This means that, regardless of whether the administration's decision at the end of the process is different from the one that was taken in relation to other participants or non-participants in an equivalent factual and legal situation, there are other compliance effects that need to be examined. Indeed, according to Torgler and Schaltegger, active taxpayer participation in the construction of tax rules is positively associated with tax compliance. For these authors, the exclusion of taxpayers from rule construction might harm tax compliance as a result of feelings of powerlessness and dissatisfaction with the system, whereas involvement in the process increases ownership of the rules and cooperation<sup>164</sup>.

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<sup>164</sup> Benno Torgler and Christoph A Schaltegger, 'Tax amnesties and political participation' (2005) 33 Public Finance Review 403. Page 409.

Thus, if we think of the agreements on the treatment of tax positions reached within the context of a co-operative compliance relationship as rules for the parties involved, it could be argued that the fact that these rules are the result of a process where taxpayers are active participants has the potential of improving said taxpayers' willingness to comply with them. In contrast, where co-operative compliance fails to involve taxpayers in rule construction (where information is disclosed but the administration reaches a decision in isolation) or where were not given access to co-operative compliance, feelings of exclusion and disengagement might lead to the rules being afforded a lower legitimacy and a reduction in compliance. The problem in relation to other external stakeholders is that if they perceive that co-operative compliance agreements lead to 'rule' construction, this type of approach might be stigmatised as 'anti-democratic', regardless of the content of the agreements, whether it was conservative or favourable for the administration, and whether it deviated from the treatment afforded to equivalent positions.

While co-operative compliance's dynamic could make it easier for administrative discretion to lead to interpretations of tax positions that differ from what the administration decides in the case of other taxpayers who are in an equivalent situation<sup>165</sup>, it cannot be concluded that the administration will abuse its discretion simply because it has more opportunities to do so. Indeed, the existence of advanced transfer pricing agreements, private rulings, or gain recognition agreements, among other figures, shows that there are other processes where the administration establishes a dialogue with taxpayers

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<sup>165</sup> Kornhauser ME, 'A Tax Morale Approach to Compliance: Recommendations for the IRS' (2007) 8 Florida Tax Review 599

seeking decisions about specific tax positions and must make use of administrative discretion to produce a response, and there is no indication that in these practices there is a greater arbitrariness or heterogeneity than in the ordinary review/challenge of taxpayer returns. In fact, the review of HMRC's practices in settling large disputes with corporate taxpayers conducted in 2012 by the UK's National Audit Office concluded that, despite the existence of punctual flaws in the processes that led to the settlements and instances of deviations from standard procedure, all examined settlements were either reasonable or better than reasonable and provided a good outcome for the public purse<sup>166</sup>.

The question of equality in terms of outcomes is one of accountability and controls of administrative discretion, since instances of administrative interpretation that can be found to openly deviate from the treatment afforded to equivalent cases both in and outside the programme should be infrequent if the parties know that the system has robust mechanisms to detect and revert arbitrary decisions.

In relation to accountability, the concern has two facets: One regarding the model's public legitimacy, and a separate one regarding the impact of the model on the system's fairness. Both facets stem from the fear that co-operative compliance leads to interpretations of applicable law that are at odds with what the objective 'meaning' of the law is. The question is not purely one of regulatory capture, since the interpretation may be one that does not favour the taxpayer, but rather of the combined 'dangers' of administrative and regulatee discretion

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<sup>166</sup> National Audit Office, *Report by the Comptroller and Auditor General: HM Revenue & Customs Settling Large Disputes*. Pages 6,9, and 18.

in a field of law characterised by its indeterminacy. For De Cogan, tax law's indeterminacy questions whether co-operative compliance enables 'objective' compliance with an already-defined set of legal precepts, or whether this type of interaction between taxpayers and the administration is used as an arena for the parties to construct the precepts that are to be complied with<sup>167</sup>.

If cooperative compliance is seen to provide a space for parties to agree on the meaning of the law with full discretion to arrive at said meaning, concern arises on the grounds of the rule of law and inequality before the law. While the issue might be addressed by the intervention of the judiciary, and potentially the legislative or independent oversight organisms, placing too much emphasis on judicial, legislative, or executive review of the tax administration's decisions under a cooperative compliance, risks introducing an element of legal uncertainty which clashes directly with one of the premises of the *quid pro quo* exchange (disclosure for legal certainty) at the base of this regulatory paradigm, paralyses administrative action, and also creates an environment of mistrust, which theoretically would not have any justification once taxpayers had already passed the administrative filters to participate in the programme. As discussed in Part II, these are some of the problems perceived by UK interviewees in relation to the sustainability of co-operative compliance in that jurisdiction.

#### **4.4.4. Accountability, confidentiality and legal certainty**

An issue with controlling administrative discretion and the outcomes of co-operative compliance is preserving confidentiality. Interparty disclosure and

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<sup>167</sup> De Cogan D, 'A Changing Role for the Administrative Law of Taxation' (2015) 24 *Social & Legal Studies* 251. Page 254.

dialogue involve the exchange of highly sensitive information, and this information must be kept highly confidential. This limits the relationship's accountability, particularly if accountability is understood to involve oversight by civil society and not only State organisations. Certainly, a properly designed co-operative compliance program can be constructed so as to include internal audits within the tax administration and even external audits by public oversight organisations such as public comptrollers; however, the problem is that the more faculties auditors are given to disagree with the administration's decisions, the less legal certainty the process is endowed with and the less attractive it becomes to the taxpayer.

In terms of legal certainty, a major point of contention regarding co-operative compliance is the degree of oversight and the possibility to challenge the actions undertaken by the tax administration as part of its working relationship with participating taxpayers. From the taxpayer's perspective, the willingness to fully disclose to the administration the nature of its tax positions and its sensitive financial and commercial data comes with the expectation that the administration will commit to examining said information, discussing it thoroughly with the taxpayer and, where possible, reaching an agreement on the legal consequences of the tax positions in question. There is an understanding that the agreement is binding on both parties, so that if the tax position discussed with the authorities is effectively adopted, the taxpayer may rely on the administration treating such position as was previously agreed. Thus, taxpayers acquire a series of legitimate expectations in relation to the authority's future actions.

However, if the content of the agreement is susceptible of challenge, be it by another executive organism, by legislative commissions, independent public organisms or by the judiciary, the outcome expected by both parties becomes uncertain and, as such, the entire regulatory approach appears to be less attractive, particularly for risk-averse parties.

Naturally, in a State where the rule of law prevails no one, including the administration and participating taxpayers, should be above the law, meaning that there should be a way of challenging the administration if it is seen to break the law in the context of a co-operative compliance, but this control should be exceptional, technical, and should be strictly legal, not political. If the taxpayers feel that what they discuss and agree during co-operative compliance exchanges is too easily challenged and/or vulnerable to politically-motivated challenges, it is unlikely that they would participate willingly, or that, if they did, their participation would be ideal.

Moreover, as highlighted by De Cogan<sup>168</sup>, implementing the right set of standards for the judicial review of taxpayer-administration interactions is rather difficult, considering the fact that tax law is so complex and ambiguous that determining a single 'objective' meaning of the law is normally not feasible and that tackling this uncertainty is probably what brought the parties to work under the umbrella of cooperative compliance in the first place.

#### **4.4.5. Negative public perceptions and legitimacy**

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<sup>168</sup> De Cogan, D 'UK Uncut Legal Action v HMRC: legal inaction and a return to Fleet Street' (2013) *British Tax Review* 552 and De Cogan, 'A Changing Role for the Administrative Law of Taxation'

As will be discussed further in Parts II and III, one of the biggest challenges for co-operative compliance is its legitimacy in relation to external stakeholders and society at large, who tend to associate it with regulatory capture, corporate privilege, and opacity. If the public perceives that co-operative compliance is an opaque practice, it is likely that legitimate dealings will be erroneously signalled out as 'sweetheart deals' or 'cozying up' and that this not only makes the continuation of the program politically unfeasible, but also damages general tax compliance because of the perception of systemic unfairness by the taxpayers that feel 'left out' and by participating taxpayers who feel unfairly attacked and possibly betrayed by an administration that starts reducing its provision of timely legal certainty or which does not appear to trust them.

Thus, cooperative compliance faces the challenge of communicating to the public how the programme works and emphasising that whenever non-compliance is detected, it will be penalised sternly. It is important for power to be seen to be exercised so that trust is not eroded and that a compliance crowd-out effect is prevented<sup>169</sup>.

Additionally, the administration must work to challenge any public misperceptions about co-operative compliance affording preferential treatment by showing that participation is conditional on demonstrating robust tax governance and low levels of tax risk, and that once the programme is running, taxpayers are required to provide full disclosure, even beyond what would be required under the ordinary legal standards. As highlighted by the OECD, 'It is

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<sup>169</sup> Kirchler, Kogler and Muehlbacher, 'Cooperative Tax Compliance'. Page 22.

also important for revenue bodies to be alert to, and promptly address, public misconceptions or inaccuracies that may impact social norms<sup>170</sup>.

#### **4.4.6. Organisational change in the administration**

Co-operative compliance's effectiveness depends on its alignment with the regulatees' behavioural characteristics, but also the regulator's ability to adapt its own behavioural patterns and organisational culture to the model's demands. As argued by Job et.al, changes in tax policy may yield varying results depending on the effects that organisational culture has on its implementation and administration<sup>171</sup>. Thus, the way in which the administration and the corporations adapt their organisations to co-operative compliance's philosophy and to the role they are expected to play is fundamental in determining the model's success.

The challenge for co-operative compliance is that adapting the administration to this type of regulation requires both thorough changes in the philosophy and behaviour of the administration's personnel, and changes in the organisations' resourcing, with heavy investment needed to train the staff that will be dedicated to conducting co-operative dialogues and to increase the administration's commercial awareness.

The biggest task lies in changing the mindset of the administration's staff, particularly when co-operative compliance represents a departure from deep-seated adversarial approaches, requiring staff to question and alter their view of

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<sup>170</sup> OECD, *Understanding and Influencing Taxpayers' Compliance Behaviour* (2010). Page 6.

<sup>171</sup> Job, Stout and Smith, 'Culture Change in Three Taxation Administrations: From Command-and-Control to Responsive Regulation'. Page 84.

taxpayers as fundamentally suspicious and of their own role as enforcers. As explained by Job et.al, and consistent with the history of ATO's adoption of its co-operative compliance model as recounted by Whait<sup>172</sup>, successful change within tax administrations from a 'command and control' paradigm to a responsive regulation paradigm like co-operative compliance involves a combination of top-down initiatives (management establishing the agenda) with 'grassroots' efforts at each tier of the administration, particularly in relation to more experienced auditors that were trained under a vertical supervision model based on deterrence or have had to deal with poorly compliant taxpayers and as such might be more reluctant to attempt what they might perceive as a softer regulatory approach<sup>173</sup>.

For the author, shifting from an enforcer to a supporter/partner role in contexts like Colombia's, where tax compliance is relatively low, is likely to be especially difficult because the tax inspectors' experience may have an engrained negative perception of taxpayers and because these officers might not have tangible evidence to justify the change in the short term since the changes in the taxpayers' tax culture that would be expected to take place following a successful co-operative compliance engagement would not be immediate.

Changing the administration's mindset is complicated because the required shift is profound and multi-faceted. It requires moving from a conception of taxpayers as suspicious, potential non-compliers to potential partners; from

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<sup>172</sup> Whait, 'Let's talk about tax compliance: Building understanding and relationships through discourse'

<sup>173</sup> Job, Stout and Smith, 'Culture Change in Three Taxation Administrations: From Command-and-Control to Responsive Regulation'. Pages 85-88.

secrecy and reactive strategic behaviour designed for the administration to increase its likelihood of prevailing in tax controversies to disclosure and proactive collaborative behaviour designed to prevent disputes from arising in the first place, from the implementation of tax base-wide policies to implementing multiple policies tailored to the characteristics of specific taxpayers, and from the use of penalties and coercive techniques as a frontline practice to their selective use as tools to maintain deterrence and address non-cooperative taxpayers.

The transition to co-operative compliance is expected to create internal conflict between different groups within the administration and possibly between different hierarchical levels. Thus, when the traditional approach has been adversarial, the existence of deep-seated practices and ideas, path dependency and tunnel vision indicate that the administrative officers that have been working in the administration for longer are more likely to be resistant to change towards co-operative compliance than new recruits who can be trained to accept co-operative compliance from the beginning. Additionally, there can be different levels of acceptance of co-operative compliance depending on the officers' function and their seniority, since staff accustomed to working in enforcement, tax controversies, and/or areas where non-compliance is elevated (e.g. customs and excise) is less likely to embrace co-operative compliance or accept the administration's adoption of co-operative compliance practices than staff normally dealing with higher compliance areas such as direct taxes and more collaborative taxpayers like large corporations. Finally, co-operative compliance might be pursued more openly by senior members of the administration that are more used to broad tax policy and tax administration discussions, are less

vulnerable to performance reviews based on collection, and have less day-to-day contact with contentious or recalcitrant taxpayers than field inspectors.

Shifting to co-operative compliance also requires deep changes in resourcing, since this model requires the addition of staff that is going to be tasked with maintaining co-operative dialogues and/or categorising taxpayers following the performance of risk or other type of rating systems. Preparing staff to handle co-operative compliance relationships involves training additional to ordinary technical training in tax law and/or tax accounting in areas such as commercial awareness, responsive regulation, and negotiation, and also requires staff to learn how to handle the degree of administrative discretion that they will be endowed with and how to coordinate and mediate between corporate taxpayers and other specialist teams within the administration. As explained by Dabner and Burton, this requires a degree of flexibility which is not easy to achieve, especially when the administration is faced with pressure from interest groups, the media, and politicians, which are often resistant to co-operative compliance<sup>174</sup>.

#### **4.4.7. Difficulties with goal-setting and policy evaluations**

A final difficulty for co-operative compliance, which is thoroughly discussed in the so-called 'Stevens Report' that was produced to assess the Netherlands' Horizontal Monitoring initiative<sup>175</sup>, is devising indicators and methods that allow

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<sup>174</sup> Burton J and Dabner M, 'Lessons for Tax Administrators in Adopting the OECD's "Enhanced Relationship" Model - Australia's and New Zealand's Experiences' (2009) 63 Bulletin for International Taxation

<sup>175</sup> Pheijffer LGM, Stevens M, Van der Broe, JGA, Keijzer TJ, Van der Hel-Van Dijk ECJM *Tax Supervision - Made To measure- Flexible when possible, strict where necessary* (2012)

for the programme to be subject to the public policy evaluations that are necessary to determine if the initiative is successful and whether it warrants to be maintained, expanded, reduced, or abolished.

The difficulty stems from the fact that, unlike other regulatory approaches which are outcome-based and focus primarily on increasing revenue collection, co-operative compliance is process-based, and its goals extend beyond revenue collection to incorporate other dimensions like trust-building, taxpayer risk-appetite-reduction and increased risk control, which are complex to measure. While the regulator can evaluate the quality of its treatment to taxpayers by using taxpayer satisfaction indicators and qualitative research, it is complicated to establish causality between improvements in the relationship between the parties and outcomes like the frequency of tax controversies, the overall and relative tax contribution per taxpayer, and efficiency parameters like hours invested by the administration per pound/peso collected. These differences mean that, as highlighted by Van der Hel-Van Dijk and Poolen, co-operative compliance struggles in evaluations that compare it to other regulatory approaches focused on intervening to increase collection<sup>176</sup>.

Moreover, changes in taxpayer behaviour like reductions in the type and frequency of aggressive or uncertain tax positions used, higher effective tax rates, and lower gaps between the taxpayer's effective rate and the statutory tax rate, result from multiple causes and it would be misleading to attribute complex outcomes to a single variable like the existence of co-operative compliance. Similarly, using system-wide indicators such as the tax gap or total tax collected

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<sup>176</sup> Van Der Hel-Van Dijk and Poolen, 'Horizontal Monitoring in the Netherlands: At the Crossroads' (2013) Bulletin for International Taxation 673

per segment may not reveal the extent to which co-operative compliance was influential, since there are too many intermediary variables and some of these might be hidden from the evaluator. Furthermore, measuring other possible benefits of co-operative compliance such as improvements in taxpayer risk control frameworks requires in-depth qualitative work that might not be feasible in a large-scale scenario, particularly with taxpayers who do not participate in co-operative compliance.

A further difficulty with evaluating the impact of co-operative compliance is that sometimes differences in taxpayer behaviour following their participation in the programme do not follow the same pattern for all taxpayers, but rather multiple patterns depending on the characteristics of the taxpayer prior to their participation. For example, results from a study conducted by Beck and Lisowsky<sup>177</sup> on firms which participated in the US' Compliance Assurance Process (CAP) suggest that both the degree of voluntary disclosure and the type of tax behaviour after involvement in the co-operative compliance programme are linked to the level of uncertain tax positions adopted by a corporation prior to its participation. According to these authors, firms with moderate levels of uncertain tax positions (as revealed by their financial statement tax reserves) are more likely than firms with high or low levels of uncertain tax positions to participate in co-operative compliance programmes like the CAP, which necessitate voluntary disclosure. For firms in the low end of the spectrum, having a high degree of certainty could make the programme less attractive, whereas those firms with high uncertainty could be deterred from participating whenever

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<sup>177</sup> Beck PJ and Lisowsky P, 'Tax Uncertainty and Voluntary Real-Time Tax Audits' (2014) 89 *Accounting Review* 867.

their high uncertainty coincided with high levels of tax aggressiveness. Thus, while corporations participating in the CAP experienced statistically and economically significant reductions in their tax reserves (meaning a decrease in disclosed uncertain tax positions), said reduction centred on those firms which had a medium level of reserves in the first place<sup>178</sup>.

This does not mean that co-operative compliance cannot be evaluated. Indeed, taxpayers can certainly provide the necessary data to evaluate whether co-operative compliance has resulted in reductions in their compliance costs, and qualitative techniques like the ones used in this thesis can be used to assess changes in taxpayer perceptions of the administration and the quality of the treatment received from it, as well as changes in the taxpayers' internal governance structures and tax control frameworks. Additionally, the tax positions, outcomes, and compliance history of participating taxpayers can be contrasted against that of non-participating taxpayers, taxpayers in different risk categories within the programme, and/or the taxpayers themselves before they began their participation – in this last case adjustments to account for macroeconomic changes and changes in applicable rules would have to be applied-. While these comparisons might not reveal causation, they would be expected to reveal inferences and trends which can also be valuable. However, the complexity of the methods that would have to be used, the fact that the programme's effects often do not lend themselves to quantitative analysis, and the fact that the sort of behavioural and cultural changes that co-operative compliance aims to contribute to are unlikely to take place in a short-term

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<sup>178</sup> Ibid. Page 870.

horizon, suggest that authorities implementing co-operative compliance might struggle to obtain evidence to justify their decisions in relation to the programme and/or that they might find it harder to update the programme in a timely fashion.

## **CHAPTER 5**

### **OVERVIEW OF SELECT CO-OPERATIVE COMPLIANCE INITIATIVES**

This chapter presents a succinct overview of the UK's co-operative compliance framework, centred around the Business Risk Review, and a selection<sup>179</sup> of co-operative compliance programmes currently operating throughout the world. The aim of this overview is not to provide an in-depth analysis of each programme, but rather to illustrate these initiatives' main features so that the reader can contrast co-operative compliance's theoretical framework with its practical implementation, contextualise the characteristics of the UK's framework, and be acquainted with the alternatives that this programme and any potential initiative in Colombia, could experiment with.

Reference is made to other studies which have evaluated different aspects of some of these programmes, like the participating taxpayers' perception about them and the difficulties or challenges faced by these initiatives. These assessments are useful to identify common practices which have worked, like providing taxpayers with dedicated administrative officials,

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<sup>179</sup> This review does not pretend to be exhaustive. Co-operative compliance initiatives not covered here are the US' Compliance Assurance Process, Spain's Code of Good Tax Practices, Japan, Slovenia and Canada's programmes, Singapore's Enhanced Taxpayer Relationship Programme, South Africa's Taxpayers Engagement Strategy, Australia and New Zealand's initiatives; diverse pilots undertaken in Portugal, France, Russia, Slovenia, and Finland, and new initiatives being launched in Poland and Belgium.

and common difficulties, such as political interference on the administration, or achieving the right balance between the timely provision of legal certainty and accountability and equality before the law. Acknowledging these trends provides a good foundation for understanding the normative proposals formulated in chapter eight.

### **5.1. Co-operative compliance in the UK and the Business Risk Review**

The Business Risk Review is HMRC's procedure to evaluate taxpayer compliance risk based on an assessment of the taxpayer's inherent (structural) and behavioural risks and determining whether the taxpayer can be classified as low risk or not-low risk<sup>180</sup>. This assessment is mandatory for all taxpayers supervised by HMRCs large business unit.

While the BRR is an element of HMRC's broader Tax Compliance Risk Management system, it constitutes, together with CCMs, one of the pillars of HMRC's Large Business Strategy, which can be described as the UK's approach to co-operative compliance. As explained by Freedman, Loomer, and Vella<sup>181</sup>, the administration has given the BRR a dual focus since its inception: First, to make HMRC's approach responsive by using compliance risk as a tool to calibrate administrative responses; and second, to modify taxpayer behaviour by encouraging (by portraying being a low risk taxpayer as beneficial) or actively intervening to reduce tax risk levels.

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<sup>180</sup> Following HMRC's BRR consultation in 2018, a new system is being piloted in which there will be four categories of risk, rather than the previous two.

<sup>181</sup> See Freedman, Loomer and Vella, 'Corporate tax risk and tax avoidance: new approaches'. Page 79.

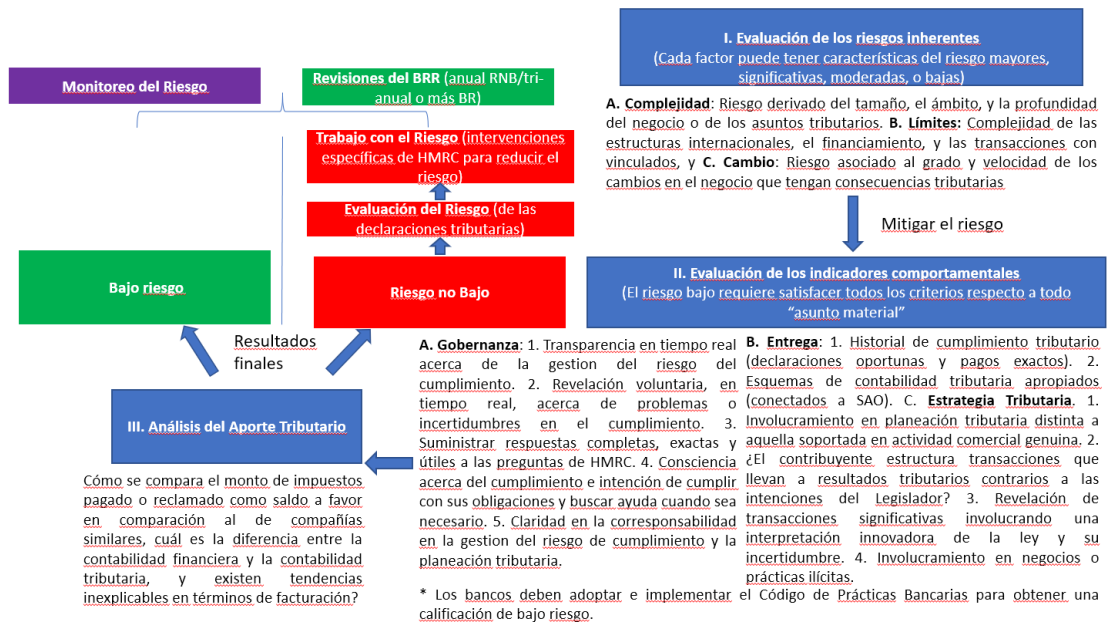
The BRR initially assesses inherent risks and then analyses, based on behavioural indicators, if and how the taxpayer manages those risks. This may involve testing the taxpayer's risk management system and, as explained in Figure 8, analysing the taxpayer's approach to tax planning, with transactions having a result contrary to Parliament's intentions, transactions lacking commerciality, and/or transactions where an innovative interpretation of tax law is not disclosed to the administration being seen as high-risk factors. Finally, HMRC compares the taxpayer's tax contribution (amount paid or claimed) against similar businesses, examines the trends regarding this contribution, and contrasts it to the taxpayer's financial accounting. Taxpayers are then classified as 'low risk' or 'non-low risk'.

Taxpayers classified as 'low risk' will have to carry out the BRR on a lower frequency than those classified as 'not-low risk'. While the frequency is not fixed, guidance indicates that the BRR would take place every three years, unless the parties agree differently. While inter-party communication is expected to continue in order to preserve business understanding (HMRC commits itself to at least one CCM meeting per year), the frequency of these meetings will be reduced, unless the taxpayer initiates contact.

Low risk regulatees are expected to see a reduction in the intensity of HMRC's checks and to be exempt of intrusive interventions, including systems audits and HMRC-initiated risk visits. Additionally, their returns are not predicted to be challenged. In exchange, taxpayers are supposed to maintain a high level of transparency by voluntarily disclosing tax positions and to maintain what the administration defines as a low-risk behaviour. In contrast, not-low risk

taxpayers will be subject to regular HMRC-initiated interventions, general audits, and annual BRRs.

HMRC reserves the right to exclude a taxpayer from its low risk classification at any point if they are found not to meet the administration's expectations in terms of low risk behaviour. According to guidance, this could mean refusing to meet with the CCM, not disclosing uncertain tax positions in real time, a substantial worsening of the taxpayer's promptness in filing returns and/or paying their taxes, or, interestingly, entering into 'aggressive tax avoidance schemes'. This last aspect is problematic for the rule of law because the administration's definition of aggressive avoidance could mask an attempt to force taxpayers to share the administration's interpretation of the law. In most cases, though, the taxpayer will have the opportunity to address the issue that has raised concerns, but in cases considered to be serious, the low risk status may be withdrawn immediately.



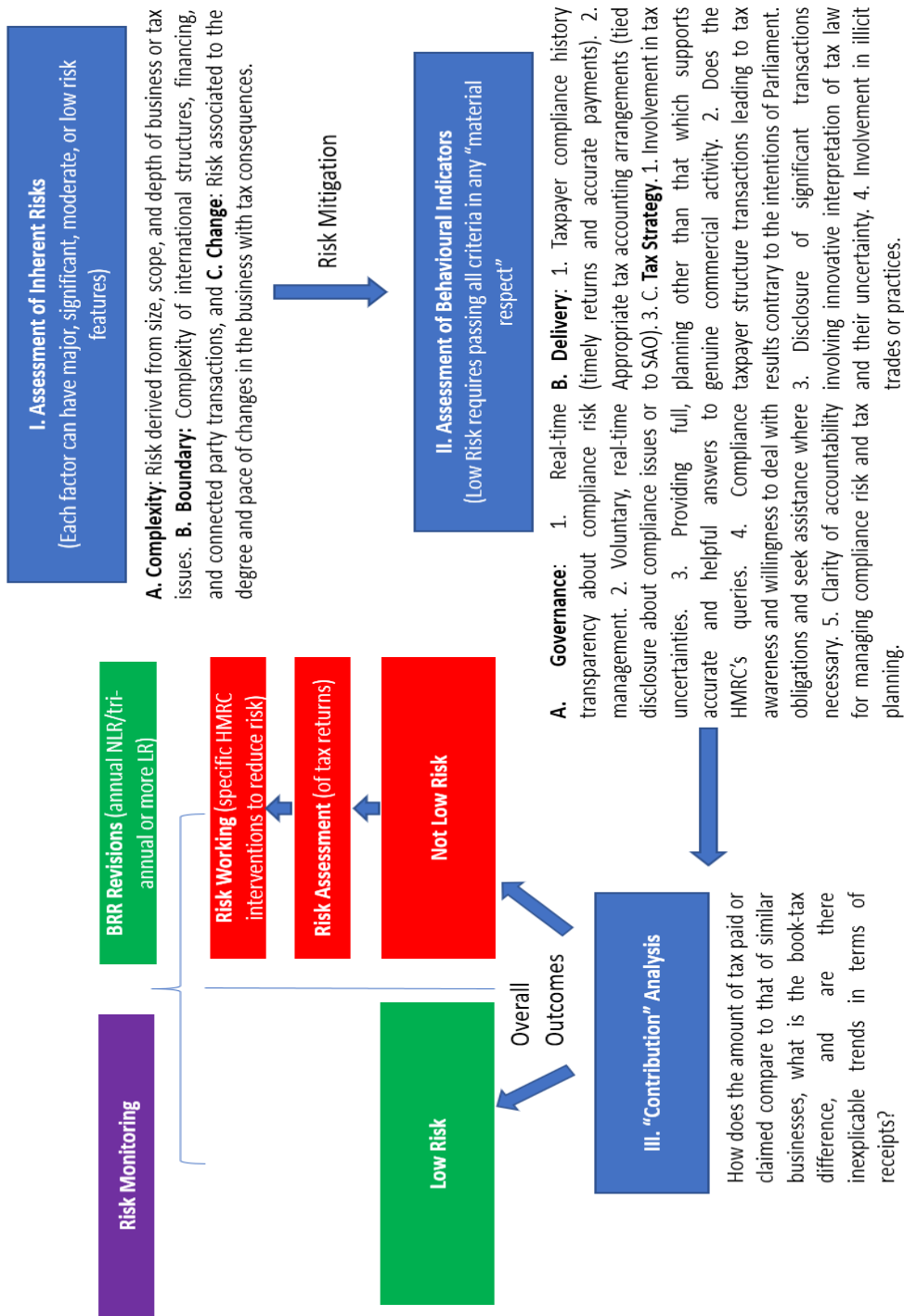


Figure 8 UK Business Risk Review and HMRC Risk Management

## 5.2. The Netherlands (Horizontal Monitoring)

Co-operative compliance in the Netherlands operates under the “Horizontal Monitoring” programme. Under this approach, piloted in 2005, large taxpayers conclude taxpayer-specific covenants with the administration, committing to self-regulate risk and collaborate with the authorities in exchange for reduced audits and a dialogue-centred, horizontal, relationship. Unlike other programmes, Horizontal Monitoring also allows for the participation for small and medium taxpayers, although under different conditions and with tax practitioners acting as intermediaries<sup>182</sup>. This extension of the programme’s scope has faced criticism because of the strain it has caused on the administration’s resources and because of doubts about the convenience of incorporating tax practitioners as intermediaries in charge of risk and compliance assurance<sup>183</sup>.

One of the characteristic features of Horizontal Monitoring is that the initiative on risk assessment and control is placed almost exclusively on the taxpayer. Unlike the UK’s combination of mandatory BRR and CRM-led co-operative exchanges, acceding to Horizontal Monitoring is conditional on the taxpayer developing a tax control framework, having an adequate internal monitoring system that allows the detection of risk control weaknesses and, where these exist, coming up with risk control proposals to be outlined in the action plan to be presented to the Netherlands Customs and Tax Administration

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<sup>182</sup> Majdanska A and Szudoczky R , 'Designing Co-operative Compliance Programmes: Lessons from the EU State Aid Rules for Tax Administrations' (2017) *British Tax Review* 204. Page 221.

<sup>183</sup> Van Der Hel-Van Dijk and Poolen, 'Horizontal Monitoring in the Netherlands: At the Crossroads'. Page 674.

(NCTA)<sup>184</sup>. While intended to increase taxpayer self-regulation and exploit the efficiency benefits of metaregulation<sup>185</sup>, the fact that taxpayers have little guidance on how to monitor, assess, and improve their tax risk controls has been signalled as one of the main difficulties with this programme<sup>186</sup>.

Under Horizontal Monitoring, taxpayers who can demonstrate a satisfactory risk control capacity (or adequate steps to improve it), see their behaviour and attitude towards taxes analysed, together with an in-depth exam of various aspects necessary for the administration to determine whether it thinks horizontal monitoring will be viable for this taxpayer. If this is so, the parties attempt to resolve pending tax issues<sup>187</sup>, and formalise the relationship by entering a “Covenant”, an agreement signalling the relationship’s main elements, and which is modelled after a standard text. As explained by Gribnau, these covenants are a fairly informal agreement laying out the parties’ commitment to cooperate reciprocally, but not listing a catalogue of obligations and penalties, as would be expected in a contract<sup>188</sup>. As with the UK’s CRMs, every participant in Horizontal Monitoring is assigned a dedicated administrative official.

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<sup>184</sup> De Widt D and Oats L, 'Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison' (2017) *British Tax Review* 230

<sup>185</sup> Braithwaite, 'Meta Risk Management and Responsive Regulation for Tax System Integrity'

<sup>186</sup> De Widt, 'Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison'

<sup>187</sup> Netherlands Tax and Customs Administration, *Horizontal Monitoring Within: The medium to very large businesses segment* (2010)

<sup>188</sup> Gribnau H, 'Cooperative compliance: Some procedural tax law issues' (2015) *Tax assurance* 183. Page 190.

In terms of its evaluation, Oats and De Widt<sup>189</sup> argue that participants believe participation in Horizontal Monitoring increases the efficiency of in-house tax teams, leads to real-time working and a faster provision of legal certainty by the administration, and allows for greater predictability of the administration's future actions, since the administration's strategic treatment plans are shared with taxpayers. Additionally, taxpayers revealed that Horizontal Monitoring has contributed to a reduction in tax disputes<sup>190</sup>. According to these authors, the taxpayers' main criticism is that insufficient administrative guidance regarding the content and practical terms of the companies' tax control frameworks leaves them unable to improve their risk control practices. Other complaints include problems obtaining legal certainty when the administration is under threat of scrutiny from the EU and feeling that maintaining and expanding the co-operative compliance relationship has placed significant stress on the administration's resources, thus limiting the administration's efficiency and its ability to address non-cooperative taxpayers adequately. Additionally, as mentioned in chapter four, the administration is said to experience difficulties with evaluating Horizontal Monitoring's results<sup>191</sup>.

The Netherlands' experience is noteworthy, among other reasons, because its pioneering status and its relative success have turned Horizontal Monitoring into a reference for other programmes. For example, administrations in Sweden, Austria, and Croatia explicitly referred to the experience of

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<sup>189</sup> De Widt, 'Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison'

<sup>190</sup> De Widt D, *Dutch Horizontal Monitoring: The Handicap of a Head Start* (FairTax : Working Paper Series, 2017). Page 23.

<sup>191</sup> Ibid.

Horizontal Monitoring as an inspiration for their respective programmes<sup>192</sup>, and even experienced administrations like HMRC have referred to Horizontal Monitoring when justifying changes in their own programmes, such as the evaluation of tax control frameworks for taxpayer profiling<sup>193</sup>.

### **5.3. Ireland (Cooperative Compliance Framework)**

Ireland's co-operative compliance programme started in 2005, making it one of co-operative compliance's pioneers. Following a thorough review in 2016, the programme was relaunched in 2017. Like the review conducted in the Netherlands by the Stevens Committee<sup>194</sup>, the Irish Revenue's review concluded that co-operative compliance was the best practice for large businesses and that it matched taxpayer expectations of certainty and non-confrontational agreements, but that it needed to be reformed to make it more selective, more focused on tax control frameworks - as appears to be the case with HMRC's TCF consultation<sup>195</sup>, and for stakeholders to have greater clarity about the consequences of participation/non-participation<sup>196</sup>.

Unlike the UK's regime, Ireland's programme is voluntary and selective (by application only). The programme places a strong emphasis on the applicants' compliance history, meaning that only taxpayers that have not been

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<sup>192</sup> See Cicin-Sain N, 'A New Approach of The Croatian Tax Administration towards Taxpayers Based on Cooperation instead of Repression: A True Change in Attitude' (2016) 16 *Croat & Comp Pub Admin*

<sup>193</sup> HMRC, *Large Business Compliance -Enhancing our Risk Assessment Approach: Summary of Responses* (2018).

<sup>194</sup> Stevens and others, *Tax Supervision - Made To measure- Flexible when possible, strict where necessary*

<sup>195</sup> Duffy and Stapleton, 'Ireland: Ireland's cooperative compliance framework' (2017) *International Tax Review*

<sup>196</sup> Dempsey, *Outcome of Review of Co-Operative Compliance Framework* (2016)

subject to substantial penalties in the past three years and who are up to date with their tax obligations can apply<sup>197</sup>. As with most contemporary initiatives, Ireland's framework requires applicants to demonstrate that they have a robust tax control framework. The programme focuses on large corporate taxpayers (previously it included high net worth individuals) and follows the international trend of having a designated administrative point-of-contact official - interestingly, these officials are labelled "Compliance Managers", as in the new UK nomenclature.

Ireland's cooperative compliance framework is based on the conclusion of action plans between taxpayers and the administration; these include details about how real-time disclosure will take place and about how the administration will answer taxpayer queries. Additionally, the plan sets out the details for the annual risk review, in which the taxpayer's tax risk profile is agreed and the taxpayer must present its plan to manage and reduce tax risk<sup>198</sup>.

As with the Netherland's Horizontal Monitoring, participants in the Irish regime benefit from a reduced level of administrative interventions, with most queries and self-review disclosures being filtered through less-intensive interventions than traditional audits. Additionally, coinciding with Italy's regime, participants benefit from streamlined VAT and Corporation Tax refunds.

#### **5.4. Italy (Regime Dell'Adempimento Collaborativo)**

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<sup>197</sup> Ibid

<sup>198</sup> See the Irish Revenue's guide on co-operative compliance available at <https://www.revenue.ie/en/companies-and-charities/cooperative-compliance/drawing-up-an-action-plan.aspx>

Co-operative compliance was initially trialled in Italy using a pilot in 2013 and then introduced permanently via legislation in 2015<sup>199</sup>. This is distinctive, since many other co-operative compliance regimes are not codified in laws, but rather in administrative guidance. Access is limited to large taxpayers, with the threshold measured as a reference to annual turnover or, exceptionally, as a function of realised investment following an advance ruling<sup>200</sup>.

Unlike most co-operative compliance programmes, the Italian programme specifies that participants are entitled to a series of benefits regarding procedural tax law and the imposition of penalties that goes beyond a greater ease in the provision of legal certainty. These include a fast track procedure to obtain rulings and a reduced-penalty system (50% reduction and minimum penalty bases) if the issues leading to the penalty were disclosed proactively during the co-operative dialogue, before the returns were filed<sup>201</sup>. Additionally, participants enjoy a waiver of guarantees for obtaining tax refunds<sup>202</sup>. While the broad nature of the benefits offered to participants in Italy's programme increases the policy's attractiveness, it raises doubts concerning equality before the law, since the taxpayers' participation and disclosure might not be a sufficiently differentiating factor to justify such dissimilar treatment versus non-participants.

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<sup>199</sup> Decreto legislativo del 05/08/2015 n. 128 (Gazzetta Ufficiale No.190) (Italy)

<sup>200</sup> Majdanska and Szudoczky, 'Designing Co-operative Compliance Programmes: Lessons from the EU State Aid Rules for Tax Administrations'. Page 220.

<sup>201</sup> Decreto legislativo del 05/08/2015 n. 128 (Gazzetta Ufficiale No.190). Article 6.

<sup>202</sup> Manca M, 'The New Italian Cooperative Compliance Regime' (2016) European Taxation

As with the Netherlands' Horizontal Monitoring, Italy's regime relies heavily on taxpayer risk control, so potential participants must prove that they have adopted a Tax Control Framework (TCF)<sup>203</sup> that matches the requirements set out in legislation.

Considering the similarities between the two countries' legal systems and the low levels of trust in public institutions existent in Italy<sup>204</sup>, it will be very interesting to follow whether co-operative compliance succeeds there, as this might shed light on how co-operative compliance would work in societies like Colombia's, where regulatee and societal trust in public authorities is particularly low, and which are influenced by legal traditions where administrative discretion is limited and vertical enforcement prevails.

### **5.5. Denmark (Tax Governance)**

Co-operative compliance in Denmark is exclusively aimed at large corporate taxpayers. Like in many jurisdictions, the programme was preceded by a pilot implemented between 2008 and 2011. Interestingly, according to Boll and Brehm, even though the programme faced opposition from external stakeholders, the administration pressed for its implementation and managed to have it become permanent in 2012<sup>205</sup>. Thus, while reluctant members of the administration can often be one of the hardest obstacles against successfully implementing co-operative compliance, a committed administration can also be fundamental in enabling it.

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<sup>203</sup> Bronzewska K and Tamburro V, 'Cooperative Compliance in Italy - Does it Stand a Chance?' (2013) 53 *European Taxation* 595. Page 596.

<sup>204</sup> *Ibid.* Page 597.

<sup>205</sup> Brehm and Boll, 'Corporate experiences with Cooperative Compliance in Denmark'

Like other co-operative compliance initiatives, Denmark's Tax Governance programme relies on dedicated point-of-contact administrative officials called Tax Governance Managers. Participating corporations are also assigned a team of specialists covering different areas of expertise. While resource-intensive, this could be an alternative to address the inefficiencies associated to arguments between non-dedicated specialist teams and dedicated administrative officials which leads to what several UK interviewees referred to as the "post-box" model of CRMs. Unlike what happens in other jurisdictions, having a dedicated administrative official is not an exclusive advantage for co-operative compliance participants, since large corporations in Denmark are assigned a corporate key contact officer regardless<sup>206</sup>. Participation is by invitation/application only and is limited to taxpayers classified by the administration as compliant.

According to research by Boll and Brehm, participants are mainly satisfied with the programme and have a positive perception of the administration's ability to provide high-quality, timely responses, and with the administrations' staff's knowledge of applicable rules. However, taxpayers criticise the fact that the administration's responses are not legally binding, and what they see as an increasing intromission of politics and media on the administration's ability to produce decisions<sup>207</sup>. This last critique echoes what was argued by most UK interviewees and highlights the need to address external stakeholders' perception of the programme and isolate the administration from undue interference. Other complaints shared by UK interviewees include the

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<sup>206</sup> Ibid. Page 22.

<sup>207</sup> Ibid. Page 34.

perception that the administration's commercial awareness is limited, and that increased internal bureaucracy limits the administration's ability to produce timely responses.

As in Ireland, the Danish model has been reformed and, since 2017, has a greater focus on taxpayer risk control, with participants now having to complete a multi-phase procedure involving selection, signing a covenant, the taxpayer presenting its control framework, the administration testing this framework, and, finally, a supervisory phase. This shift towards metaregulation and an emphasis on risk control is in line with the trends seen elsewhere, including the UK, and responds to the idea that the regulator needs to ensure that trust in the taxpayer is "justified" to increase the model's public legitimacy. Unfortunately, though, this progress in pressing for better taxpayer risk control has not been accompanied by reciprocity in justifying trust, since taxpayers are still expected to maintain their collaboration regardless of whether the administration has proven trustworthy or not.

## **5.6. Austria**

Co-operative compliance in Austria started with a pilot launched in 2011 with the participation of 15 companies<sup>208</sup>, and which finished recently.

Under the pilot, only large business taxpayers supervised by the large business unit could apply to participate. Taxpayers initially applied, had their suitability assessed by means of an initial audit, and needed to prove that they

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<sup>208</sup> See <https://home.kpmg.com/xx/en/home/insights/2018/04/tnf-austria-proposed-administrative-tax-law-changes-horizontal-monitoring-and-advance-rulings.html>. Also, JEnachescu J and others, 'Horizontal Monitoring in Austria: subjective representations by tax officials and company employees' (2018) Business Research

were implementing a tax control framework and had maintained a consistent tax strategy<sup>209</sup>.

Austrian participants formalized their commitment by signing together with the tax authority a declaration of intent. This declaration operated in a similar way to the Netherlands' Horizontal Monitoring Covenant since it did not create rights and obligations legally-speaking but did lay out both parties' expectations in terms of taxpayer transparent disclosure and commitment to implementing recommendations and tax control structures, and the administration responding with a less coercive approach and providing clarity - however, non-legally-binding- about its views on tax positions.

The Austrian pilot relied on point-of-contact dedicated administrative officials<sup>210</sup>. Once the programme was running, corporations would have regular meetings with assigned tax inspectors, where the taxpayer presented its positions and supporting evidence, in exchange for administrative feedback.

Following the pilot's conclusion and having received favourable feedback from the studies commissioned by the government to monitor and evaluate the project<sup>211</sup>, it has been reported that the government has decided to introduce legislation to implement co-operative compliance formally in 2019<sup>212</sup>. Like the pilot, it is expected that the programme will rely on taxpayer voluntary participation, conditional to passing an administrative initial audit designed to

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<sup>209</sup> Ibid. Page 3.

<sup>210</sup> Majdanska and Szudoczky, 'Designing Co-operative Compliance Programmes: Lessons from the EU State Aid Rules for Tax Administrations'. Page 215.

<sup>211</sup> Enachescu and others, 'Horizontal Monitoring in Austria: subjective representations by tax officials and company employees'.

<sup>212</sup> Ibid.

clear legacy issues and being able to demonstrate the existence of an adequate internal tax control framework. Administrative decisions produced following co-operative dialogues will most likely not be legally binding, and the administration will maintain its commitment not to undertake traditional audits in relation to participants<sup>213</sup>.

An interesting characteristic is that the Austrian model will apparently allow taxpayers to demonstrate the adequacy of their internal tax control frameworks by showing that their processes are certified by an auditor. This move towards involving tax practitioners as assurance intermediaries, which is in line with the trend initiated in Australia<sup>214</sup>, and with the Netherlands' system for SMEs, can strengthen impartiality by leaving the assessment on the quality of the company's control frameworks outside the hands of the directly-interested taxpayer. However, it introduces the need monitor the quality of the auditor and ensure that conflicts of interest are not present.

## **5.7. Croatia**

Croatia's co-operative compliance program was launched in legislation dating from 2015 and 2016. Access is voluntary (by application) and is conditional on having a clear record of compliance, demonstrating the existence of an internal tax control framework, agreeing to disclose all material information to the administration and, unusually, proving that none of the company's board

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<sup>213</sup> Ibid.

<sup>214</sup> Van der Enden E and Bronzewska K, 'The concept of cooperative compliance' (2014) 68 Bulletin for International Taxation 567.

members have been convicted a crime in the last three years<sup>215</sup>. An interesting feature of the application stage is that, together with the necessary information regarding risk controls, previous compliance, and the organisation's characteristics, the taxpayer must describe to the administration what it expects from its participation. This is useful since it allows the administration to know what the taxpayer believes the programme entails so that, if necessary, expectations can be adjusted before the relationship begins, thus avoiding the conflicts based on a mismatch between those expectations and reality which, as will be discussed in Parts II and III, can threaten the continued validity of co-operative compliance initiatives.

Upon admission, the dynamic is very similar to the one present in other jurisdictions, with the parties formalising an agreement whereby the taxpayer discloses all material information and queries about any uncertain tax positions, and the administration commits itself to providing timely legal opinions and guidance regarding those positions, as well as to adjusting its interventions to the taxpayer's characteristics and behaviour. Unlike other systems where co-operative compliance can run concurrently with vertical enforcement, the Croatian administration seeks to terminate the co-operative relationship unilaterally if it initiates an audit against the taxpayer. Additionally, all the information provided by the taxpayer is protected by a high degree of secrecy, meaning it cannot be disclosed outside the tax administration. While this reduces the initiative's accountability, it prevents the sort of difficulties evidenced

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<sup>215</sup> Cicin-Sain, 'A New Approach of The Croatian Tax Administration towards Taxpayers Based on Cooperation instead of Repression: A True Change in Attitude'. Page 856.

in Sweden, where taxpayers refused to cooperate under the fear that their information would be publicly accessible<sup>216</sup>.

### **5.8. Sweden (Fördjupad Dialog)**

Before the current programme, Fördjupad Dialog, Sweden initiated co-operative compliance in 2011 with the Fördjupad Samverkan initiative, which, unusually, was not preceded by a pilot. The programme sought a more trusting taxpayer-administration relationship, where the administration would use risk-based classifications to increase efficiency. This initial programme relied on invitations and, after a series of meetings between the parties involving existing risks and steps to address them, the signature of non-legally binding declarations of intent and the institution of dialogues intermediated by a dedicated administrative official.

Sweden's case is particularly interesting because it is one of the few initiatives that seems to have encountered a degree of failure which, according to Björklund Larsen, has meant that the model is 'almost entirely put on hold'<sup>217</sup>. While there is not a single cause that explains the programme's difficulties, qualitative evidence gathered by the author mentioned above indicates that the initial programme encountered active opposition from corporate taxpayers, industry associations, the academia, and other external stakeholders from its inception. These actors were concerned about the balance between the burdens and the benefits of participating and about specific legal issues including confidentiality (Sweden's domestic legal system requires most documents in

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<sup>216</sup> Björklund Larsen, 'SWEDEN: Failure of a Cooperative Compliance Project?'

<sup>217</sup> Ibid. Page 6.

possession of the authorities to be public), equality before the law in terms of the treatment granted to participants vs. non-participants, and whether the administration's discretion within the programme would breach the principle of legality<sup>218</sup>. Additionally, taxpayers were concerned about the lack of legal certainty any decisions reached within the programme would have. These concerns led to a situation where most large corporations declined to participate and only a handful of, mostly-government-owned, enterprises joined, with only one participant remaining active.

While the administration tried to change this situation and relaunched the programme in 2014, offering a reduced-scope version where taxpayers were asked for less disclosure, the criticism did not abate, and no new participants have joined. Unlike the UK or Denmark, it appears that the sector most opposed to co-operative compliance is not the political establishment, NGOs, the public at large or disgruntled members of the administration, but rather corporate taxpayers and their confederations. This highlights the need for co-operative compliance to be concerted with its potential regulatees prior to its launch.

Moreover, that most of the obstacles faced in Sweden appear to derive from the belief that the proposed co-operative compliance initiative would conflict with different features of that country's legal system such as its treatment of secrecy, the relationship between administrative agreements and the principle of legality, or the understanding of the concept of the equality under the law, suggest that co-operative compliance can be particularly difficult to implement in jurisdictions where there is a highly-rule-based conception of administrative

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<sup>218</sup>Ibid. Page 22.

law and where administrative discretion and flexibility are not a distinctive feature. This is potentially concerning for Colombia, which shares these characteristics.

### **5.9. Norway**

Norway exemplifies those cases where, despite the absence of a formal co-operative compliance programme, the relationship between large corporate taxpayers and the administration operates under a collaborative approach, which is heavily influenced by co-operative compliance. While Norway did carry out a co-operative compliance pilot from 2011 to 2013, and co-operative compliance was facilitated because the country had already introduced tax control framework regulations in 2009<sup>219</sup>, a decision was made not to roll out co-operative compliance formally upon completion of the pilot.

According to Brøgger and Aziz, the pilot was relatively successful, causing little conflict and developing smoothly. For these authors, the project fared well because of the tradition of collaboration already existing in Norway, but also because it ran concurrently with ordinary tax assessments and audits, participating taxpayers knew not to expect any preferential treatment in terms of substantive tax obligations, participation was voluntary, and because the project was designed to enhance the administration's knowledge, with a special administrative team tasked with obtaining constant feedback from the parties,

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<sup>219</sup> Brøgger B and Aziz K, *The setting for collaboration about tax compliance in Norway* (FairTax : Working Paper Series, 2018). Page 5.

rather than participating in the actual discussion of cases, and consequently being able to engage without making any moral or legal judgment<sup>220</sup>.

Regardless of the decision not to implement co-operative compliance formally, the high levels of taxpayer trust in the administration existing in Norway, together with a customary practice of non-binding consultations about uncertain tax positions and a high respect for institutional relationships have led to what Brogger and Aziz term 'collaboration on corporate tax compliance'<sup>221</sup>: A relationship which shares elements of co-operative compliance like the presence of dedicated administrative officials endowed with a degree of discretion and frequent candid dialogue between the parties. This collaborative approach is the result of a conscious effort by the administration to combine co-operative elements and a trusting philosophy with reinforced tax risk controls and enforcement, where needed. Administrative officials interviewed by Brogger and Aziz justified this combination based on the need to devise a model suitable for dealing with corporate taxpayers which provide a large part of the country's revenue, have highly sophisticated transactions, and expect a high-quality service in return for their compliance-mindedness and proper recordkeeping. According to these authors, the internal interaction between administrative staff more aligned with a risk assessment enforcement approach and those focused on building a trusting, non-adversarial relationship with corporations has not yet led to a synthesis of the two, meaning that regulation currently shows both vertical and horizontal enforcement characteristics.

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<sup>220</sup>Ibid. Page 15.

<sup>221</sup> Brøgger and Aziz, 2018. The Setting for Collaboration about Tax Compliance in Norway. Page 9.

Norway's commitment to institutional, rather than personal, relationships, means that dedicated administrative officials are not allowed to meet corporate taxpayers on their own if the company is only represented by another individual. Similarly, these officials are rotated between companies on a regular basis to avoid regulatory capture. While these measures assist in preventing corruption and strengthening the administration's accountability and public legitimacy, they reduce the model's efficiency and, considering how damaging excessive CRM rotation was seen by UK interviewees, can erode trust between the parties and reduce the potential to enhance commercial awareness.

Overall, Norway's decision to implement an approach that mixes co-operative compliance with traditional compliance is reported by different stakeholders interviewed by Brogger and Aziz to work reasonably well, with corporate taxpayers seeing the administration as service-oriented, and the administration seeing them as wanting to comply<sup>222</sup>. That said, taxpayers do have some of the UK and Colombian interviewees' concerns: a need for greater predictability from the administration, the feeling that the administration's commercial awareness is insufficient, and a desire for greater administrative guidance.

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<sup>222</sup>Ibid.

**PART II**  
**EMPIRICAL RESEARCH FROM THE UK AND COLOMBIA: RESULTS AND  
ANALYSIS**

## CHAPTER 6

### RESULTS OF UK EMPIRICAL RESEARCH

#### 6.1. Introduction.

This chapter presents the results of the empirical research carried out by the author in relation to the UK. As explained in chapter two, the main research method involved sixteen, one-on-one, semi-structured, interviews with Tax Directors of some of the largest corporate taxpayers in the UK conducted by the author during 2016-2017. To preserve confidentiality, participants are identified with a pseudonym and their employers are not named.

The questions formulated to interviewees sought to uncover whether the beliefs and practices in relation to tax -the tax culture- of UK large corporations and their tax directors are aligned with the premises of this regulatory model, particularly after considering the impact of the ongoing co-operative compliance engagement with HMRC.

Overall, findings indicate that co-operative compliance's validity in the UK's corporate context is high. The ideal taxpayer-administration relationship envisioned by interviewees appears to coincide with different guiding principles behind co-operative compliance including certainty, efficiency, mutual trust, and collaboration. Furthermore, interviewees' beliefs about the objectives HMRC should pursue also refer to features which characterise co-operative compliance, such as horizontal dialogue, transparency, and reciprocity.

Moreover, co-operative compliance's validity is strengthened by evidence of shifts towards higher tax risk aversion among corporate officers and corporations and the existence of various compliance-minded personal and

social norms including identifying compliance and risk minimisation as professional and corporate objectives, and perceiving other corporations, tax directors, and external tax advisors to be broadly compliant and not tax-aggressive. Responses also illustrate a change in corporate practices towards an increased focus on tax risk mitigation and/or compliance, higher involvement of boards in tax matters, a more robust risk-control role for in house tax teams, and modifications in how tax is considered within the business-decision-making process.

Additionally, most UK interviewees view their organisations' relationship with HMRC positively – often associating this with the introduction of co-operative dynamics, have a high level of trust in the administration, and tend to see its interventions as adequate. This suggests that HMRC's engagement with large corporate taxpayers under a more co-operative model has yielded some positive results. According to HMRC, implementing the model, together with other elements, has meant that 'the number of businesses who believe tax avoidance is acceptable and actively engage in aggressive tax planning continues to reduce'<sup>223</sup>.

However, findings also raise questions regarding co-operative compliance's sustainability in the UK: First, taxpayer trust in HMRC appears to be eroding because HMRC is perceived to be motivated by agendas other than ensuring compliance - which is what most interviewees see as the administration's ideal objective- and as modifying its behaviour to cater to political and public pressure. Second, several participants believe that two key

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<sup>223</sup> HMRC, *Large Business compliance -enhancing our risk assessment approach*. Page 6.

elements of the UK's large business compliance programme, CCMs (Customer Compliance Managers, formerly Customer Relationship Managers) and the BRR, exhibit serious flaws regarding responsiveness and certainty. Third, multiple respondents see HMRC's commercial awareness as poor, something that conflicts with co-operative compliance's requirement of a high level of insight into the regulatee's circumstances to produce targeted responses. Fourth, multiple interviewees perceive that HMRC has difficulties discovering non-compliance, and this can increase strategic taxpayer behaviour antithetical to co-operative compliance. Finally, interviews suggest that an important portion of the UK's large corporate taxpayers might only be superficially committed to compliance: While there is a trend towards greater risk aversion, and there are personal and social norms which favour voluntary compliance, a significant portion of corporations, and particularly corporate boards, are concerned with avoiding public exposure/reputational damage, rather than compliance *per se*, so strategic behaviour counter to co-operative compliance is still likely to be present in relation to sophisticated or low-visibility tax positions.

## **6.2. Alignment of taxpayer ideals with co-operative compliance's core elements**

Co-operative compliance's validity can be examined by assessing the factors which impact this model's legitimacy, its fairness, and/or its efficiency. These are hypothesised to be positively linked with the degree of alignment between a.) The regulation's objectives and those of its subjects; b.) The tax morale and behaviour which the model assumes regulatees have and what these are; and, c.) The role afforded to the regulator and the regulatee's expectations regarding such role.

### **6.2.1. Alignment between participant ideals about the taxpayer-administration relationship and the co-operative compliance model**

As explained in chapter four, co-operative compliance seeks to establish a taxpayer-administration relationship that is horizontal, collaborative, transparent, and based on mutual trust. Parties contribute to the same goal - compliance- through a reciprocal exchange of obligations: the administration is expected to provide legal certainty in a timely manner, and the taxpayer is expected to disclose its tax affairs truthfully and completely.

Thus, interviewees were asked about how the ideal taxpayer-administration relationship should be, and their views reveal a close alignment with the engagement envisioned by co-operative compliance. Values such as trust, timeliness, certainty, risk management, mutual understanding, and transparency were mentioned repeatedly<sup>224</sup>. Unlike related studies<sup>225</sup>, interviewees were asked about abstract ideals in addition to their views on specific values/characteristics associated with the co-operative model so that values mentioned in responses were “free” associations. The following word cloud illustrates:

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<sup>224</sup> 200-word frequency analysis (Nvivo), includes stemmed words and excludes selected terms.

<sup>225</sup> In HMRC/BMRB, 'Research to Support the Implementation of Proposals in the Review of Links with Large Businesses' (2007) 1, interviewees were asked about certainty and risk; in Freedman, Loomer and Vella, 'Corporate tax risk and tax avoidance: new approaches' (2009), they were asked about risk, PBL, TAARs, and their current relationship with HMRC, and in Freedman, Vella and Ng, *HMRC's Relationship with Business* (2014) questions centred around the current relationship with HMRC, the Business Risk Review, and HMRC's Litigation and Settlement Strategy. While HMRC/TNS/BMRB, 'Exploring Large Business Tax Strategy Behaviour' (2015) 1 enquired about businesses' tax culture, and HMRC, it did not ask participants about abstract ideals.



taxpayers' perception of the administration as helpful can boost compliance<sup>227</sup>, seeing the taxpayer as a 'customer' that requires 'friendly' service can be problematic, since it diffuses public authority, and entails shifts in power dynamics which might not be desirable<sup>228</sup>. Indeed, P29, criticized what they perceived as HMRC's concern with being 'taxpayer friendly':

'I wonder if they have tried to be taxpayer friendly, but calling taxpayers customers is ridiculous, perhaps they have tried to go too far...'

Excessive closeness between the parties can be detrimental to compliance if it leads the administration to breach legal equality, allowing them to engage in practices for which comparable non-participants would be disciplined, or if it damages the system's public legitimacy<sup>229</sup>.

However, results indicate that the interviewees' aspiration is not a subservient administration, but rather one which provides timely certainty. Certainty is associated with knowing the administration's position in advance, not necessarily with reaching agreements. This coincides with existing research<sup>230</sup> and is understandable, both from a legal perspective, where certainty is a systemic objective, and from an economic one, since uncertainty affects taxpayers' ability to calculate the costs and benefits of compliance

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<sup>227</sup> Gangl K and others, "'How can I help you?'" Perceived service orientation of tax authorities and tax compliance' (2013) 69 *FinanzArchiv: Public Finance Analysis* 487.

<sup>228</sup>Tuck, 'The Changing Role of Tax Governance: Remaking the Large Corporate Taxpayer into a Visible Customer Partner'.

<sup>229</sup>See Freedman, *Responsive Regulation, Risk, and Rules: Applying the Theory to Tax Practice*; De Cogan, 'A Changing Role for the Administrative Law of Taxation', and Picciotto S, 'Indeterminacy, Complexity, Technocracy and the Reform of International Corporate Taxation' (2015) 24 *Social & Legal Studies* 165.

<sup>230</sup> HMRC/BMRB, 'Research to Support the Implementation of Proposals in the Review of Links with Large Businesses', page 45

decisions<sup>231</sup>. Additionally, certainty relates to the conception of risk management as foreseeing possible outcomes of engaging in determinate tax positions - rather than increasing compliance- that was exhibited by participants throughout their interviews. For P4,

...the step forward should be that HMRC make their position clear and either settle, prosecute or go away and make the position conclusive as opposed to leaving things standing.

For P36, what is expected is not consensus, but willingness to discuss openly:

Openness, transparency, real-time engagement, an ability to discuss transactions in advance, not so much getting a ruling but being able to tell them: “this is what we are doing and how we see risk, what do you think about it?” I know the Board values it highly...If you were to ask: “Do you want a tax cut or certainty?” We would take the latter.

Thus, the interviewees’ ideal taxpayer-administration relationship embraces dialogue, another important feature of co-operative compliance, per opposition to ‘Command and Control’ models, where the authority does not seek a regulatory conversation, but rather to issue mandates<sup>232</sup>.

Interviewees also showed alignment with co-operative compliance in their desire for a transparent and proactive engagement with the administration: for P1, the relationship should entail ‘Real-time full disclosure and transparency’, for P27 the right approach involves an ‘open...real-time interaction’, and for P16, the ideal relationship should be ‘transparent, cooperative, and in real time’.

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<sup>231</sup>Van der Hel-van Dijk and Siglé, 'Managing compliance risks of large businesses: A review of the underlying assumptions of co-operative compliance strategies', page 763.

<sup>232</sup> Braithwaite, 'Responsive Regulation and Taxation: Introduction'.

Based on existing HMRC-commissioned research<sup>233</sup>, transparency and openness have remained as constant aspirational points.

Interestingly, several interviewees stated that their aspiration of *proactiveness* or effective real-time exchanges is not being fulfilled by HMRC because of CRMs having limited authority/ability to provide responses about complex or highly material positions, and/or the administration's reluctance to reach agreements following events like the UK Uncut case and various amendments to the Litigation and Settlement Strategy<sup>234</sup>.

As expected for a regulatory model relying on voluntary compliance, self-regulation, and full and truthful disclosure<sup>235</sup>, trust is crucial for several respondents: Thus, P10 emphasized the importance of 'mutual trust', P18 referred to 'mutual trust and respect', and P20 argued that the parties need to 'be honest...display integrity, build a position of trust.'. Responses commonly described trust as bilateral and involving different facets, including reliability and predictability, transparency, and, consistent with literature on procedural fairness<sup>236</sup>, respect - recognizing the other party as *prima facie* free of suspicion.

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<sup>233</sup>HMRC/BMRB, 'Research to Support the Implementation of Proposals in the Review of Links with Large Businesses', page 45, and HMRC/IFF, *Large Business Panel Survey 2014* (HM Treasury 2015), page 2,

<sup>234</sup> See De Cogan, 2013, 'UK Uncut Legal Action v HMRC: legal inaction and a return to Fleet Street', and Freedman, Vella and Ng, 2014, *HMRC's Relationship with Business*.

<sup>235</sup> Van der Hel-van Dijk and Siglé, 'Managing compliance risks of large businesses: A review of the underlying assumptions of co-operative compliance strategies', page 769, and OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance*, page 29.

<sup>236</sup> See Tyler and Blader, 'The Group Engagement Model: Procedural Justice, Social Identity, and Cooperative Behavior'.

According to P25, lack of trust towards taxpayers meant that the relationship with HMRC was facing difficulties:

‘You expect the starting point not to be that you are doing something egregious and lying about it, but unfortunately that’s the starting point for all discussions.’

Interviewee ideals also evidence alignment with co-operative compliance in seeing the relationship as horizontal, with parties collaborating on an equal footing, regardless of having different perspectives<sup>237</sup>. As argued by the Netherlands Tax Administration,

‘Constructive cooperation is possible only when both parties understand the position and (on occasion, conflicting) interests of the other party’<sup>238</sup>

Precisely, for P16, the ideal relationship,

‘should be healthy enough...to have differences of views and adequately resourced on both sides’

Likewise, for P20, in an ideal engagement, the corporation feels,

Comfortable talking to them [the administration] and them feeling they receive all the information they needed. We get healthy challenges from HMRC, I find it constructive. You see each other’s perspective

These quotes suggest that some regulatees see HMRC as a partner who should be robust, something which contradicts the expected utility model’s assumption of a strategic taxpayer interested in a weaker administration. Moreover, the taxpayers’ recognition that even in an ideal setting there would be differences regarding tax positions suggests that, unlike what critics of co-operative

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<sup>237</sup>Osofsky, 'Some Realism About Responsive Tax Administration', page 127.

<sup>238</sup> Netherlands Tax and Customs Administration, *Horizontal Monitoring Within: The medium to very large businesses segment*. Page 7.

compliance worried about regulatory capture often argue<sup>239</sup>, taxpayers do not necessarily base the model's validity on authorities agreeing with them.

Different interviewees explicitly referred to co-operative compliance as ideal. Thus, P1 and P3 explicitly stated that 'co-operative compliance' was ideal and P23 argued that the current relationship was 'pretty close to ideal', suggesting only the need for HMRC to increase its commercial awareness and, surprisingly, for corporate tax officers to boost their knowledge of how 'HMRC works'. This supports the conclusion that taxpayers see co-operative compliance as valid, and that most of them, with exceptions like P25, P29, and P4, who have had negative experiences with obtaining legal certainty and feeling like they are trusted, perceive their experience of it as broadly positive.

#### **6.2.2. Interviewee beliefs about the objectives that *should* drive HMRC coincide with co-operative compliance's theoretical expectations**

Another area where participants revealed ideological alignment with co-operative compliance's premises is in their views about the objectives that *should* guide HMRC, since they believe that the administration ought to commit itself to objectives coinciding with those of this regulatory model.

Thus, P16 and P25 highlighted the importance of providing certainty as an administrative goal and combined it with other elements of co-operative compliance like collaboration or responsiveness. For P16, the administration should 'contribute to practices which give certainty [and] be more effective in

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<sup>239</sup>Picciotto, 'Indeterminacy, Complexity, Technocracy and the Reform of International Corporate Taxation', 2015.

supporting companies', and for P25, HMRC should 'manage certainty' and 'spend less resources' by being 'proportionate'.

Additionally, several interviewees mentioned that HMRC should use taxpayers' risk profiles to calibrate regulation, something which demonstrates alignment with co-operative compliance's responsiveness<sup>240</sup>, and which matches HMRC's risk-based approach following the Varney Review<sup>241</sup> and the OECD's push for linking co-operative compliance to tax control frameworks<sup>242</sup>. For example, P17 argued that HMRC 'should be adopting a risk-based approach' and P20 stated that 'in an ideal world' the administration's focus should be on taxpayer 'governance and controls'. Thus, participants see risk-based responsive regulation as valid and are comfortable with the meta-regulation associated with co-operative compliance<sup>243</sup>, particularly now that HMRC is considering relying further on the corporations' tax control framework<sup>244</sup>.

As when describing the ideal taxpayer-administration relationship, several interviewees highlighted the importance of mutual understanding and trust. Thus, P20 referred to the need for HMRC to focus on parties understanding and feeling comfortable with each other. Similarly, P23 mentioned that preserving 'confidence' was necessary, and P22 stressed the

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<sup>240</sup> Black J and Baldwin R, 'Really Responsive Risk-Based Regulation' (2010) 32 Law & Policy 181

<sup>241</sup> See Varney D, *Service Transformation: A Better Service for Citizens and Businesses, a Better Deal for the Taxpayer* (HM Treasury 2006), page 24.

<sup>242</sup> OECD, *Co-operative Tax Compliance: Building Better Tax Control Frameworks*.

<sup>243</sup> Braithwaite, 'Meta Risk Management and Responsive Regulation for Tax System Integrity'.

<sup>244</sup> HMRC, 2018 HMRC, *Large Business Compliance -Enhancing our Risk Assessment Approach: Summary of Responses*

importance of the administration 'understanding the business model', something which can also be linked to responsiveness.

Finally, the connection between co-operative compliance's elements and interviewee beliefs was explicitly seen in P3's response, according to which the administration's objective 'should be co-operative compliance...' based on horizontal collaboration:

'I believe that we both have the same job, my job is to pay the right amount of tax and theirs is to collect it, there should be no conflict between us.'

### **6.3. Evidence of a corporate shift towards higher tax risk aversion and of compliance-minded personal and social norms**

#### **6.3.1. Evidence of a corporate shift towards higher tax risk aversion and/or *compliance-mindedness***

##### **6.3.1.1. Reputational risk as an increasingly prominent driver of corporate tax behaviour.**

Interview responses show that UK corporations and tax directors are increasingly aware of reputational risks related to corporate taxation, making them more risk-averse. This strengthens co-operative compliance's validity because this model is premised on risk-based responsiveness, and on taxpayers voluntarily controlling risk. While this coincides with previous studies<sup>245</sup>, responses indicate an increased concern about reputational risk

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<sup>245</sup> See Gallemore J, Maydew EL and Thornock JR, 'The Reputational Costs of Tax Avoidance' (2014) 31 Contemporary Accounting Research 1103; Freedman, Loomer and Vella 'Corporate tax risk and tax avoidance: new approaches'; Dyreng SD, Hoopes JL and Wilde JH, 'Public Pressure and Corporate Tax Behavior' (2016) 54 Journal of Accounting Research 147; Holland K, Lindop S and Zainudin F, 'Tax Avoidance: A Threat to Corporate Legitimacy? An Examination of Companies' Financial and CSR

parallel to heightened media coverage and political scrutiny which boost corporate tax affairs' visibility. Thus, while reputation was an emerging concern in 2009<sup>246</sup>, it is now an overbearing, practically omnipresent, preoccupation. Thus, co-operative compliance's potential to control tax risk by limiting the probability of being involved in a highly-visible tax controversy increases the model's attractiveness to regulatees.

According to interviewees, reputational risk is one of the main factors behind a corporation's tax behaviour, a criterion for determining a tax position's acceptability, a trigger for board involvement in corporate tax affairs, and a key element in devising corporate tax strategies and tactics. Reputational risk would regulate tax behaviour because corporations fear the economic impact of negative publicity<sup>247</sup> and, because tax directors personally fear stigma<sup>248</sup>, particularly in the context of closely-knit occupational networks<sup>249</sup>.

For participants, companies analyse key stakeholders' perception of the companies' tax behaviour and the consequences this might have for the organisation's financial/business standing and its 'license to operate' (P16).

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Reports' (2016) British Tax Review 310; Freedman, Vella and Ng. *HMRC's Relationship with Business* (2014)

<sup>246</sup> Doyle, Hughes and Glaister, 'Linking Ethics and Risk Management in Taxation: Evidence from an Exploratory Study in Ireland and the UK'

<sup>247</sup> Hanlon M and Slemrod J, 'What does tax aggressiveness signal? Evidence from stock price reactions to news about tax shelter involvement' (2009) 93 *Journal of Public Economics* 126, and Kim JB, Li Y and Zhang L, 'Corporate tax avoidance and stock price crash risk: Firm-level analysis' (2011) 100 *Journal of Financial Economics* 639.

<sup>248</sup> Dhami and al-Nowaihi, 'Why do people pay taxes? Prospect theory versus expected utility theory'

<sup>249</sup> Based on interviewee responses to questions about their participation in occupational networks (100% discuss tax with peers, 92% participate in tax-related organisations) and their influence (92% and 100% find them influential or partially influential), this is an important factor.

Responses evidenced that reputational risk depends on the industry sector involved. As explained by P11:

The industry sector is important: if you are a “direct-to-consumer” business it is easier for the public to boycott your products if they don’t agree with what they are reading about your tax practices and this is different to “business-to-business” businesses

This connection is supported by research by Hanlon and Slemrod<sup>250</sup>, according to which industries with a direct relationship with consumers and firms engaged in public procurement are likely to experience more negative market reactions to adverse tax news, and by Dyreng et.al’s<sup>251</sup> findings of higher reactance among *politically sensitive* industries.

As argued by Loretz and Moore<sup>252</sup>, group conformity and market competition place pressure on corporations to emulate their competitors’ behaviour whenever said behaviour is thought to provide an economic advantage. Furthermore, research by HMRC/TNS<sup>253</sup> shows that the competitors’ tax behaviour is influential for UK firms’ tax strategy.

Nevertheless, as argued by Freedman, Vella, and Loomer, concern with reputational risk does not guarantee tax behavioural changes<sup>254</sup>. Thus, while Dyreng et.al concluded that reputational costs lead firms to change their behaviour by increasing disclosures, altering their use of ‘tax haven’ subsidiaries

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<sup>250</sup> Hanlon and Slemrod, 'What does tax aggressiveness signal? Evidence from stock price reactions to news about tax shelter involvement'

<sup>251</sup> Dyreng, Hoopes and Wilde, 'Public Pressure and Corporate Tax Behavior'

<sup>252</sup> Loretz and Moore, 'Corporate tax competition between firms'

<sup>253</sup> HMRC/TNS, 2015 HMRC/TNS/BMRB, 'Exploring Large Business Tax Strategy Behaviour'

<sup>254</sup> Freedman, Loomer and Vella, *Analyzing the Enhanced Relationship Between Corporate Taxpayers and Revenue Authorities: A U.K. Case Study*, page 118

and increasing their tax expense<sup>255</sup>, Gallemore et.al found that revelations about using tax shelters did not decrease companies' tax avoidance, that negative capital market fluctuations were temporary and fully reversible, and that identification as a tax shelter user did not increase executive turnover or negative media bias<sup>256</sup>.

However, interviews indicate that reputational risk does have consequences in determining tax positions for some UK corporations. Thus, reputation was one of the criteria mentioned by interviewees for determining a tax position's acceptability. For P36, a tax position should not be:

'...something that, if it becomes public, the coverage and perception would be negative... [the test] now is: If I'm being interviewed, how do I justify this?'

While some participants argued that reputational risk, exemplified by the so-called 'Daily Mail test' (P10), is not overly concerning because 'media don't understand the technicality', 'because it doesn't make for a good story' (P10), or because of the public's perceived inability to understand technical issues (P23), these views were a small minority (12.5%)..

#### **6.3.1.2. Public perception is an increasingly important factor in devising tax strategies and tactics.**

Another finding evidencing UK factors which strengthen co-operative compliance's validity is the heightened importance that most interviewees believe corporations attach to public perception when devising tax strategies

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<sup>255</sup> Dyreng, Hoopes and Wilde, 'Public Pressure and Corporate Tax Behavior', page.181

<sup>256</sup> Gallemore, Maydew and Thornock, 'The Reputational Costs of Tax Avoidance'

and tactics. As with reputational risk, responses suggest that, while this phenomenon is not new<sup>257</sup>, it has intensified. In P29's words,

'[public perception is taken into account] increasingly now, ten years ago it would be further down the list...'

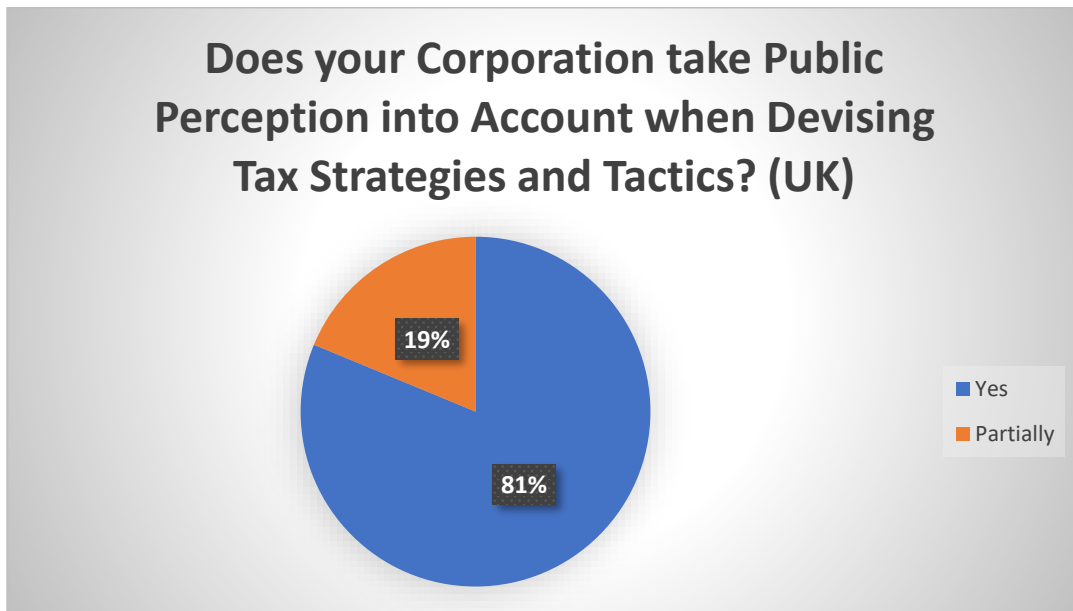


Figure 10 UK Interviewee responses on the importance of public perception for corporate tax strategies and tactics

Consistent with research by Graham et.al<sup>258</sup>, most interviewees stated that public perception is an important variable during the tax decision-making process.

The relationship between public perception's role in corporate tax strategies and positions and co-operative compliance is twofold: Reputational risk aversion influences the corporation's decision-making processes, increasing the importance of obtaining certainty through co-operative compliance; additionally, taxpayers adapt their tax control frameworks and may

<sup>257</sup>Freedman. Loomer and Vella, 'Corporate tax risk and tax avoidance: new approaches', page 90

<sup>258</sup> See Graham JR and others, 'Incentives for Tax Planning and Avoidance: Evidence from the Field' (2014) 89 Accounting Review 991

censure positions judged to be publicly unsustainable. Thus, valuing public perception in tax decision-making suggests that corporate taxpayers are risk-conscious and that the desire to avoid risk may translate into self-regulation, something desirable for co-operative compliance.

Generally, interviewees linked public perception's impact to the press coverage of the corporations' tax affairs: For P29, public perception, shaped by media coverage, -what this interviewee labels the 'Daily Mail Test'- filters potentially reputationally-damaging tax positions. Likewise, for P4,

'We are careful about our reputation and don't want to do anything that would embarrass us in a major newspaper'.

Moreover, P36 explained that past experiences with negative coverage drove corporations to alter behaviour and prevent a reiteration.

The increased importance of public perception associated with reputational risk coincides with previous findings by Freedman, Vella, and Ng<sup>259</sup>, according to which boards in several UK corporations were concerned with tax because of a desire to prevent media/political exposure. Additionally, it parallels findings from other jurisdictions like the United States<sup>260</sup>.

While public perception's higher influence might indicate risk aversion and self-regulation positive for co-operative compliance's validity, it must be acknowledged that for some taxpayers, what matters is preventing negative exposure, not compliance itself. Hence, some interviewees stated that corporations consider public perception when devising their tax positions, not

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<sup>259</sup> Freedman and others, *HMRC's Relationship with Business*, page 82.

<sup>260</sup>Mulligan E and Oats L, 'Tax risk management: evidence from the United States' (2009) *British Tax Review* 680, page 688; Dyreng, Hoopes and Wilde, 'Public Pressure and Corporate Tax Behavior'

intending to change them, but rather to anticipate their disclosure's effect and 'manage' it. P22 summarised:

'can we explain it to shareholders, and for them to understand how and why we have done it?'

This attitude of 'explaining' to confront and change public opinion was described by Holland et.al, according to which a portion of large UK corporations reacted to public scrutiny by trying to change public views, in what these authors label 'influencing'<sup>261</sup>.

Coincidental with previous UK findings<sup>262</sup>, consumer-facing industries appear to find public perception more influential than their non-consumer-facing peers. For P27:

'We are a customer facing business, so the impact of reputational damage for us is greater than a "b2b" business...'

For P10, considering public perception is important to protect consumer brands:

[public perception] is important...we are a consumer brand so reputational risk is hugely important, the culture is that we have a low risk appetite, certainly for tax, but probably for most things.

Nevertheless, even corporations with low consumer visibility may consider public perception to protect their business' standing. This is so for corporations involved in public procurement, who fear losing government contracts if they face public scrutiny regarding tax<sup>263</sup> or if they are required to disclose non-compliance under the UK's Public Contract Rules 2015. Additionally, existing research shows that UK corporations are concerned with the administration's

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<sup>261</sup>Holland, Lindop and Zainudin, 'Tax Avoidance: A Threat to Corporate Legitimacy? An Examination of Companies' Financial and CSR Reports', page 314.

<sup>262</sup> Freedman, Loomer and Vella, 'Corporate tax risk and tax avoidance: new approaches'; HMRC/TNS/BMRB, 'Exploring Large Business Tax Strategy Behaviour'.

<sup>263</sup> Dyreng, Hoopes and Wilde, 'Public Pressure and Corporate Tax Behavior'.

perception of them and 'placed a high value on their reputation with HMRC and sought to maintain trusted status'<sup>264</sup>. This strengthens the link between reputational risk awareness and co-operative compliance.

Paradoxically, while heightened public awareness about tax may increase co-operative compliance's validity by making corporate taxpayers adopt more robust tax risk control frameworks and/or become more risk averse, it could also weaken it: Sensationalistic media coverage might lead the public to confuse cooperation with regulatory capture, lowering public legitimacy and making corporations question their participation. Moreover, taxpayers who perceive public opinion to be fleeting, incapable or unwilling to engage with taxation's technicalities might not develop enough risk aversion to commit them to co-operative compliance or might not participate in it if their disclosure is not *bullet-proofed* against leaks. For example, for P11, an 'education gap' means that the public might not comprehend when a position is aggressive and when it is not, and for P17:

'I am concerned about the public because media doesn't want to educate, and the public at large doesn't understand or is not willing to understand'

These concerns about 'incorrect' or 'inaccurate' press coverage coincide with Freedman, Vella, and Loomer's argument that,

...the public reaction to engagement in legal tax planning is unlikely to be clear cut, given that attitudes to tax are wide-ranging, and also given that the media may have considerable difficulties understanding and reporting complex tax issues.<sup>265</sup>

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<sup>264</sup> HMRC/TNS/BMRB, 'Exploring Large Business Tax Strategy Behaviour', page 16.

<sup>265</sup> Freedman, Loomer and Vella, *Analyzing the Enhanced Relationship Between Corporate Taxpayers and Revenue Authorities: A U.K. Case Study*. Page.124.

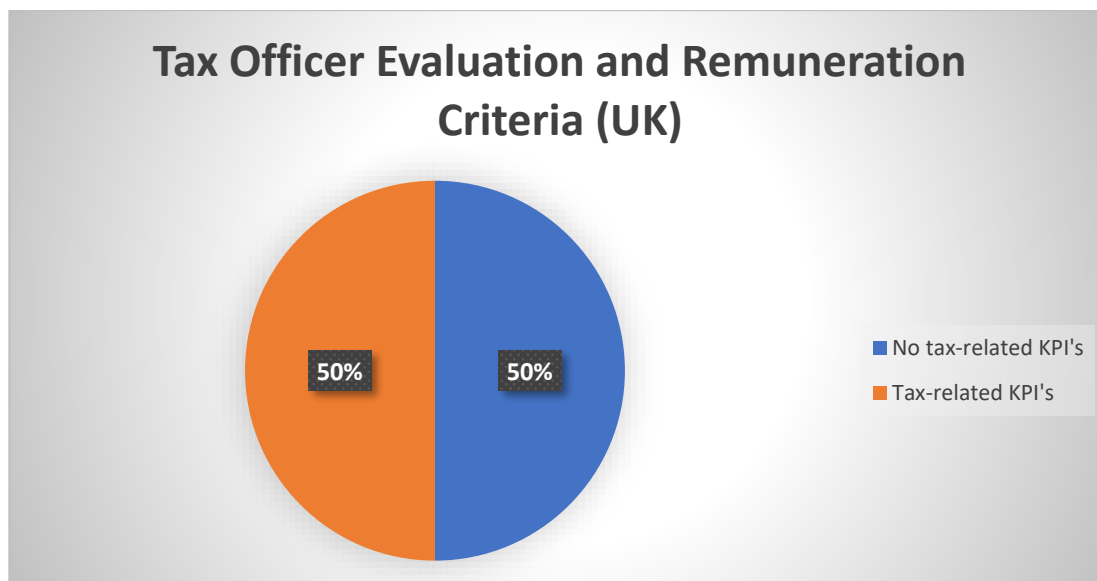
Moreover, tax authorities might be influenced by the pressure to respond to public opinion, and this can damage co-operative compliance. As detailed in 6.6.1.1, multiple interviewees stated that their relationship with HMRC is deteriorating precisely because of what they perceive as the administration taking a 'step back' in reaction to public opinion.

### **6.3.1.3. Reduced use of tax-related KPI's and shift away from tax-expense or ETR minimisation for tax director remuneration and/or evaluation**

A third interview finding evidencing co-operative compliance-conducive UK corporate practices and beliefs is that, according to interviewees, corporations are moving away from a tax director remuneration and/or evaluation centred on achieving tax reductions, towards non-tax savings benchmarks, or not using tax-related metrics. P10 illustrates:

The ETR used to be a key performance indicator, but now that is not the case. My incentive is...to minimise tax risk and make sure disputes are managed to conclusion...

This is positive for co-operative compliance because reducing the incentives for corporate tax officers to maximise tax savings diminishes the likelihood that regulatees engage in strategic, potentially non-compliant behaviour designed to reduce tax payments and allows tax directors to focus on compliance and/or reducing tax risk.



*Figure 11 UK interviewees' corporate evaluation and remuneration criteria*

Only 50% of interviewees reported being evaluated and/or remunerated using tax-specific metrics. The remaining participants were assessed using “ordinary” HR metrics applied to all employees. For example, P17 stated that ‘We are evaluated like any global function...based on the group results’ and P18 expressed that ‘We are not measured by tax rates, cash flows or release of provisions.’

Moreover, among those evaluated and/or compensated using tax-specific metrics, only half were assessed using benchmarks incentivising tax-expense reduction. Even if given ETR targets, interviewees believe that the use of aggressive tax planning to reach targets is now limited:

The days are long gone where people think “we are short on the tax line, let’s implement a clever plan” ...clever plans no longer work in an after-BEPS world... (P11)

Other interviewees argued that instead of seeking tax savings, their targets encouraged predicting tax outcomes and reducing contingencies:

We do have an ETR target, but it's not about you having to hit an ETR of X, but rather, what is my prediction, and then, why did I reach it or not? It's about forecasting... (P25)

These findings contrast with older UK studies, according to which achieving tax savings and the tax rate were two of the main evaluation criteria for in house tax departments<sup>266</sup>. Additionally, they suggest that UK large corporations might be adopting a less-aggressive tax posture by removing incentives for tax leadership to embrace risk. As pointed in existing literature<sup>267</sup>, performance-based remuneration geared towards risky behaviour is correlated with higher levels of tax-reducing behaviour, so removing these incentives might contribute to lower tax risk and points towards a risk-wary taxpayer that would be expected to function well under a risk-management-based co-operative compliance framework.

#### **6.3.1.4. Corporate tax team resources are devoted primarily to compliance, rather than controversies or tax planning.**

Another area where interviews depict a context favourable to co-operative compliance is corporate tax team resource allocation, measured by the time spent by teams on specific tasks. As shown by Porter<sup>268</sup>, and Robinson et.al<sup>269</sup>,

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<sup>266</sup> Porter BA, 'Survey of in house tax departments in United Kingdom corporates' (1999) *British Tax Review* 32. Page 38.

<sup>267</sup> Armstrong CS, Blouin JL and Larcker DF, 'The incentives for tax planning' (2012) 53 *Journal of Accounting and Economics* 391; Gaertner FB, 'CEO After-Tax Compensation Incentives and Corporate Tax Avoidance' (2014) 31 *Contemporary Accounting Research* 1077, and Taylor G and Richardson G, 'Incentives for corporate tax planning and reporting: Empirical evidence from Australia' (2014) 10 *Journal of Contemporary Accounting & Economics* 1

<sup>268</sup> Porter, 'Survey of in house tax departments in United Kingdom corporates'

<sup>269</sup> Robinson JR, Sikes SA and Weaver CD, 'Performance Measurement of Corporate Tax Departments' (2010) 85 *The Accounting Review* 1035

tax departments' resource allocation can elucidate the corporation's views regarding tax.

Responses reveal that most interviewees' corporations devote most of their resources to compliance, that planning is often a secondary area, and that some taxpayers are reducing the resources allocated to disputes because of adopting a more collaborative engagement with HMRC. Notwithstanding exceptions in relation to the individual role of tax directors, these trends suggest regulatees are more concerned with compliance than with the tax minimisation and/or adversarial attitude that might conflict with co-operative compliance.

Interviews reveal that, while corporations differ, compliance consumes the most resources, with almost half of interviewees stating that this was their team's primary task, taking up to 60 or 70% of the team's time (P38, P3). Planning was often described as a secondary, with participants like P16 referring to 'limited planning', or as having lower percentages of resource allocation like 20% (P17) or 10% (P20).

When compared to Porter's findings, according to which UK tax teams spent an average of 28% of their time in tax planning, and only 10% in advisory<sup>270</sup>, interview findings suggest that a.) more time is now spent on advisory - associated by interviewees to internal tax risk control-, b.) time previously spent on planning is now devoted to tax policy (e.g. P11, P18, and P22), and/or c.) that more resources are allocated to compliance, particularly tax reporting. This implies that corporate tax cultures are more compliance-oriented

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<sup>270</sup> Porter 'Survey of in house tax departments in United Kingdom corporates', page 42.

and/or concerned with tax risk, characteristics which show alignment with co-operative compliance and strengthen its validity.

Interviews also reveal that participating in the UK's co-operative compliance programme has led some corporate taxpayers to embrace collaboration with the administration. According to P29, this explains a reduction in the resources allocated to disputes:

Not that much time [spent] in disputes, because of the way we work with Revenue. It's not about disputes, but agreeing something upfront, real time stuff...we have tried to agree positions.

*Proactiveness*, another important element of co-operative compliance, is seen as reducing controversies. For P36:

we've tried to move to a much more engaged process with the tax authorities, so we are proactive and deal with things real-time...that has reduced dispute-related compliance...

However, some interviewees raised the possibility that, despite the tax team spending less resources on it, planning has not decreased, but rather shifted to be an exclusive responsibility of the tax director or senior executives. P23 illustrated this:

For the team, [the resource allocation is] probably 40% compliance, 40% disputes and 20% planning; for me, about 5% compliance, 40% disputes, and 55% planning.

Likewise, according to P17,

'My senior team is much more heavily weighted towards dispute resolution and planning'

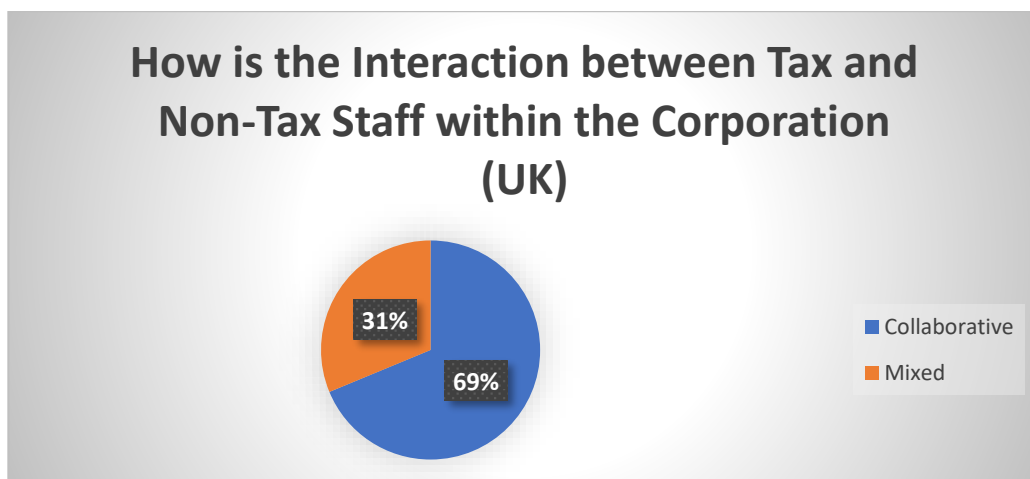
While it is possible that the restrictions placed on planning in recent years (e.g. those derived from the BEPS Action Plan or the ATAD) and the heightened tax risk sensitivity mean that tax planning has been assigned to more senior staff because it requires extra-careful consideration, it is also possible that planning has not changed substantively but has just been left to the device of tax

directors. This suggests that HMRC should exercise caution and closely examine the projects personally conducted by tax directors.

### **6.3.1.5. Corporate tax teams and non-tax teams are increasingly collaborating**

Interview responses regarding the interaction between in-house tax teams and non-tax teams provide further evidence about a corporate context where increased risk aversion and/or focus on compliance strengthen co-operative compliance's validity. Most participants reported that tax teams collaborate with other teams, potentially reducing tax risk and strengthening self-regulation.

In a collaborative environment where the tax team is trusted, proactive consultations between teams can reduce unintentional non-compliance and, provided the tax team is compliance-focused and risk averse, intentional non-compliance initiated by business units. Inversely, where the interaction is contentious, the policies and mandates of the tax team may be resisted or disregarded.



*Figure 12 Interaction between tax and non-tax staff in interviewees' corporations (UK)*

A sizeable majority of interviewees described the interaction between corporate tax teams and non-tax teams as collaborative. A recurring theme was the concept of 'partnership'. According to P17,

'I'd say they [non-tax] see us as partners, we've all got a role and a contribution to make, we get on well'

The partnership described by interviewees resembles the taxpayer-administration interaction envisioned by co-operative compliance, with non-tax teams being 'open' (P23) about their tax uncertainties, and the tax team 'helping' (P11) them 'control' (P16) tax risk. Building personal connections and commercial awareness are key elements, and several tax directors including P22, P38, and P18 mentioned the tax team's increased understanding of the company's underlying business as a crucial improvement. For P20,

'...We try to work with people. Get out into business, get to know key people'

Enhanced tax-team commercial awareness is positive for co-operative compliance because tax specialists can have a greater knowledge of their companies' potential tax issues, prevent non-compliance, and have a full knowledge of the positions that, being uncertain and material, should be disclosed.

As with most other findings related to risk aversion, the collaborative interaction described by interviewees appears to be the result of a gradual process of change. According to P10,

'I can think of a time when tax would say something and people would try to go over the top, but that is no longer the case'

Likewise, for P36,

...there's been change... before I started, the tax department was seen as remote and no one understood it, and business did its own thing, we spent a lot of time trying to change that.

This might be partly attributable to the UK's environment, where corporate taxation's higher public visibility has increased the importance of tax control and risk awareness among corporations. As argued in existing studies<sup>271</sup> and consistent with taxpayer responses to HMRC's BRR Consultation<sup>272</sup>, this may also be an impact of penalty-supported tax-related legislation like the Senior Accounting Officer rules and of HMRC's efforts to engage company boards.

Alternatively, corporations initiated change endogenously, by fostering intra-company dialogue and/or by adopting other organisational policies. For example, P4 mentioned that their employer stopped basing employee variable compensation on after-tax results, focusing instead on pre-tax results to reduce the incentive to engage in aggressive tax behaviour. Considering that research by Phillips has shown that 'annual after-tax accounting-based bonuses provide incremental motivation' for executives to promote efforts to lower firm ETRs<sup>273</sup>, changes like this one can reduce tax risk and facilitate compliance, since the corporation's tax burden is not associated by tax executives with take-home pay.

Finally, the fact that most interviewees referred to the interaction in positive terms contrasts with the findings of HMRC's 2015 report, according to which businesses reported the relationship between the tax team and other units

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<sup>271</sup> Freedman, Vella and Ng, *HMRC's Relationship with Business*

<sup>272</sup> HMRC, *Large Business Compliance -Enhancing our Risk Assessment Approach: Summary of Responses*

<sup>273</sup> Phillips JD, 'Corporate Tax-Planning Effectiveness: The Role of Compensation-Based Incentives' (2003) 78 *The Accounting Review* 847. Page 868.

as 'occasionally antagonistic'<sup>274</sup>. This suggests that relationship has continued to improve over the past years.

#### **6.3.1.6. Tax is most frequently analysed alongside other business variables before making a business decision**

A final finding about corporate factors that strengthen co-operative compliance's validity in the UK is that over half of the interviewees' companies were reported to have shifted towards considering tax alongside other variables before business decisions are taken, not driving them, or reactively. This is favourable for co-operative compliance because it reduces the likelihood of intentional non-compliance from tax savings being the main or primary purpose of a transaction, and of accidental non-compliance resulting from business plans that didn't adequately account for their tax consequences. In P4's words,

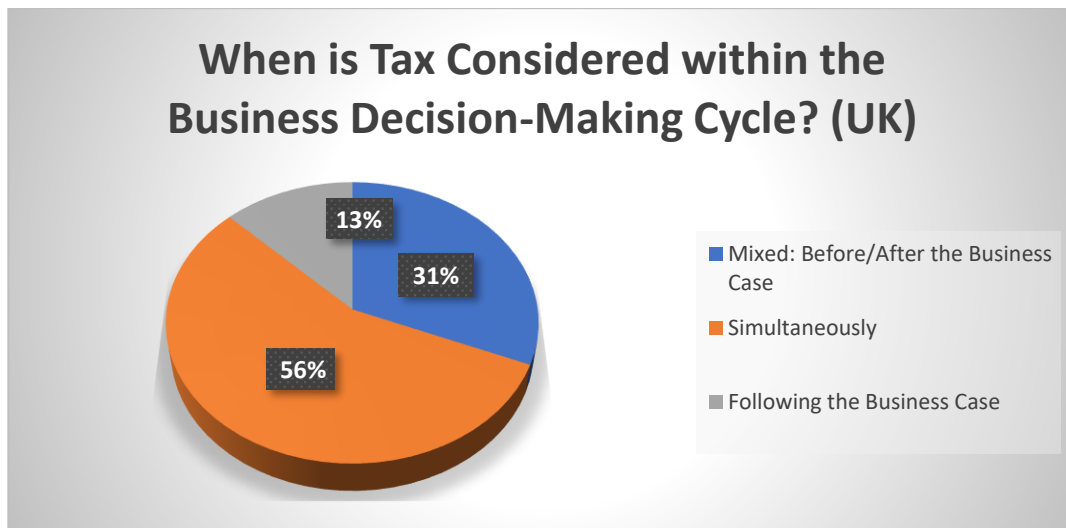
there is someone in the tax team that understands the opportunities and can influence in real time in order to get an optimised tax result in line with the commercial objective, which is paramount. If we are alongside, we can mitigate risk.

Most participants stated that their corporations analyse a business case's tax impact simultaneously to other variables. Consequently, transactions are normally not driven by a pre-conceived tax plan and tax is ordinarily evaluated together with other costs. For P29, 'tax is not the driver but informs the cost of doing it [the business]'.

For a smaller group of interviewees, the situation varies, with instances where tax drives transactions, others where it is considered alongside business variables, and others where it is only considered *ex post facto*.

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<sup>274</sup>HMRC/TNS/BMRB, 'Exploring Large Business Tax Strategy Behaviour', Page 9.



*Figure 13 Timing of tax considerations within the business-decision-making process (UK)*

Glaister and Frecknall Hughes, who studied this variable in the UK, had originally concluded that tax was normally not driving business strategy and that business and tax decisions were increasingly taken simultaneously<sup>275</sup>. This trend appears to have consolidated, the difference being that, among companies which do not follow the trend, tax considerations may predate business decisions or lag behind them, something that is equally problematic in terms of compliance and tax risk. According to P27:

The danger happens when the business does something and doesn't talk to tax, someone does something stupid and we've got a problem...trying to keep track of everything is quite a challenge...there are instances where that doesn't happen, we are not asked to give input, much to my frustration.

Several interviewees referred to the need to have a 'partnership' between tax and business to further the company's business and simultaneously prevent non-compliance deriving from rash, commercially-driven decisions. This

<sup>275</sup> Glaister KW and Frecknall Hughes J, 'Corporate strategy formulation and taxation: evidence from UK firms' (2008) 19 British Journal of Management 33. Page 40

'partnership' language coincides with the one in responses concerning tax and non-tax team interactions. In P1's words:

[we]...operate in tandem. We would only apply tax once an investment opportunity has been identified. Our tax team would work with the business opportunity manager to identify the extent to which there might be different options available, to understand likely consequences, and find the choice that is most aligned with the business interests.

For multiple participants, considering tax alongside other business factors represents a break from previous practices, where tax would have been the driver. For P18:

10 years ago, things might have been different, you could seed ideas into people...that is not frequent now... that is part of how the code has evolved and now it needs to start with the commercial.

According to interviewees, considering tax simultaneously often involves the tax department performing a "greenlighting" procedure whereby, once a commercial plan has been devised, the tax department assesses it and approves or vetoes it. According to P25:

nothing gets signed off if it doesn't have a tax green light, we will rarely red-light, we are involved in conceptual discussions, all driven by the commercial guys, but we are a business partner. The days have gone where you created an instrument because it saves us tax, it used to be that you had "tax companies", not anymore.

Whilst contemplating tax before a business plan does reduce the risk of potentially abusive tax-driven transactions, there is a risk that the company's tax function is overwhelmed by the pressure to greenlight a business case that the firm has developed, regardless of the associated tax risks. In that instance, tax risk is not diminished and therefore there is no positive effect for co-operative compliance.

#### **6.4. Evidence of compliance-minded or otherwise co-operative compliance-conducive personal and social norms among tax directors.**

#### **6.4.1. Tax directors' professional objectives relate mainly to risk minimisation, certainty, and/or sustainability, rather than tax minimisation.**

In addition to the evidence about corporate factors associated with greater risk aversion and/or a concern for tax compliance, interviews revealed the existence of a series of co-operative compliance-conducive and/or compliance-minded personal and social norms among corporate tax directors which strengthen co-operative compliance's validity.

As defined by Bobek, Roberts, and Sweeney, norms are 'self-based standards or expectations for behaviour'<sup>276</sup>. Their importance stems from the fact that taxpayers operate in a complex social environment, populated with actors and interaction networks<sup>277</sup>. Tax directors are expected to see their tax morale and behaviour influenced by the beliefs and practices perceived in others, particularly those they identify closely with and/or share group membership, and by what they think that behaviour *should* be. Thus, social norms influence corporate tax behaviour both indirectly, through corporate tax officers internalising social norms and moulding their own personal norms in accordance, and directly, through the impact that public perception and the behaviour of competitors might have on companies<sup>278</sup>.

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<sup>276</sup> Bobek D, Roberts R and Sweeney J, 'The Social Norms of Tax Compliance: Evidence from Australia, Singapore, and the United States' (2007) 74 J Bus Ethics 49. Page 50.

<sup>277</sup> Sigala M, Burgoyne CB and Webley P, 'Tax communication and social influence: evidence from a British sample' (1999) 9 Journal of Community & Applied Social Psychology 237, Traxler C, 'Social norms and conditional cooperative taxpayers' (2010) 26 European Journal of Political Economy 89

<sup>278</sup> Finocchiaro Castro M and Rizzo I, 'Tax compliance under horizontal and vertical equity conditions: An experimental approach' (2014) 21 Int Tax Public Finance 560

The first of these norms is the widespread belief among interviewees that their professional objectives centre around minimising tax risk, increasing certainty, and achieving sustainable compliance, rather than on maximising tax savings. For the author, this indicates an increased validity for co-operative compliance because the personal standards of the executives playing a key role defining corporations' tax approaches show alignment with co-operative compliance's ethos regarding risk aversion, a desire to increase compliance, and bolster certainty.



Figure 14 Tax Directors' Professional Objectives in relation to Taxation (UK)

When asked about their main professional objective<sup>279</sup>, most interviewees were primarily concerned with risk management, assurance and predictability<sup>280</sup>, whereas only a minority saw tax savings as their main goal (e.g. P29). For

<sup>279</sup> Word frequency analysis: 200 terms with stemmed words grouping and selected filters.

<sup>280</sup> Six of the top-ten most frequent terms refer to risk management and certainty: 'surprises', 'risk', 'sure', 'manage', 'accurately', and 'sustainable'.

multiple participants like P16, P18, P20, P36, or P25, the objective of tax directors is to manage tax risk and provide certainty by means of accurate forecasting and predictability. For example, P18 stated that

‘we are in an era at the moment where we don’t want unwelcome surprises’.

Similarly, according to P20,

My key objective is giving some reliable guidance. We are a publicly listed company and the analysts and shareholders want to know the numbers, so I want to avoid surprises, make sure that everything is robust and can be supported, no nasty surprises and audits.

For others, like P11 and P23, sustainability was an essential objective:

‘My main goal is to make sure that the corporation’s tax policies and practices are on a sustainable footing now and for the future.’ (P11)

Interviewees like P1, P22, and P4, referred to compliance explicitly:

My main objective is to ensure that we tax effect every transaction in an appropriate way, that we don’t miss anything, that we are accurate in our compliance and report completely and accurately to external stakeholders... (P4)

These responses show regulatee alignment with two of co-operative compliance’s assumptions: That taxpayers seek certainty, and that they are, in principle, risk averse. However, as will be discussed later, this does not necessarily translate into higher compliance because some taxpayers may comply superficially to avoid risk, whilst maintaining substantive non-compliance. Indeed, some of the participants that expressed concern about managing tax risk have not stopped seeing taxes under a utility maximisation optic. Thus, interviewees like P27 and P10 saw obtaining tax savings as a parallel objective, exposing views akin to the traditional *tax-as-a-cost* philosophy, rather than the *tax-as-a-payment-to-a-presumed-state-shareholder*

notion favoured by contemporary CSR scholars<sup>281</sup>. In them, the notion of an alleged “fiduciary duty”<sup>282</sup> of the corporate tax officer to reduce tax remains present. P27 illustrates this *mixed* view:

‘...my role is two-fold: one, to mitigate risk, the latent tax liabilities, and then, simply, the optimisation of tax cost for the business. ‘

#### **6.4.2. Most interviewees perceive the main objectives of large corporations in the UK to be risk averse and/or compliance-minded**

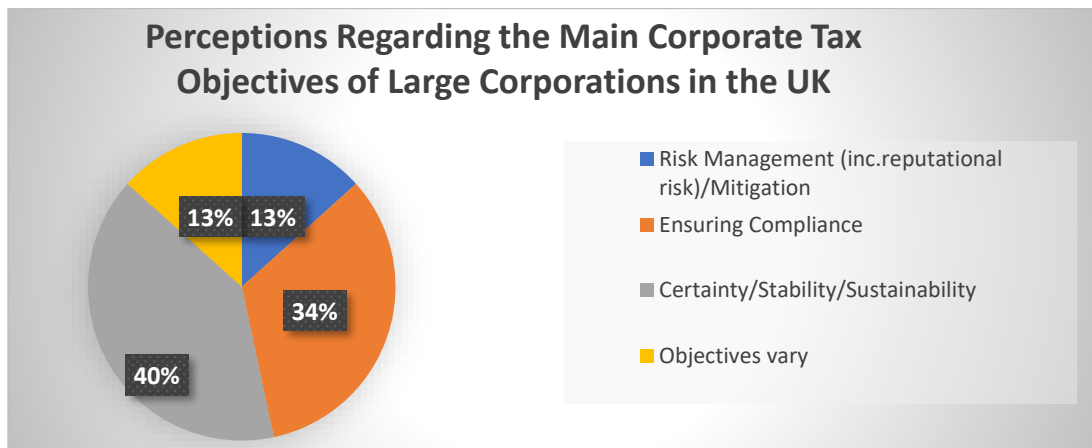
A second finding suggesting that UK tax directors exhibit personal and social norms associated to tax risk aversion and/or compliance, and therefore, that co-operative compliance’s validity in the UK is high, is that most interviewees perceive that the main tax objectives of corporations are compliance-minded, including ensuring compliance, managing/reducing tax risk, and maintaining the certainty/stability/sustainability of tax positions. Less than 20% of interviewees felt tax minimisation was still a primary objective. These perceptions constitute what Wenzel calls a ‘descriptive norm’, a standard of conduct based on what ‘reference others actually do’<sup>283</sup>, since these attitudes are perceived by taxpayers to be prevalent in the environment they identify with.

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<sup>281</sup> See Gribnau H, 'Corporate Social Responsibility and Tax Planning: Not by Rules Alone' (2015) 24 *Social & Legal Studies* 225, Lanis R and Richardson G, 'Is Corporate Social Responsibility Performance Associated with Tax Avoidance?' (2015) 127 *J Bus Ethics* 439, and Hasseldine J and Morris G, 'Corporate social responsibility and tax avoidance: A comment and reflection' (2013) 37 *Accounting Forum* 1.

<sup>282</sup> Garbarino C, 'Aggressive Tax Strategies and Corporate Tax Governance: an Institutional Approach' (2011) 8 *European Company and Financial Law Review* 277

<sup>283</sup> Wenzel M, 'Misperceptions of social norms about tax compliance: From theory to intervention' (2005) 26 *Journal of Economic Psychology* 862. Page 863.



*Figure 15 Interviewee perceptions about the main tax objectives of large corporations in the UK*

Most interviewees felt that the main tax objective of large corporations in the UK is to have tax certainty, stability, or sustainability. This view, expressed by P17, P22, P25, P36, P23, and P1, appears to relate with reputational risk and public perception, since certainty and stability are seen as what key stakeholders desire. P1 explained,

‘...A number of corporations have the main concern of stability...It has to do with the perception of the market and analysts and investors.’

The interviewees’ perception of risk mitigation as a key corporate objective coincides with the importance attributed to tax risk and reputation, responses about board involvement, and the drivers of corporate tax behaviour, and with previous UK research<sup>284</sup>.

Additionally, a large proportion of interviewees like P11, P20, P29, P4, and P18, argued that corporations see compliance as their main objective. In P4’s words,

‘There’s definitely alignment on compliance, no tax director wants problems here’

<sup>284</sup> Freedman, Vella and Ng *HMRC’s Relationship with Business*; Freedman, Loomer and Vella ‘Corporate tax risk and tax avoidance: new approaches’

The interviewees' perception of corporate taxpayers as intending to reduce tax risk and ensure compliance indicates the existence of taxpayer norms that suggest that policies based on voluntary compliance like co-operative compliance can be ideologically legitimate for regulatees.

However, where the motivation for complying or managing risk is limiting negative publicity, rather than commitment to the rules, it is possible that the regulatees' postures are ones of *capitulation*, or *game playing*, to use V.Braithwaite's terminology<sup>285</sup>, where strategically-minded taxpayers attempt to game HMRC, maintaining covert non-compliant positions, provided their risk of exposure is low.

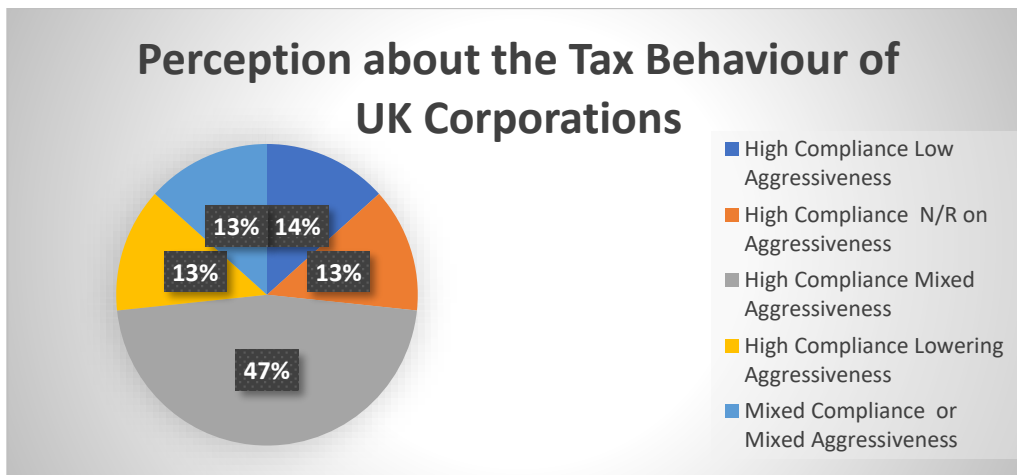
#### **6.4.3. Most interviewees believe that corporations in the UK are highly tax-compliant and display low tax aggressiveness.**

Coinciding with the finding that most interviewees perceived large corporations in the UK focus on compliance and tax risk management, over 87% of interviewees perceived UK corporations as behaving in a broadly compliant fashion. While most participants felt that UK corporations display varying degrees of tax aggressiveness, no respondents saw a highly tax aggressive panorama, and a significant fraction argued that aggressiveness is low or is being reduced. This shows that tax directors and corporations are exposed to social norms favourable to co-operative compliance's validity because they portray compliance as a socially-extended, and therefore, expected, behaviour.

Participant views are summarised below:

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<sup>285</sup> Braithwaite, Murphy and Reinhart, 'Taxation Threat, Motivational Postures, and Responsive Regulation'



*Figure 16 Interviewee Perceptions about the Tax Behaviour of UK Corporations*

Thus, UK corporations were said to be ‘broadly compliant’ (P18) and ‘becoming more so’ (P3), ‘compliant’ (P16, P17, P25, P27), ‘very compliant’ (P29, P22), ‘excellent’ in complying (P11) or ‘responsible’ (P23).

The panorama regarding tax aggressiveness is more complex. For some participants, there has been a decrease in tax aggressiveness among corporations as they try to ‘unwind’ pre-existing schemes (P11) in an environment which shuns this type of behaviour, both in the UK and globally. In P17s words,

...in the past there were differences in levels of aggressiveness, planning to a certain degree, but I would say that there is definitely a levelling of the playing field happening as a result of all of the changes, so much global scrutiny...

For a second, larger group of participants, high levels of compliance are accompanied by widely varying degrees of tax aggressiveness, with differences associated to the industry sector (P1), ownership (P29), or other factors like the possibility of disputes with the administration (P4). P20 illustrates:

The majority of UK corporates do their best to pay the right tax at the right time. I think there are definitely companies that are more aggressive than others, I don’t know if it’s driven by culture or by individuals...

Finally, a minority of respondents felt that corporations in the UK were highly compliant and not tax aggressive. For P23, this would be attributable to a broader 'low risk appetite'.

Most interviewees' perception of other corporations' tax behaviour as compliant and not uniformly tax aggressive suggests that compliance-oriented social norms are being *signalled*<sup>286</sup>, meaning that tax directors responsive to group conformity are more likely to steer their organizations in that direction. This increases co-operative compliance's validity because it shows regulatee compliance-mindedness.

While the facts that compliance was identified to be a general trend, that tax aggressiveness was not seen as uniformly high, and that some interviewees felt aggressiveness was low or that it was decreasing, support the idea that there are social and personal norms in the UK corporate context which impact co-operative compliance's validity positively, the fact that most interviewees still perceive tax aggressiveness to be present counsels caution and suggests that HMRC ought to remain vigilant regarding strategically-minded taxpayers.

#### **6.4.4. Most interviewees believe tax directors and external advisors exhibit a broadly compliant tax behaviour**

Interviews indicate that, in addition to social norms of compliance and/or risk aversion among corporations, participants perceive similar norms in relation to other tax directors and external tax advisors. The author believes this combination of compliance-inducing and risk-averse norms at the organisational and individual levels strengthens co-operative compliance's validity in the UK.

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<sup>286</sup> Posner, 'Law and social norms: The case of tax compliance'

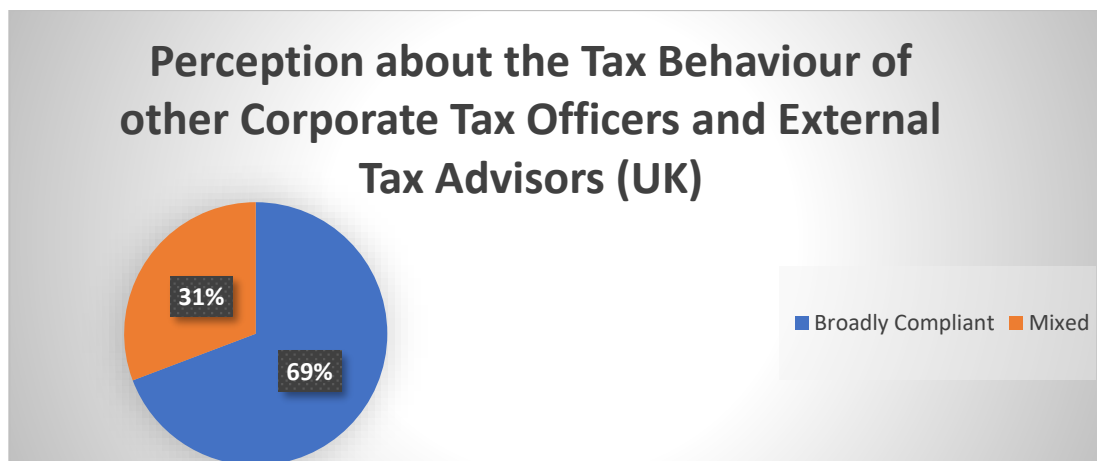
The importance of other tax professionals' perceived behaviour comes from identification and conformity. Following Wenzel, group identification allows for patterns of behaviour and ideas from reference groups to be internalised<sup>287</sup>. Because the tax community can be identified as an occupational group<sup>288</sup>, perceived behaviours from those seen as self-references can become personal (and organisational) standards and, even if found incompatible, shape behaviour by distinguishing it from that which is judged negatively. The internalisation or resistance to reference group norms is influenced by the array of variables at the social, organisational, and personal level that tax directors are exposed to. Thus, assuming high group identification, a group norm could be more or less attractive depending on those other factors.

As displayed below, 69% of interviewees stated that they perceive their peers to be broadly compliant and minimally tax-aggressive. The remainder argued that behaviour varies, with some professionals complying and others exhibiting non-compliance or tax-aggressiveness:

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<sup>287</sup> Wenzel, 'An analysis of norm processes in tax compliance'

<sup>288</sup> Hasseldine, Holland and Van der Rijt, 'Companies and taxes in the UK: Actors, actions, consequences and responses'



*Figure 17 Interviewee perceptions about the tax behaviour of other tax directors and external advisors (UK)*

In line with the trend found in other responses, the current situation of perceived compliance and lower tax aggressiveness among tax professionals was often seen as the result of a shift from aggressive tax planning and ‘dodgy tax practices’ (P16) towards lower risk (P10), ‘business-focused’ (P27, P36), compliance (P11, P18). For P22:

... [tax officers and tax advisors] are very compliant; they like to be compliant. They are not aggressive. They are less aggressive than they used to be, also large corporations. What was acceptable 10 years ago is probably now deemed to be avoidance.

Interestingly, several respondents stated that advisors have been ‘slower’ to change than corporations. According to P18:

Advisors were a little bit behind as Plc’s wanted to shift their attitude towards tax...some advisors might have thought this was temporary and that they would go back, but companies were just moving, realigning...their days of spending time thinking about schemes are largely gone...

Similarly, several participants felt that tax advisors faced conflicting interests:

For P3, ‘advisors are conflicted [because] they like to get fees from selling tax schemes’, and for P25 advisors ‘are struggling to find a business model’ and, consequently, display a variable behaviour. This coincides with literature,

according to which tax advisors sometimes facilitates compliance, and sometimes non-compliance, depending on whether their know-how is used for mitigating risk, or encouraging tax aggressiveness<sup>289</sup>. Hasseldine et.al summarise this point: 'In essence, accounting firms are not only enforcers, but also exploiters'<sup>290</sup>.

Notably, several participants stated that, while large tax advisory firms were broadly compliant and not tax aggressive, smaller firms were highly aggressive. Thus, for P23, 'smaller firms are different; some are very aggressive', and for P29,

'some of the smaller firms are ridiculously aggressive, particularly [in relation to] employment schemes'

The author believes that most interviewees' perception of tax directors and external tax advisors as displaying compliant, and often conservative, tax behaviour supports the hypothesis that UK corporate taxpayers are confronted with compliance-minded and/or risk averse descriptive social norms that are favourable for co-operative compliance because participating taxpayers feel that they are conforming to their reference group by behaving compliantly and shunning tax risk. Nevertheless, while aggressive positions identified as risky would be expected to be reduced, those with low visibility or materiality might remain.

#### **6.4.5. The interviewees' criteria for classifying tax positions and judging their acceptability reveal tax risk aversion and discouragement of aggressive tax-reduction.**

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<sup>289</sup> Frecknall-Hughes and Kirchler, 'Towards a General Theory of Tax Practice'

<sup>290</sup> Hasseldine, Holland and Van der Rijt, 'The market for corporate tax knowledge'. Page 46.

Interview responses show that, despite definitional differences, UK tax directors' criteria for classifying tax positions and determining their acceptability are broadly comparable to the parameters used by HMRC and the judiciary for this purpose. Referring to concepts such as commerciality and artificiality, even if differently understood, is positive for co-operative compliance's validity, because interparty discussions can be narrowed down to coming to an agreement on whether the tax position breaches the benchmark rather than having to agree a different benchmark and then assess it against the facts.

Most respondents stated that they rely on multiple factors to assign labels like "avoidance", "planning" or "tax optimisation" to tax positions. These combinations generally involve criteria present in primary or secondary legislation, administrative guidance, and case law, such as whether a transaction was primarily motivated by tax or non-tax purposes (*commerciality*), whether it was contrived or lacking economic substance (*artificiality*), and if the applicable legal mandates regarding the transaction in question are being followed (*legality*). While several interviewees view extra-legal factors as indicative of tax compliance, these often sit alongside legal factors, or demonstrate risk aversion. Only a minority of interviewees referred to criteria like their 'gut feeling' or a sense of moral or ethical obligation:

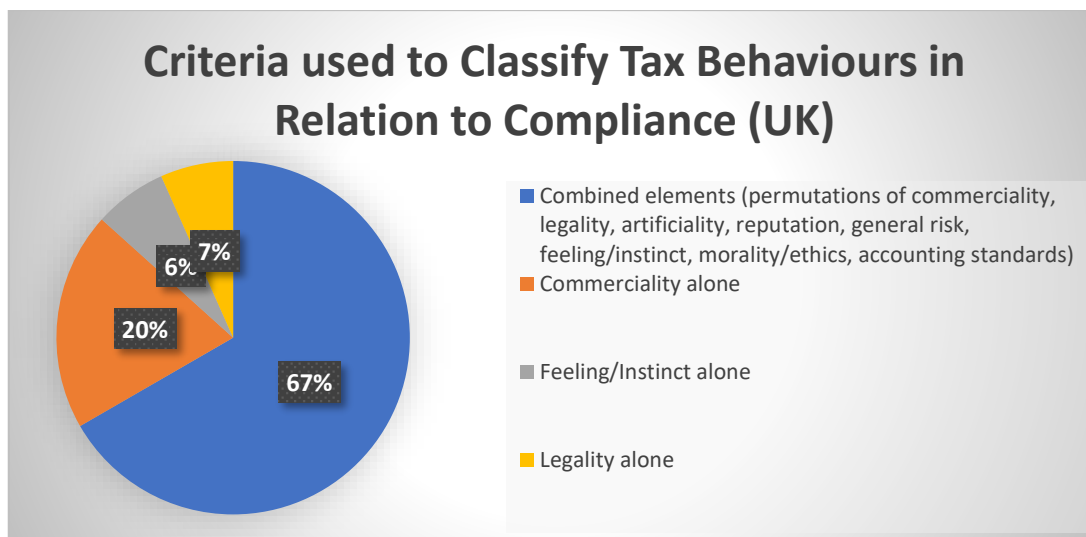


Figure 18 Criteria used to classify tax positions' compliance by interviewees (UK)

Commerciality was often associated to asking what drove the transaction<sup>291</sup>.

P10 illustrates,

‘is something commercial, would we have done it this way, or is it a tax thing?’

Commerciality's importance can be related to the prominence given to this concept by HMRC within the BRR's framework, where a taxpayer's 'tax strategy' risk is measured by the presence of planning 'which does not support genuine commercial activity'<sup>292</sup>.

Artificiality was associated with 'substance' (P22), not 'adding' elements which would not have been there but for tax savings (P1), or not 'manufacturing' tax savings 'out of nothing' (P3). Legality's role was more complex because, whilst most interviewees associated it with respecting the *letter* and *intent* of the law, they used different approaches to ascertain the latter (e.g., P4 saw it as 'how the government would interpret it', whereas P10 focused on whether

<sup>291</sup> This is interesting considering the OECD's MLI's and the EU's ATAD's reliance on primary purpose tests for preventing tax abuse. See Freedman, Loomer and Vella 'Corporate tax risk and tax avoidance: new approaches' for UK tax directors' views on main purpose tests.

<sup>292</sup> HMRC, *Large Business compliance -enhancing our risk assessment approach*. Page 12.

parliament would be 'comfortable with the outcome'). As explained by Freedman<sup>293</sup>, defining and discovering the 'spirit' of the law is a particularly complex matter. While complex, among others, because of the absence of clear and univocal parliamentary materials, the legislature's intent, and not that of the administration, should be the guiding parameter.

Legality's use as a criterion for classifying a tax position is interesting for co-operative compliance because, as explained in chapter five, some of the 'behavioural factors' assessed by HMRC in its BRR are the taxpayer's disclosure of 'significant innovative interpretations of the law', 'legal uncertainty', and 'regularly structuring transactions in a way which gives a tax result contrary to the intentions of Parliament'<sup>294</sup>.

The findings described above are echoed in the responses regarding the criteria used to determine a tax position's acceptability, since most interviewees rely on combinations of the criteria for classifying positions discussed earlier, including legality, commerciality, artificiality, and reputational risk. The importance placed on commerciality and artificiality coincides with earlier research conducted by Freedman, Vella, and Loomer, who reported that these criteria were used by UK tax directors to judge a hypothetical tax position's acceptability<sup>295</sup>. However, as shown below, artificiality has acquired greater pre-eminence:

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<sup>293</sup> Freedman J, 'Interpreting tax statutes: tax avoidance and the intention of Parliament' (2006) 123 Law Quarterly Review 53

<sup>294</sup> HMRC, *Large Business compliance -enhancing our risk assessment approach*. Page 15.

<sup>295</sup> Freedman, Loomer and Vella, 'Corporate tax risk and tax avoidance: new approaches'. Pages 96-99.

## What are the Criteria for Determining whether a Tax Position is Acceptable? (UK)

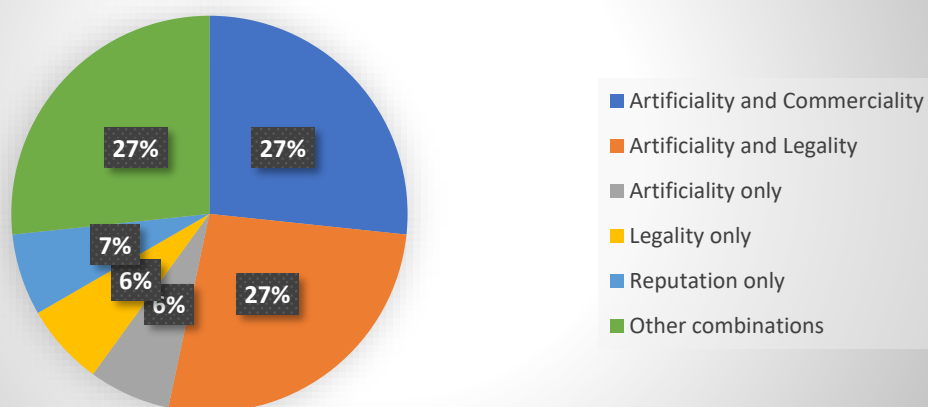


Figure 19 Criteria used for determining a tax position's acceptability in interviewees' corporations (UK)

The interviewees' focus on these factors, shared by the administration and other authorities (naturally, with different approaches and potential confrontations), supports the idea that, despite different interpretations about each factor's meaning, there are elements of a shared regulatory language between them. This does not mean that the standards are objective, or that taxpayers and the administration judge a position equally. Indeed, the open texture of tax rules means that taxpayers might see a position as "planning" where HMRC sees "abuse"<sup>296</sup> and that the parties interpret the criteria differently. Indeed, HMRC argues that differences between their and taxpayers' interpretation of the law account for are behind 18% of the UK's tax gap<sup>297</sup>.

Nevertheless, regardless of the parameters' subjectivity, referring to the same benchmarks to assess tax positions enhances co-operative compliance's

<sup>296</sup> Devereux, Freedman and Vella, *Paper 1: Tax Avoidance* (Oxford University Centre for Business Taxation 2012).

<sup>297</sup> See HMRC, *Measuring tax gaps* 2017 edition. Page 11.

validity because it is easier to enter discussions when parties have different interpretations of a concept than when they use completely different benchmarks.

## **6.5. Findings about the UK's experience with co-operative compliance that increase co-operative compliance's validity.**

This section introduces evidence supporting the hypothesis that the UK's experience with co-operative compliance contributes to the model's validity because of its association with corporate taxpayers' increased trust in HMRC and their perception of the administration's use of power as legitimate.

In this section, findings are analysed using the *Slippery Slope* framework<sup>298</sup>, according to which taxpayers' voluntary compliance depends, among others, on the taxpayer's perception of the administration's power and trustworthiness. Responses suggest that currently there is a high level of trust in HMRC among corporate taxpayers and that the administration's exercise of power is seen as *legitimate*, thus creating a dynamic that would be conducive for co-operative compliance.

### **6.5.1. Evidence of increases in taxpayer trust**

#### **6.5.1.1. Participants revealed high levels of trust in HMRC. Co-operative compliance practices are linked with *implicit* trust<sup>299</sup>**

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<sup>298</sup> Refer to chapter three.

<sup>299</sup> Gangl, Hofmann and Kirchler, 'Tax authorities' interaction with taxpayers: A conception of compliance in social dilemmas by power and trust'

Taxpayer trust in the administration, labelled by Scholtz and Lubell<sup>300</sup> and Frey and Torgler<sup>301</sup> as *vertical* trust, plays a crucial role in incentivising voluntary tax compliance. While trust has multiple definitions, and is a multifaceted concept, it has been proven by multiple authors, analysing different dimensions like predictability/reliability, integrity/neutrality<sup>302</sup>, respect, or goals seen as legitimate, to be positively associated with tax compliance, generally as a result of trust's impact on the taxpayers' assessment of the tax system as procedurally fair<sup>303</sup> and its effect on the *posture* or attitude assumed by them in relation to the administration<sup>304</sup>.

Trust is particularly important for co-operative compliance because it enables parties emotionally, but also rationally, to switch from a traditionally confrontational dynamic, to a collaborative one<sup>305</sup>. Thus, trust is essential for co-operative compliance because it allows parties to feel comfortable about their reciprocal obligations: Taxpayers need to trust the administration to preserve confidentiality and provide them with legal certainty in order to be persuaded to fully disclose their uncertain positions, come to agreements, and uphold them.

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<sup>300</sup> Scholz and Lubell, 'Adaptive Political Attitudes: Duty, Trust, and Fear as Monitors of Tax Policy'

<sup>301</sup> Frey BS and Torgler B, 'Tax morale and conditional cooperation' (2007) 35 *Journal of Comparative Economics* 136

<sup>302</sup> Murphy K, 'Regulating More Effectively: The Relationship between Procedural Justice, Legitimacy, and Tax Non-compliance' (2005) 32 *Journal of Law and Society* 562

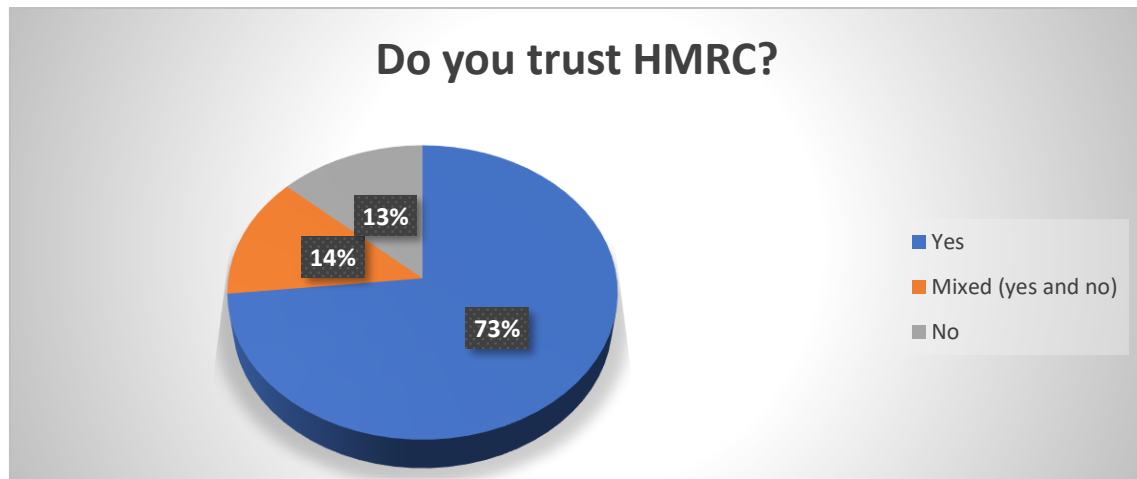
<sup>303</sup> Frey, 'Deterrence and tax morale in the European Union' and Stalans and Lind, 'The meaning of procedural fairness: A comparison of taxpayers' and representatives' views of their tax audits'

<sup>304</sup> Braithwaite, Murphy and Reinhart, 'Taxation Threat, Motivational Postures, and Responsive Regulation'

<sup>305</sup> OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance*

Similarly, the administration must trust taxpayers to allow them to self-regulate, to tailor its responses to their characteristics and behaviour, and to engage in a horizontal dialogue aimed at increasing certainty.

Interviews revealed that taxpayers' trust in HMRC is particularly high, with most respondents stating that they trusted HMRC unreservedly:



*Figure 20 Interviewees' trust in the administration (UK)*

This generalised trust may indicate an environment conducive to voluntary compliance, akin to what Wahl et.al describe as a 'synergistic' tax climate:

In a synergistic climate, the authorities trust that taxpayers pay their taxes honestly, and therefore the authorities treat them with courtesy and respect. In turn, the taxpayers trust that authorities provide good services for them, and thus they pay their fair share of taxes.<sup>306</sup>

Interestingly, some participants stated that they trusted HMRC despite instances of whistle-blowers (P4), disturbances (P10), or being treated as suspects (P3). This combination of unqualified trust and/or trust following negative experiences suggests that in some cases trust might have moved from an evidence-based, rational calculation, to an emotion-based social norm that has arisen after

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<sup>306</sup> Wahl, Kastlunger and Kirchner, 'Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the "Slippery Slope Framework"'. Page 385.

several years of trust-creating practices, including those associated to co-operative compliance, like the availability of CRMs. However, as shown by the interviewees' high levels of trust in the judiciary for tax matters (62% of UK interviewees trust it), it is also possible that high levels of trust are also related to a broader society-wide tradition of trust in public authorities.

It is possible to see parallels between the interviewees' notion of trust in HMRC and what Gangl et.al, described as the passage from *reason-based* trust to *implicit* trust. For these authors, what separates reason-based trust and implicit trust is that the former stems from a deliberate, instrumental mental calculation that pre-empts action, whereas the latter is unintended and irrational, an unconscious impulse activated as a response. Under Gangl et.al's theory, as reason-based trust increases and becomes routine, it can transform into implicit trust.<sup>307</sup>

Reaching a point where a routine of administrative trust-building behaviours leads taxpayers to trust it in a more automatic, less-calculated fashion, does not mean that reason-based trust is not present, since the two can coexist. Emotionally trusting taxpayers are still expected to rationally assess the administration's attitude and competence, both in relation to specific discussions or exchanges, and to aspects such as the role of CRMs, or HMRC's perceived commercial awareness.

While the interviewees' high levels of trust support the idea of an increased validity of co-operative compliance in the UK's corporate context,

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<sup>307</sup> Gangl, Hofmann and Kirchler, 'Tax authorities' interaction with taxpayers: A conception of compliance in social dilemmas by power and trust'. Page 16.

there is concern for the future. Responses to different questions indicate that this elevated level of trust is being eroded because of a perceived misalignment between the goals taxpayers perceive HMRC pursues and those they think it ought to pursue, and because taxpayers sense that the administration is increasingly unwilling and/or unable to provide legal certainty in a timely manner.

### **6.5.2. Evidence related to taxpayers' perception of HMRC's power as *legitimate*<sup>308</sup>**

#### **6.5.2.1. Most respondents felt that HMRC's interventions on their corporations' tax affairs were adequate**

In addition to the impact of high levels of trust in the administration, responses reveal that co-operative compliance's validity in the UK is also strengthened because of the interviewees' prevailing perception of HMRC's exercise of power as adequate.

As posited in the Slippery Slope Framework, voluntary compliance thrives when, in addition to trusting it, taxpayers feel that the administration exercises its power *legitimately*, channelling its strength at non-compliant taxpayers, treating those who comply non-coercively, focusing on material issues, and not being arbitrary. According to Prinz et.al,

'The willingness of compliance-minded taxpayers to cooperate with the tax authorities might be enhanced by the service quality of tax authorities'<sup>309</sup>

Thus, co-operative compliance's validity should increase when taxpayers feel that administration's interventions are adequate, rather than excessive or weak.

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<sup>308</sup> Prinz, Muehlbacher and Kirchler, 'The slippery slope framework on tax compliance: An attempt to formalization'

<sup>309</sup> Ibid. Page 21.

Most interviewees felt that HMRC exerted an *adequate* degree of intervention on their companies:

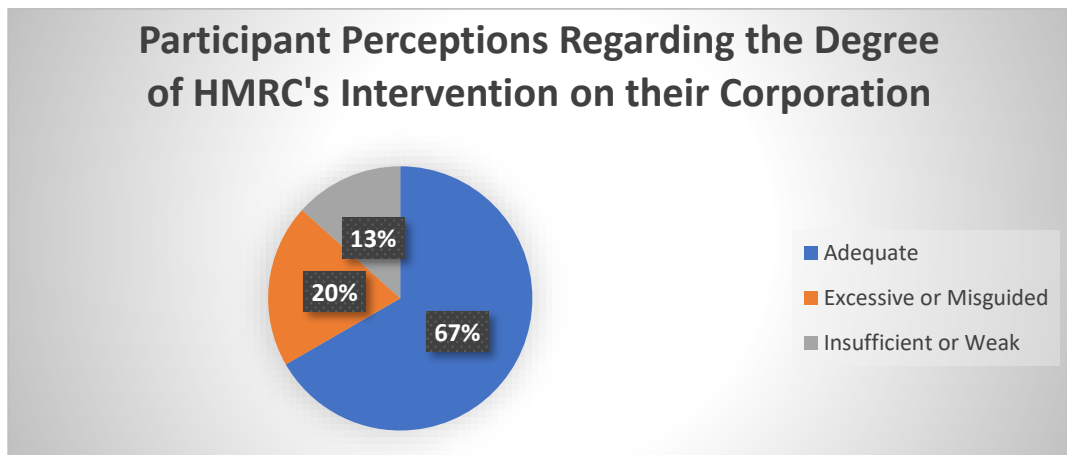


Figure 21 Interviewee perceptions about the administration's interventions on their corporations (UK)

Several of those who saw HMRC's intervention as adequate, associated this with the administration's use of risk-based responsive regulation, a key factor in co-operative compliance. According to P17,

'I do think they [HMRC] adopt a risk-based approach, they focus on the things they should be focusing on'

Similarly, for P3, whose views reveal a strategic-behaviour approach,

...they [HMRC]...take a very different approach to low risk and other types of risk. If you play fair, they play fair with you; if you don't want to play, they recognise you are not a player. With a low risk taxpayer, they assume you are telling them the truth, with a risky taxpayer you have to prove everything you are saying.

These perceptions of HMRC's interventions as responsive coincide with the taxpayer views that were reported by Freedman, Vella, and Ng's 2014 study, where most participants expressed the opinion that HMRC had become increasingly focused following the implementation of the BRR<sup>310</sup>.

<sup>310</sup>Freedman, Vella and Ng, *HMRC's Relationship with Business*

Other participants who viewed HMRC's interventions as adequate referred to different aspects associated with co-operative compliance. For example, P20 mentioned the importance of dialogue and timely provision of certainty, and P22 highlighted real-time working, focusing on material issues, and increased mutual understanding.

The minority which found HMRC's interventions inadequate reiterated themes analysed later in this chapter, like the administration not necessarily being responsive, but rather seeking yield maximization, and the perception that the administration's performance is affected by political interference. For P11,

There is a poisonous environment and they [HMRC] are under pressure to provide revenue. It's a shame because HMRC were actually leaders and were seen as leaders by other countries. HMRC has become politicised. Margaret Hodge and the PAC did a lot of damage to HMRC.

## **6.6. Interviewee perceptions of their companies' relationship with HMRC as positive are associated to key elements of co-operative compliance.**

### **6.6.1. Most respondents assessed their corporations' relationship with HMRC positively.**

Another finding which can be associated with a strengthened validity for co-operative compliance in the UK is that most interviewees described their corporations' relationship with HMRC as positive. While seeing the relationship as good - something which coincides with earlier research by Freedman, Vella, and Loomer<sup>311</sup>; Freedman, Vella, and Ng<sup>312</sup>, and HMRC's Large Business Panel Surveys<sup>313</sup> - is not exclusively attributable to co-operative compliance,

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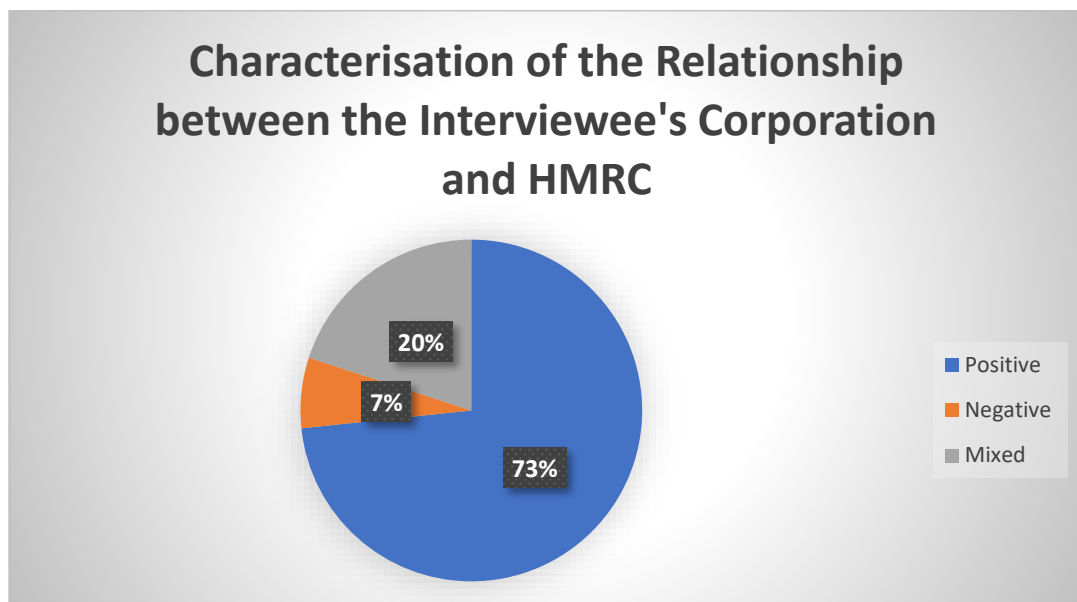
<sup>311</sup> Freedman, Loomer and Vella, 'Corporate tax risk and tax avoidance: new approaches'

<sup>312</sup> Freedman, Vella and Ng, *HMRC's Relationship with Business*

<sup>313</sup> These surveys, initiated in 2009 and carried out yearly thereafter, ask corporate taxpayers to rate their satisfaction with HMRC's service, and about specific aspects of HMRC's large business initiatives.

responses indicate that for a large portion of interviewees, perceiving that the relationship is co-operative is an important factor in justifying their positive opinion.

The author believes that tax directors' seeing the relationship with HMRC as positive and linking this to the presence of elements characteristic of co-operative compliance bolsters this model's validity in the UK because a.) co-operative compliance is associated to a desirable outcome, and b.) Tax directors show that their approval of co-operative compliance is not only about the ideal model, but also about the model, once implemented.



*Figure 22* Interviewee categorisation of their employers' relationship with the administration (UK)

Coinciding with responses to other questions, where the UK's corporate tax scene was portrayed as qualitatively different from the one in the recent past, some interviewees felt that their companies' current positive relationship with HMRC is the outcome of a gradual process of improvement involving changes by both parties. Since HMRC's implementation of co-operative compliance is

less than ten years old, many interviewees remember how the relationship was before this initiative and believe the change has been favourable. For example, P1 felt that there had been a positive change in 'recent years', and P10 argued that the relationship has 'improved' because taxpayers have moved away from seeing tax as 'an attribute to be gained, exploited', because of an effort to 'clear contentious transactions', and 'establishing quite a degree of trust'.

Multiple interviewees justified their positive evaluation by referring to factors which match several of the elements identified in chapter four as characteristic of co-operative compliance. P1, according to whom the relationship was 'very positive' and 'constructive', explicitly mentioned having a 'co-operative compliance relationship', describing it as one where,

[we] agree the tax treatment of significant transactions on a real-time basis. [have] quarterly meetings with the CRM, we describe what we plan to do, reveal uncertainty and find a way to resolve the uncertainty...

P17 highlighted transparency and cooperation, and a dynamic of meeting 'regularly' and 'planning pre-emptively'. P20 and P18 also focused on real-time working. According to the latter, this represents a change:

whereas in the past we would have tended to look at things and taken external advice and done it, now it's more about talking to the revenue and, if possible, talking pre-emptively

For P27, the relationship is good because of its openness, *proactiveness*, and the notion that parties are not 'adversarial' and support each other despite 'professional disagreements', all essential elements of co-operative compliance.

Furthermore, some participants referred to the interaction between the parties as one where one side's behaviour triggers an equivalent reaction from the other. According to P3,

'I trust them, and they trust me...you get what you pay for: If you play they play.'

This suggests that reciprocity, a central component of co-operative compliance, is present in the mind of tax directors. However, the use of the verb 'to play' suggests that co-operative compliance might not be exempt from strategic behaviour, since the relationship is sometimes seen as a *game*, something which can be connected to the expected utility model and to concepts such as McBarnet's *creative compliance*<sup>314</sup> or V.Braithwaite's "gaming" motivational posture<sup>315</sup>.

As mentioned by P10, P20 and P23, and in agreement with the premises of the Slippery Slope Framework, a positive assessment of the relationship was often associated with increases in mutual trust. Interestingly, in what highlights the nature of co-operative compliance as a closely-knit relationship, but also one vulnerable to regulatory capture, P23 approached trust emotionally, linking it with 'cordiality' and having 'fantastic personal relationships with vast numbers of people' within HMRC.

Interviewees like P36 evaluated the relationship positively under a comparative perspective, seeing HMRC as 'one of the best in the world'. Since co-operative compliance is not present in all countries, by having pioneered its adoption, HMRC is seen by taxpayers who engage with different tax authorities as a relatively good administration, regardless of the difficulties that the model might be experiencing. This comparative evaluation is consistent with previous

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<sup>314</sup> McBarnet, 'Whiter than White Collar Crime: Tax, Fraud Insurance and the Management of Stigma'

<sup>315</sup> Braithwaite, Murphy and Reinhart, 'Taxation Threat, Motivational Postures, and Responsive Regulation'

findings from HMRC/TNS, according to which HMRC was seen by businesses as 'relatively reasonable' in comparison to other administrations<sup>316</sup>.

Whilst most interviewees believe that the relationship between HMRC and their corporations is positive, several of them (e.g. P11, P36) stated that the relationship has deteriorated, voicing their concern about the future of the co-operative compliance in relation to CRMs, the BRR, and the perception that HMRC is increasingly unwilling and/or incapable of providing timely certainty concerning complex tax positions because of fear of being prosecuted by politicians, the media and/or the public. Nevertheless, the interviewees' association of co-operative compliance practices with their perception of the relationship with HMRC's as positive supports the argument that there are various factors which increase this regulatory model's validity in the UK.

#### **6.7. Findings questioning the continued validity of co-operative compliance**

The findings analysed thus far support the contention that co-operative compliance has a high validity among UK corporations because of a combination of compliance-minded and/or tax-risk-averse personal and social norms, changes in corporate tax culture, and favourable perceptions of HMRC's trustworthiness and exercise of power.

However, they also reveal several factors negative for co-operative compliance's validity, thus jeopardising its future sustainability in the UK. This section examines these factors, including the erosion of presently-high levels of trust in HMRC, doubts concerning the administration's ability to deliver truly

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<sup>316</sup> HMRC/TNS/BMRB, 'Exploring Large Business Tax Strategy Behaviour'. Page 23

responsive regulation, negative perceptions about HMRC's power, and the possibility that many taxpayers are only superficially committed to increasing compliance.

### **6.7.1. Co-operative compliance's validity is threatened by an erosion of the high levels of trust in HMRC.**

As discussed in 6.4.1, taxpayer trust in the administration is crucial for voluntary compliance, particularly under co-operative compliance. While most interviewees stated that they see HMRC as trustworthy, for many, this trust is being eroded because HMRC is perceived as being motivated by objectives like publicity or yield maximisation, which differ from what interviewees believe the administration ought to pursue. Moreover, significant percentages of interviewees expressed negative or mixed views about HMRC's capabilities and its staff's attitude.

#### **6.7.1.1. Multiple participants perceived HMRC as being driven by publicity, yield maximisation, and responding to political intervention**

While most interviewees felt HMRC was trustworthy, several argued that trust was declining because HMRC was no longer seen as driven by ensuring compliance, but rather by objectives like publicity or yield maximisation, leading it to behave arbitrarily or to revert to an adversarial relationship. Considering trust's importance in fostering voluntary compliance and convincing the parties in a co-operative relationship that reciprocity will occur, this indicates that co-operative compliance's high validity in the UK might not be sustainable.

For example, for P23, HMRC tries,

'to maximise their yield [and] doesn't want to be in front of the PAC being criticised'

Similarly, for P11, HMRC's 'motivation' could not be trusted, since the

'pressures that are being placed on them are misleading'

These concerns with HMRC being motivated by yield maximisation echo what practitioners revealed in a survey recently published by the Tax Journal, according to which the administration's urge to maximise revenue collection was, among others, impeding dispute settlement<sup>317</sup>.

Most interviewees<sup>318</sup> perceived that HMRC is not exclusively motivated by ensuring compliance, but rather by maximising yield, publicity satisfying public/political pressure, or a combination of these.

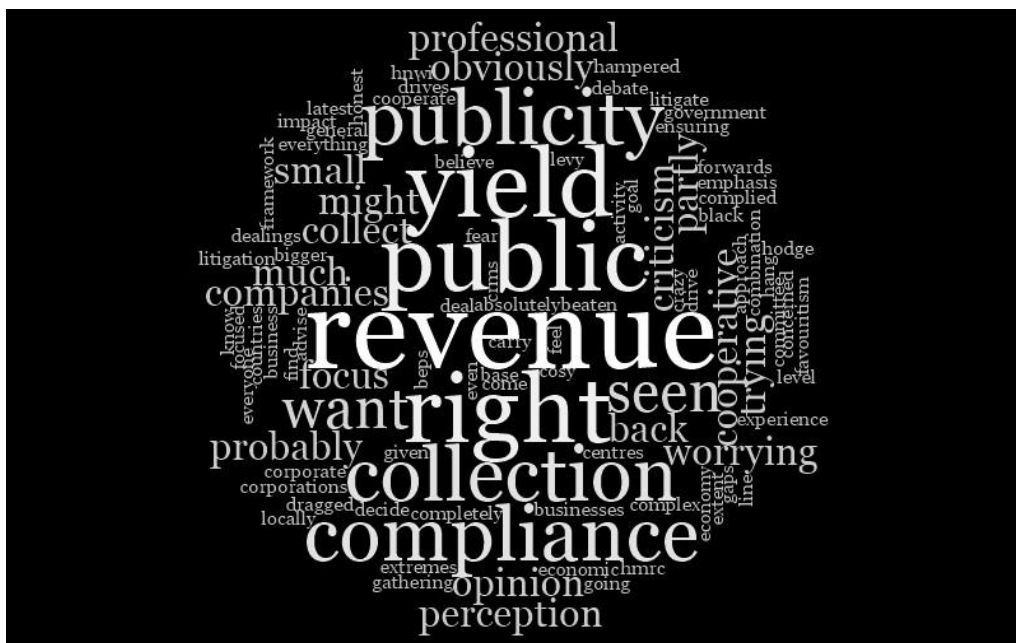


Figure 23 Interviewee perceptions about the administration's motivations (UK)

<sup>317</sup> Goodall A, 'HMRC's approach to handling enquiries and disputes: practitioners' views' (2018) 8 Tax Journal.

<sup>318</sup> Word frequency query performed on Nvivo, 200 most frequent words.

Following Wahl et. al<sup>319</sup>, the concern is that if taxpayers believe the administration's actions are not guided by public interest, they might see HMRC as unfair, and would be less inclined to collaborate. Under the Slippery Slope framework, one of the aspects that parties evaluate when approaching trust rationally is "goal" achievement, 'whether the other party is pursuing a goal that is important to the trustor'<sup>320</sup>. Thus, there is decrease in trust attributable to misalignment between the goals taxpayers foresee for the administration and the ones they perceive it to pursue.

While not all interviewees agree on what 'public interest' means and what this means for HMRC's objectives, responses reveal that, despite linguistic differences, most view ensuring compliance as the administration's ideal objective. Thus, for P25, HMRC's goal should be collecting 'the right tax at the right time...', for P22

'to ensure they [taxpayers] are paying an appropriate amount of tax',

and for P17, HMRC,

'should be adopting a risk-based approach to make sure corporates pay the right amount of tax'.

The interviewees' objection regarding yield maximisation is not the administration's desire to increase revenue, but rather this leading it to side-track compliance and behave arbitrarily, for example, by interpreting statute to extend tax liability beyond legal mandates. Thus, for P23,

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<sup>319</sup>Wahl, Kastlunger and Kirchler, 'Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the "Slippery Slope Framework"'.

<sup>320</sup> Gangl, Hofmann and Kirchler, 'Tax authorities' interaction with taxpayers: A conception of compliance in social dilemmas by power and trust'. Page 16

'I feel they [HMRC] think their job is to collect the maximum amount of tax, which in my opinion is not the right goal.'

For several interviewees, HMRC's perceived shift in motivation is primarily attributable to political intervention. For P25, HMRC,

' [is motivated by] fear of public criticism, they are completely hampered, can't decide, they are terrified about bad press and criticism...'

According to P27, this is associated to the role of the PAC<sup>321</sup>:

I would absolutely say [HMRC's motivation is] public pressure. You look at the Parliamentary Committee and you see them [HMRC] dragged up and beaten up.

This perception of HMRC constrained by political pressure is not new: Freedman, Vella, and Ng reported that some tax directors saw the administration as being concerned by the prospect of facing PAC criticism<sup>322</sup>. Similarly, HMRC-commissioned research also found that taxpayers felt that HMRC faced external pressures resulting in a negative change in attitude<sup>323</sup>. However, whereas in previous studies interviewees were split about whether external pressures led to changes in HMRC's behaviour, most interviewees now feel that political intervention translates into actual changes in HMRC's behaviour, which were perceived as damaging. For P11,

There is a poisonous environment and they are under pressure to provide revenue. It's a shame because HMRC were actually leaders and were seen as leaders by other countries. HMRC has become politicised. Margaret Hodge and the PAC did a lot of damage to HMRC.

For some interviewees, this directly affects co-operative compliance. For P3,

...co-operative compliance was about trying to get the right amount of tax, the whole PAC and Margaret Hodge<sup>324</sup> are much more concerned

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<sup>321</sup> The UK's Parliamentary Public Accounts Committee.

<sup>322</sup> Freedman, Vella and Ng, *HMRC's Relationship with Business*. Page 77.

<sup>323</sup> HMRC/IFF, *Large Business Panel Survey 2014*. Page 7.

<sup>324</sup> PAC former chair

about not being seen to cooperate with business, so that co-operative compliance is not seen as cosy relationship.

Likewise, for P23,

political pressure means that the administration is expected to collect as much as possible, but this erodes the confidence in the co-operative compliance approach and, in the end, they will collect less because companies will be less forthcoming.

The issue of political interference on HMRC highlights the complicated role of legitimacy: While co-operative compliance might be seen as more legitimate by the public when the programme is seen as closely scrutinised and with administrative discretion curtailed, participant taxpayers may experience an inverse effect since an erosion of trust in the administration can lead them to see its exercise of power as illegitimate<sup>325</sup>.

**6.7.1.2. While a sizeable portion of interviewees evaluate HMRC's staff's attitude and professional expertise positively, most respondents expressed mixed or negative opinions**

Another finding related to trust which could reduce co-operative compliance's validity in the UK's is that most (57%) interviewees held a mixed or negative opinion about HMRC's staff's attitude and/or professional expertise.

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<sup>325</sup> Gribnau, 'Cooperative compliance: Some procedural tax law issues'

## Perception about HMRC's staff's attitude and professional expertise



Figure 24 UK interviewees' perception about the administration's attitude and professional expertise

From the perspective of *reason-based* trust, taxpayers' trust in the administration depends, among others, on their evaluation of its attitude and competence<sup>326</sup>. Thus, perceptions of shortcomings in one or both aspects could erode trust, weakening voluntary compliance and crowding out taxpayers' motivations to participate in co-operative compliance.

Different participants perceived HMRC's staff as non-collaborative, something which is contrary to co-operative compliance. For P11, HMRC's staff was 'fundamentally unhelpful', and for P23 and P25, HMRC's staff was perceived to act with an attitude of suspicion towards taxpayers. For the former, 'the trouble is they see avoidance everywhere', according to the latter,

'[HMRC's] attitude starts off with thinking that everyone is doing something inappropriate, and that is unhelpful.'

<sup>326</sup> Gangl, Hofmann and Kirchler, 'Tax authorities' interaction with taxpayers: A conception of compliance in social dilemmas by power and trust'. Page 16.

If taxpayers feel that the administration does not treat them as equals, or as partners cooperating towards the same goal, the notion of horizontality, which is fundamental in co-operative compliance, is damaged, and parties feel like they have reverted to a 'command and control' or 'cops and robbers' regulation.

In terms of HMRC's professional expertise, interviewees highlighted different issues, including quality rifts between senior and junior staff (P11), the loss of expertise attributable to high CRM turnover, difficulties dealing with fast-changing rules (P17) and international tax aspects (P18 and P36), problems with the junior staff's inexperience (according to P25 'If you have someone that has been qualified for four years against a 35-year tax director, they'll run rings around them'), and poor technical expertise (P27, P29).

As explained by P27, co-operative compliance depends on responsiveness and timely certainty, so its validity can suffer if regulatees feel the administration has insufficient expertise to fulfil its part of the exchange:

[HMRC] might lack technical depth to know what we should be talking about. There are plenty of occasions where we need advice and we can't get it quickly, that's when the frustration comes.

### **6.7.2. There are doubts concerning HMRC's responsiveness**

A second area where findings raise concerns regarding co-operative compliance's continued validity in the UK is HMRC's ability to implement truly responsive regulation. Responses reveal that participants perceive administrative shortcomings regarding commercial awareness, an essential administrative skill for co-operative compliance, and two of the UK's co-operative compliance programme's characteristic features: CRMs, and the BRR.

### 6.7.2.1. Most interviewees had a negative or mixed perception of HMRC's business understanding

Most interviewees (66%) stated a negative or mixed opinion regarding HMRC's business understanding, identifying problems with comprehending general business operations, as well as the characteristics of specific economic sectors and the rules applicable to them. This indicates that co-operative compliance's otherwise high validity in the UK is at risk from deteriorating because commercial awareness is an administrative skill that is crucial for co-operative compliance<sup>327</sup>.

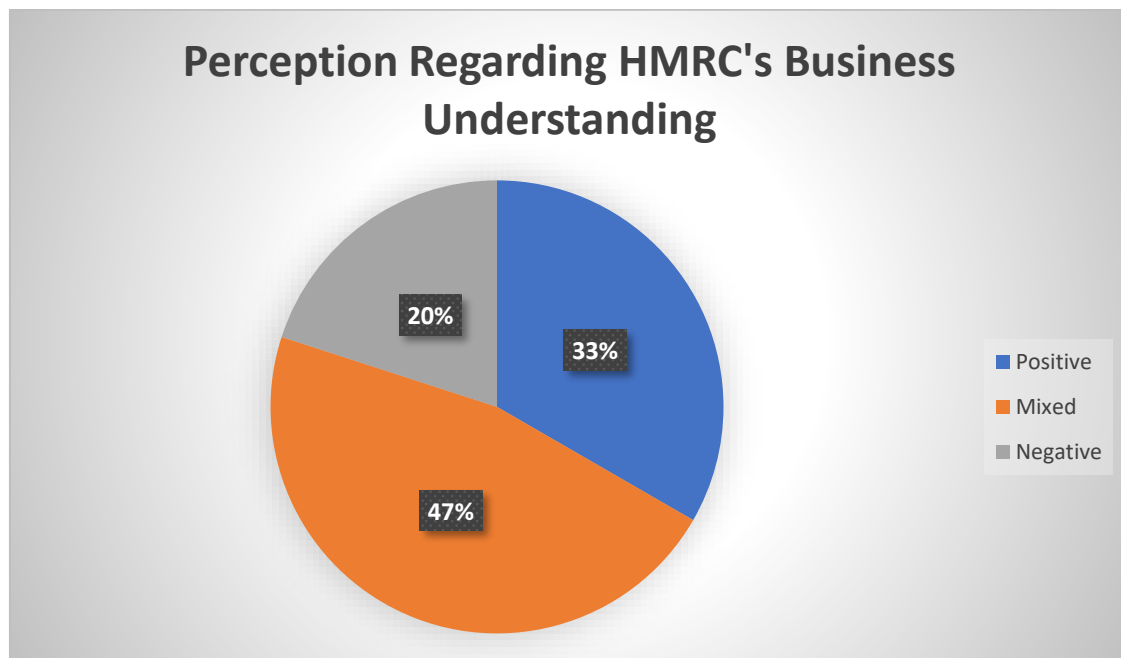


Figure 25 UK Interviewees' perception about the administration's business understanding

Responsiveness requires that the administration fully comprehends the taxpayer's business to assess its risk profile accurately, determine an appropriate regulatory response, and carry out the horizontal dialogues

<sup>327</sup> OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance*

necessary for the taxpayer to obtain legal certainty and for the administration to ensure compliance. Moreover, as evidenced in the interviewees' responses about evaluating tax positions, commercial awareness is especially relevant in the UK, where a position's *commerciality*, has become one of the main factors in determining whether abusive tax behaviour is present.

It is concerning that these perceptions are not new; they had been identified in HMRC-commissioned research from 2007<sup>328</sup>, and evidence presented by Freedman, Vella, and Loomer in 2009 suggested that UK tax directors saw HMRC's poor commercial understanding as an obstacle for achieving a functional principles-based rule system<sup>329</sup>. Moreover, the positive perceptions reported in HMRC Large Business Panel Surveys<sup>330</sup> were not matched here. Thus, unlike what was reported in previous UK research<sup>331</sup>, only one interviewee described CRMs as having better commercial awareness than other staff, and none of the positive responses referred to CRMs specifically, suggesting that concerns about limited commercial understanding have now extended to CRMs, a key element of the UK's co-operative compliance model.

Interviewees justified their position in various manners: For some, HMRC's business understanding varies depending on the unit or issue involved

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<sup>328</sup> HMRC/BMRB, 'Research to Support the Implementation of Proposals in the Review of Links with Large Businesses' Page 46.

<sup>329</sup> Freedman, Loomer and Vella. 'Corporate tax risk and tax avoidance: new approaches' Page 87.

<sup>330</sup> HMRC/IFF, *Large Business Panel Survey 2015* (HM Treasury 2016) and HMRC/IFF Research, *Large Business Panel Survey: Businesses' experience of HMRC* (HM Treasury 2011)

<sup>331</sup> Freedman, Vella and Ng, *HMRC's Relationship with Business*. Page 21.

(e.g. P17, P18, P16). For others, HMRC struggles to understand the complex rules applicable to equally complex businesses:

‘You are putting complicated legislation onto a complicated business...they don’t understand our business very well and legislation is far too complicated.’ (P3)

For several participants, HMRC’s poor commercial understanding is aggravated by staff presuming that tax is always the driver for regulatee positions, when there can be other factors at play. For P25:

They [HMRC] don’t understand how business works. It’s about business fundamentals, but also industry specifics. It’s about presuming that things are done because of tax, when in reality they are done because of other issues.

Similarly, for P29

...They [HMRC] don’t understand the commercial world, you list 15 reasons why business does something, and most don’t understand, they think the world revolves around tax and it doesn’t.

This perception of poor commercial awareness is concerning for co-operative compliance because it might indicate limited responsiveness and erode *rational-based* trust, weaken perceptions of the authority as powerful - its ability to detect non-compliance is questioned, and encourage strategic behaviour like selective disclosure by parties who do not see the benefit in disclosing all their businesses’ material aspects to an administration that does not seem to understand them or is unwilling to do so. Thus, for P17, poor business understanding is the biggest obstacle in the taxpayer-administration relationship:

...the really big thing is around the tax authorities understanding the business, typically they are not very commercial, so trying to understand how things work is quite hard.

The danger is that the validity of a regulatory model based on administrative responses tailored to the regulatee’s behaviour may be reduced when the

regulator is perceived to fail to understand the business context to which that behaviour undoubtedly relates.

**6.7.2.2. Despite acknowledging that the figure is positive, interviewees voiced concerns about CRMs<sup>332</sup> ability to provide timely legal certainty.**

A second finding related to the perception of HMRC as not having the ability to implement a truly responsive regulation is that, even though interviewees valued the figure of Customer Relationship Managers (CRMs), many felt that this feature is losing its value because of these officers' high turnover, and their limited ability to provide legal certainty. Since the UK's co-operative compliance model relies heavily on CRMs to facilitate horizontal dialogue between the parties, assess taxpayer risk profiles, and reach agreements on tax positions<sup>333</sup>, negative taxpayer perceptions about them, particularly in relation to their ability to provide certainty, can reduce co-operative compliance's validity.

Most interviewees do find CRMs to be valuable (e.g. P29) and positive for corporate tax compliance in an abstract sense. Coinciding with previous research, CRMs are seen as crucial for facilitating effective communication with HMRC and negotiating settlements<sup>334</sup>. However, interviews reveal a dissatisfaction with the way in which CRMs function under the UK's current regime that, together with other factors, can erode co-operative compliance's validity.

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<sup>332</sup> Starting 2018, HMRC has changed the denomination of CRMs to "Customer Compliance Managers". Since the term "CRM" was the one in use at the time of the interviews, it is maintained to prevent confusion.

<sup>333</sup> HMRC, *Large Business compliance -enhancing our risk assessment approach*.

<sup>334</sup> Freedman, Vella and Ng, *HMRC's Relationship with Business*. Pages 17 and 73.

Taxpayers expressed concerns about CRMs is staff turnover. Coinciding with previous research by Freedman, Vella, and Ng<sup>335</sup>, and with HMRC-commissioned research<sup>336</sup>, interviewees like P20, P22 and P36, were critical about what they perceived as excessive CRM turnover. For P36:

The rotation of CRMs we don't find particularly helpful. In five years we have had three CRMs and it's not because they've left Revenue; that causes problems including repeating meetings with our board, and that doesn't go very well.

Similarly, for P27,

'The frustration is that there's too much rotation, and I know that I'm not alone with this...'

While some rotation is necessary to prevent regulatory capture - and indeed interviewees like P17 stated that some rotation 'makes sense', taxpayers need to know that their assigned CRMs will work with them long enough to learn about them and their business and provide certainty regarding complex positions. Companies invest significant resources and time familiarising CRMs with their business and building trust, so taxpayers can see CRM rotations as a resource drain.

Given co-operative compliance's reliance on trust and responsiveness, CRMs should remain in their post long enough to gain an adequate business understanding and build trust with taxpayers, but not so long that they lose objectivity or perspective. If taxpayers perceive too much CRM rotation and feel this is a recurring issue, they may stop seeing trust-building and/or certainty as feasible/possible objectives, and thus lose interest in co-operative compliance.

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<sup>335</sup> Ibid

<sup>336</sup> HMRC/IFF, *Large Business Panel Survey 2014*; HMRC/IFF, *Large Business Panel Survey 2015*

In fact, HMRC research has already identified a reduced willingness to engage in real-time working from tax directors concerned about CRM turnover<sup>337</sup>.

Another issue highlighted by several respondents is the perception that CRMs are unable to provide corporations with certainty because of HMRC's unwillingness to agree on tax issues that may prove unpopular, and the complications arising from the administration's organigram and current dispute resolution strategy<sup>338</sup>. Thus, CRMs are seen as lacking the authority to answer most queries independently (P23) or to reach settlements without exhausting the multi-tiered<sup>339</sup> procedure devised by HMRC following the *UK Uncut* case and other high-profile settlement controversies. For P25:

[the CRM model is] a very valuable business model being steadily eroded...now they can't discuss transfer pricing, so what's the point if you can't discuss...the administration is taking a huge step back...CRMs increasingly have to go back to the administration, they didn't use to...This has definitely jeopardised certainty.

Likewise, for P36, HMRC governance/organisational issues prevent a functional relationship:

We feel they [CRMs] don't have enough authority to agree things, too much is passed to the head office. The relationship is open, professional and transparent, but they are not allowed to agree things of their own accord.

For P3, the CRM-based model might be 'bust' because CRMs are 'afraid to take decisions' and these agents act as 'post boxes', 'passing on [the issue] to other people'. Similarly, for P18,

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<sup>337</sup> HMRC/IFF, *Large Business Panel Survey 2014*. Page 2.

<sup>338</sup> See HMRC's Code of Governance for Resolving Tax Disputes.

<sup>339</sup> Case Team-Panel-Board-Commissioners. See HMRC's Code of Governance for Tax Disputes, available at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/655362/HMRC\\_Code\\_of\\_governance\\_for\\_resolving\\_tax\\_disputes.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/655362/HMRC_Code_of_governance_for_resolving_tax_disputes.pdf)

There's an increasing concern about the quality of some CRMs, and, to a certain extent, that the Revenue is worried about its governance and gone too far...

While these views of HMRC as inflexible and constrained by excessive levels of decision-making coincide with the views expressed by practitioners in a recent survey<sup>340</sup>, they contrast with the view of the administration as 'flexible and pragmatic' that had been found by Hasseldine, Holland, and Van Der Rijt in earlier research<sup>341</sup>, indicating a possible deterioration of HMRC's image.

In line with other responses, several participants identified political intervention and undue external pressure as leading CRMs to become less co-operative. For P11

'There is an attitude shift because HMRC have been so bashed by PAC and the media that the focus now is just on collecting money.'

P17 argued that public pressure regarding the closeness between CRMs and corporate taxpayers was unjustified and damaging:

...CRMs seem to be reluctant to make decisions, and that has a lot to do with scrutiny, they are paranoid, and the reality is that they've never been cosy, they've been portrayed as such and it's difficult to deal with that image.

Compared with previous research by Freedman, Vella, and Ng, where most interviewees were said to consider CRMs 'of good quality' and as 'performing their job well'<sup>342</sup>, findings indicate a deterioration of the taxpayers' assessment of CRMs. While interviewees in that study had referred to variability in the quality of CRMs and high turnover, and dissatisfaction with decreased CRM discretion

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<sup>340</sup> Goodall, 'HMRC's approach to handling enquiries and disputes: practitioners' views'.

<sup>341</sup> Hasseldine, Holland and Van der Rijt, 'The market for corporate tax knowledge' Page 44.

<sup>342</sup> Freedman, Vella and Ng, *HMRC's Relationship with Business*. Page 18.

had begun to appear in other research<sup>343</sup>, current interviews evidence a more pessimistic assessment, characterised by a stronger belief that political intervention and excessive public scrutiny are hampering HMRC's function.

Although CRMs are a feature of the UK's current model rather than an essential element of co-operative compliance itself, the concern is that UK corporate taxpayers assess co-operative compliance's validity according to their experience of the UK's approach, meaning their frustration with CRMs morphs into scepticism regarding co-operative compliance and crowds out the elements which were identified as strengthening co-operative compliance's validity earlier in this chapter.

### **6.7.2.3. Most interviewees believe HMRC's Business Risk Review has flaws regarding its criteria for assessing risk, risk categories, and/or the rating's consequences.**

A third finding which also places doubts on the continued validity of co-operative compliance in the UK's corporate context is taxpayer dissatisfaction with HMRC's BRR, arguably, the core of the UK's approach to co-operative compliance<sup>344</sup>.

While participants like P10 and P16 felt that the BRR, HMRC's framework for determining a taxpayer's risk profile and calibrating administrative responses accordingly, was 'broadly fair' (P10), 'constructive' (P16), or 'valid' (P3), several

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<sup>343</sup> HMRC/IFF, *Large Business Panel Survey 2014*; HMRC/IFF, *Large Business Panel Survey 2015*

<sup>344</sup> HMRC, *Large Business compliance -enhancing our risk assessment approach*. Page 2;

interviewees stated that it did not assess risk accurately, and did not have appropriate outcomes, thus limiting HMRC's responsiveness.

While the interviewees' concerns with the BRR coincide with those voiced to HMRC in the 2017 BRR consultation<sup>345</sup>, there is a quantitative contrast, since 80%<sup>346</sup> of the consultation's respondents were reported to have favourable perceptions of the BRR. Possible explanations include self-selection bias and/or response bias (the sample of consultation respondents is self-selected and their responses could be positively-biased because respondents to the consultation knew HMRC and the public would know their identity), that the addition of tax practitioners and trade organizations altered results, that HMRC's consultation positively impacted taxpayer perceptions or, that in the period of less than a year since the interviews, perceptions have changed, possibly in line with a greater emphasis by the OECD on risk control as a key component of co-operative compliance<sup>347</sup>.

Among those dissatisfied, the view is that the BRR is inconsistent and/or biased against large corporations because it sees them as inherently risky due to their size and/or complexity, regardless of their risk management practices, their compliance history, and/or previous engagement with HMRC. For P27,

I'm not massively satisfied with their risk rating...You are either high risk or low risk and we've kind of been told "you are not low risk because of

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De Widt, 'Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison'

<sup>345</sup>HMRC, *Large Business Compliance -Enhancing our Risk Assessment Approach: Summary of Responses*

<sup>346</sup> HMRC, *Large Business Compliance -Enhancing our Risk Assessment Approach: Summary of Responses*. Page. 6.

<sup>347</sup> OECD, *Co-operative Tax Compliance: Building Better Tax Control Frameworks*

being sophisticated and your size”, etc. Some other companies might not have that treatment.

Similarly, for P23:

...they feel because we are complex and international, we are 'high risk', and this is regrettable because this is not the way in which this [the model] was set up to be.

Although HMRC stresses that inherent risk does not necessarily result in a not-low risk assessment, provided the taxpayer mitigates risk, adopts a cooperative attitude, and a tax strategy that shuns what HMRC understands as 'tax avoidance'<sup>348</sup>, interviewees feel that HMRC will never see their behaviour as effectively mitigating risk. Thus, co-operative compliance's validity can be eroded by the regulatees' perception that the administration does not trust them and/or does not respond to their risk-averse or compliant-minded behaviour.

The perception that HMRC's view of inherent risk prevents large companies from being classified as 'low risk' regardless of their actual behaviour and/or controls coincides with findings by Oats and De Widt<sup>349</sup> as well as earlier findings from Freedman, Loomer and Vella, and Freedman, Vella, and Ng<sup>350</sup>.

On this issue, Lloyd and Georgiou argue that:

the current process is not always risk-based [and] a number of businesses will still receive a 'non-low' risk rating, despite being able to provide evidence of robust tax risk management and governance, openness with HMRC, and an appropriately commercially driven approach to tax planning...<sup>351</sup>

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<sup>348</sup> HMRC, *Large Business compliance -enhancing our risk assessment approach*. Page 17.

<sup>349</sup> De Widt, 'Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison'. Page 237.

<sup>350</sup> Freedman, Loomer and Vella. 'Corporate tax risk and tax avoidance: new approaches'; Freedman, Vella and Ng. *HMRC's Relationship with Business*. Page 43.

<sup>351</sup> Lloyd G and Georgiou J, 'Q&A – HMRC's business risk review consultation Insight and Analysis' (2017) 14 *The Tax Journal*. Page 3.

When contrasted with HMRC-commissioned research, businesses appear to have shifted from accepting this gap between behaviour and risk assessments as a circumstance they had to deal with<sup>352</sup> to a more vocal resistance or opposition to the criteria being used by HMRC.

This represents a very different picture from that presented in HMRC's materials. For example, in its guidance, HMRC states that,

'With the right behaviour any customer, regardless of their size or complexity, can benefit from Low Risk status.'<sup>353</sup>

The fact that HMRC launched a consultation in 2017 to try and 'refresh' the BRR, and that in the summary of responses to the consultation it accepted that the current risk segmentation may not adequately reflect the different types of profiles, and that a pilot needs to be introduced to address this and other issues related to the weight and composition of risk factors<sup>354</sup> and their connection with tax control frameworks shows that HMRC is aware of the BRR's shortcomings.

Quantitative analyses performed by the author on a sample of 1423 UK corporations<sup>355</sup> reveal that the association between taxpayer behaviour, measured in relation to ETRs (income statement tax expense and cash tax paid), and several of the factors related to HMRC's assessment of taxpayers' 'inherent' risk is tenuous, or even statistically insignificant. Thus, ordinary least square regressions performed on corporations' size, measured both by total

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<sup>352</sup> HMRC/TNS/BMRB, 'Exploring Large Business Tax Strategy Behaviour'. Page 24.

<sup>353</sup> HMRC. Tax Compliance Risk Management Manual (TCRM1000). Available at <https://www.gov.uk/hmrc-internal-manuals/tax-compliance-risk-management/tcrm1000>.

<sup>354</sup> HMRC, *Large Business Compliance -Enhancing our Risk Assessment Approach: Summary of Responses*

<sup>355</sup> Sample composed by the author using data from FAME. Refer to chapter one.

assets and total turnover, their number of subsidiaries, the number of corporations in a company's corporate group, and cash and income statement ETRs (Averaged longitudinally from 2013 to 2015), suggest that:

- a.) The complexity of the corporation's corporate group (one of HMRC's 'boundary' factors in the BRR), measured by the number of companies in the group, is not statistically significant as an ETR predictor for cash or income statement ETRs.
- b.) The complexity of the taxpayer's structure in terms of its number of subsidiaries (related to HMRC's 'boundary' and 'complexity' factors) is not statistically significant as an ETR predictor for income statement ETRs, being marginally significant for unfiltered cash ETR proxies (10%-level significance, marginally negative association).
- c.) The corporation's size, measured in total assets, is not statistically significant as a cash ETR predictor and is only significant in relation to filtered income statement ETRs (at the 5% level, where it has a medium negative association). And;
- d.) The corporation's size, measured in total revenue, is somewhat significant in the case of income statement ETRs (5% level significance, filtered, and 10% significance unfiltered, having a medium positive association in both cases), but is not significant for cash ETRs.

Regressions and bivariate correlations suggest that other variables highlighted below, like the corporation's age, profitability, and selected expenditures (e.g. interest payments), would be more closely connected to the taxpayer's tax contribution, measured in terms of ETRs. These findings support the

interviewees' perception that the criteria used for measuring inherent risk as part of the BRR might not be an accurate indicator of the taxpayer's actual risk profile.

**Model Summary OLS UK Corporations Average ETR (P/L 2013-2015) Filtered ETRs from 0 to 1 (1398 cases)<sup>b</sup>**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	,281 <sup>a</sup>	,079	,070	,08652	,079	9,152	13	1385	,000

a. Predictors: (Constant), average wage intensity 2013-2015, SUBSSCALETH, Average ROE 2013-2015, Average interest intensity 2013-2015, Ln of CORPORATIONAGE, Average Depreciation Intensity 2013-2015, COINCORPGROUPSCALEDTH, average intangible intensity 2013-2015, Average Gearing Ratio 2013-2015, average inventory intensity 2013-2015, average size by turnover scaled (ln) 2013-2015, Average ROA 2013-2015, average size by assets scaled (ln) 2013-2015

b. Dependent Variable: Average P/L Effective Tax Rate 2013-2015

*Figure 26 Summary statistics for the regression performed on a filtered sample of UK corporations' Average Income Statement ETRs (2013-2015)*

**Linear Regression (OLS) Coefficients UK Corporations Average ETR (P/L) 2013-2015 Filtered by ETRs equal/larger than 0 and equal/smaller than 1 (1398 cases)<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B		Correlations			Collinearity Statistics		
		B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF	
1	(Constant)	,319	,044		7,301	,000	,233	,405						
	SUBSSCALETH	-,050	,048	-,037	-1,043	,297	-,143	,044	-,018	-,028	-,027	,538	1,860	
	COINCORPGROUPSCALEDTH	-,013	,016	-,023	-,822	,411	-,043	,018	-,035	-,022	-,021	,841	1,189	
	average size by turnover scaled (ln) 2013-2015	,010	,005	,179	1,962	,050	,000	,019	-,003	,053	,051	,080	12,552	
	average size by assets scaled (ln) 2013-2015	-,010	,005	-,196	-2,058	,040	-,019	,000	-,025	-,055	-,053	,073	13,712	
	Ln of CORPORATIONAGE	-,008	,004	-,067	-2,369	,018	-,015	-,001	-,079	-,064	-,061	,820	1,220	
	Average ROE 2013-2015	,000	,000	-,038	-,863	,388	,000	,000	-,089	-,023	-,022	,337	2,966	
	Average Gearing Ratio 2013-2015	,000	,000	,046	1,325	,186	,000	,000	,079	,036	,034	,556	1,797	
	Average ROA 2013-2015	-,002	,001	-,176	-4,328	,000	-,003	-,001	-,180	-,116	-,112	,402	2,487	
	Average Depreciation Intensity 2013-2015	,006	,082	,002	,079	,937	-,153	,166	-,036	,002	,002	,738	1,356	
	Average interest intensity 2013-2015	-,167	,108	-,053	-1,547	,122	-,378	,045	-,063	-,042	-,040	,565	1,769	
	average intangible intensity 2013-2015	,090	,017	,163	5,427	,000	,057	,122	,157	,144	,140	,741	1,350	
	average inventory intensity 2013-2015	,016	,017	,028	,901	,368	-,018	,050	,001	,024	,023	,710	1,408	
	average wage intensity 2013-2015	,016	,023	,022	,702	,483	-,029	,061	,023	,019	,018	,695	1,440	

a. Dependent Variable: Average P/L Effective Tax Rate 2013-2015

*Figure 27 Regression coefficients, filtered sample of UK corporations' Average Income Statement ETRs (2013-2015)*

**Model Summary OLS UK Corporations ETR (P/L) Average 2013-2015 Non-filtered 1423 cases<sup>b</sup>**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	,239 <sup>a</sup>	,057	,048	,10075	,057	6,541	13	1409	,000

a. Predictors: (Constant), average wage intensity 2013-2015, Average ROE 2013-2015, SUBSSCALETH, Average interest intensity 2013-2015, Ln of CORPORATIONAGE, Average Depreciation Intensity 2013-2015, COINCORPGROUPSCALEDTH, average intangible intensity 2013-2015, Average Gearing Ratio 2013-2015, average inventory intensity 2013-2015, average size by turnover scaled (ln) 2013-2015, Average ROA 2013-2015, average size by assets scaled (ln) 2013-2015

b. Dependent Variable: Average P/L Effective Tax Rate 2013-2015

*Figure 28 Summary statistics for the regression performed on an unfiltered sample of UK corporations' Average Income Statement ETRs (2013-2015)*

Linear Regression (OLS) Coefficients UK Corporations Average ETR (P.L) 2013-2015 Non-filtered 1423 cases<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Correlations			Collinearity Statistics		
		B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF	
1	(Constant)	,298	,051		5,905	,000	,199	,397						
	SUBSSCALETH	-,076	,055	-,048	-1,373	,170	-,184	,032	-,010	-,037	-,036	,542	1,846	
	COINCORPGROUPSCAL													
	EDTH	-,006	,018	-,009	-,331	,741	-,041	,029	-,014	-,009	-,009	,841	1,188	
	average size by turnover scaled (ln) 2013-2015	,010	,006	,161	1,747	,081	-,001	,021	,026	,046	,045	,079	12,661	
	average size by assets scaled (ln) 2013-2015	-,008	,005	-,144	-1,497	,135	-,019	,003	,002	-,040	-,039	,072	13,893	
	<b>Ln of CORPORATIONAGE</b>	-,010	,004	-,067	-2,360	,018	-,018	-,002	-,078	-,063	-,061	,821	1,218	
	Average ROE 2013-2015	,000	,000	-,030	-,661	,508	,000	,000	-,059	-,018	-,017	,336	2,976	
	Average Gearing Ratio 2013-2015	,000	,000	,048	1,392	,164	,000	,000	,073	,037	,036	,556	1,797	
	<b>Average ROA 2013-2015</b>	-,002	,001	-,132	-3,242	,001	-,003	-,001	-,135	-,086	-,084	,401	2,494	
	Average Depreciation Intensity 2013-2015	-,004	,094	-,001	-,038	,970	-,188	,181	-,038	-,001	-,001	,733	1,364	
	Average interest intensity 2013-2015	-,189	,124	-,053	-1,523	,128	-,432	,054	-,056	-,041	-,039	,561	1,783	
	<b>average intangible intensity 2013-2015</b>	,092	,019	,145	4,811	,000	,054	,129	,143	,127	,124	,740	1,352	
	average inventory intensity 2013-2015	,009	,020	,013	,439	,661	-,031	,048	,004	,012	,011	,711	1,406	
	average wage intensity 2013-2015	-,016	,026	-,019	-,619	,536	-,068	,035	-,016	-,016	-,016	,694	1,441	

a. Dependent Variable: Average P/L Effective Tax Rate 2013-2015

Figure 29 Regression coefficients, unfiltered sample of UK corporations' Average Income Statement ETRs (2013-2015)

Model Summary OLS UK Corporations Average Cash ETR 2013-2015 filtered ETR 0 to 1 1381 cases<sup>b</sup>

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	,291 <sup>a</sup>	,085	,076	,10937	,085	9,750	13	1367	,000

a. Predictors: (Constant), average wage intensity 2013-2015, Average ROE 2013-2015, COINCORPGROUPSCALEDTH, Average interest intensity 2013-2015, average intangible intensity 2013-2015, Ln of CORPORATIONAGE, Average Depreciation Intensity 2013-2015, SUBSSCALETH, Average Gearing Ratio 2013-2015, average inventory intensity 2013-2015, average size by turnover scaled (ln) 2013-2015, Average ROA 2013-2015, average size by assets scaled (ln) 2013-2015

b. Dependent Variable: Average Cash ETR 2013-2015

Figure 30 Summary statistics Ordinary Least Squares regression, filtered sample of UK corporations' Average Cash ETRs (2013-2015)

Regression Coefficients (OLS) UK Corporations Average ETR (Cash ETR 2013-2015) Filtered by CASH ETR greater than or equal to 0 and smaller than or equal to 1 (1380 cases)<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B		Correlations			Collinearity Statistics		
	B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF	
1	(Constant)	,279	,056	4,962	,000	,169	,390						
	SUBSSCALETH	-,104	,063	-1,635	,102	-,228	,021	,005	-,044	-,042	,547	1,827	
	COINCORPGROUPSCALEDTH	-,010	,020	-,014	,515	-,049	,028	-,013	-,014	-,013	,851	1,175	
	average size by turnover scaled (ln) 2013-2015	,007	,006	,099	1,076	-,282	-,006	,019	,039	,029	,028	,080	12,538
	average size by assets scaled (ln) 2013-2015	-,002	,006	-,033	-,346	,730	-,014	,010	,032	-,009	-,009	,073	13,713
	Ln of CORPORATIONAGE	-,015	,004	-,095	-3,326	,001	-,024	-,006	-,092	-,090	-,086	,818	1,223
	Average ROE 2013-2015	,000	,000	-,046	-1,024	,306	-,001	,000	-,109	-,028	-,026	,337	2,964
	Average Gearing Ratio 2013-2015	,000	,000	,016	,460	,645	,000	,000	,050	,012	,012	,552	1,810
	Average ROA 2013-2015	-,003	,001	-,163	-3,999	,000	-,004	-,001	-,173	-,108	-,103	,402	2,487
	Average Depreciation Intensity 2013-2015	-,041	,105	-,012	-,391	,696	-,247	,165	-,036	-,011	-,010	,727	1,375
	Average interest intensity 2013-2015	-,334	,149	-,078	-2,240	,025	-,626	-,041	-,050	-,060	-,058	,551	1,816
	average intangible intensity 2013-2015	,120	,021	,172	5,718	,000	,079	,161	,188	,153	,148	,740	1,351
	average inventory intensity 2013-2015	,030	,022	,041	1,345	,179	-,014	,073	-,006	,036	,035	,714	1,401
	average wage intensity 2013-2015	,054	,029	,059	1,886	,060	-,002	,111	,052	,051	,049	,694	1,441

a. Dependent Variable: Average Cash ETR 2013-2015

Figure 31 Regression coefficients, filtered sample of UK corporations' Average Cash ETRs (2013-2015)

Model Summary OLS UK Corporations Average Cash ETR 2013-2015 Unfiltered<sup>b</sup>

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	,243 <sup>a</sup>	,059	,051	,15721	,059	6,810	13	1407	,000

a. Predictors: (Constant), average wage intensity 2013-2015, Average ROE 2013-2015, SUBSSCALETH, Average interest intensity 2013-2015, Ln of CORPORATIONAGE, Average Depreciation Intensity 2013-2015, COINCORPGROUPSCALEDTH, average intangible intensity 2013-2015, Average Gearing Ratio 2013-2015, average inventory intensity 2013-2015, average size by turnover scaled (ln) 2013-2015, Average ROA 2013-2015, average size by assets scaled (ln) 2013-2015

b. Dependent Variable: Average Cash ETR 2013-2015

Figure 32 Summary statistics Ordinary Least Squares regression, unfiltered sample of UK corporations' Average Cash ETRs (2013-2015)

Coefficients OLS UK Corporations Cash Average ETR 2013-2015 Unfiltered (1420 cases)<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Correlations			Collinearity Statistics		
	B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF	
1	(Constant)	,435	,079	5,517	,000	,280	,590						
	<b>SUBSCALETH</b>	-,142	,086	-,058	-1,646	,100	-,311	,027	-,035	-,044	-,043	,542	1,846
	COINCORPGROUPSCAL	-,004	,028	-,004	-,137	,891	-,059	,051	-,020	-,004	-,004	,841	1,188
	EDTH	-,002	,009	-,020	-,218	,827	-,019	,016	-,004	-,006	-,006	,079	12,680
	average size by turnover scaled (ln) 2013-2015	,004	,009	,047	,487	,626	-,013	,021	-,011	,013	,013	,072	13,914
	average size by assets scaled (ln) 2013-2015	-,026	,006	-,115	-4,046	,000	-,038	-,013	-,107	-,107	-,105	,821	1,218
	<b>Ln of CORPORATIONAGE</b>	,000	,000	-,047	-1,045	,296	-,001	,000	-,091	-,028	-,027	,336	2,975
	Average ROE 2013-2015	,000	,000	,025	,712	,476	,000	,000	,041	,019	,018	,557	1,797
	Average Gearing Ratio 2013-2015	-,003	,001	-,134	-3,284	,001	-,005	-,001	-,144	-,087	-,085	,401	2,494
	Average Depreciation Intensity 2013-2015	-,083	,147	-,017	-,567	,571	-,371	,205	-,045	-,015	-,015	,733	1,364
	<b>Average interest intensity 2013-2015</b>	-,518	,194	-,092	-2,672	,008	-,897	-,138	-,060	-,071	-,069	,561	1,783
	<b>average intangible intensity 2013-2015</b>	,110	,030	,111	3,688	,000	,052	,169	,113	,098	,095	,739	1,353
	<b>average inventory intensity 2013-2015</b>	,053	,031	,052	1,698	,090	-,008	,115	,035	,045	,044	,711	1,406
	average wage intensity 2013-2015	-,002	,041	-,001	-,041	,967	-,082	,079	-,004	-,001	-,001	,693	1,442

a. Dependent Variable: Average Cash ETR 2013-2015

Figure 33 Regression coefficients, unfiltered sample of UK corporations' Average Cash ETRs (2013-2015)

Interviewees object to the criteria used by HMRC to assess risk because they see them as highly subjective, what P10 referred to as a 'lack of science'. Thus, some of the seven criteria used by the BRR include subjective evaluations like assessing the taxpayers' 'attitude towards tax avoidance', their engagement in 'innovative interpretations of tax law', if their tax contribution 'looks reasonable' compared to sector peers, or whether the taxpayer's strategy involves planning which doesn't 'support genuine commercial activity'<sup>356</sup>.

Coincidental with previous literature<sup>357</sup>, different interviewees saw being assigned a low risk rating as undesirable because they felt that this reduced the attention provided by HMRC and, subsequently, provided fewer opportunities for discussing uncertain tax positions. P4 illustrated this point:

...I don't want to be low risk anyway because that would be low attention and I need attention... I'm happy with moderate to low risk rating...it gives us a platform for dialogue

<sup>356</sup> HMRC, *Large Business compliance -enhancing our risk assessment approach*

<sup>357</sup> De Widt and Oats, 'Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison'

P27 stated a similar opinion:

‘If you are low risk the inference is that as a business you have little attention from the authorities, so you might want more attention’

Since a low risk qualification in the BRR may reduce the frequency of contact with HMRC in comparison to a non-low risk assessment<sup>358</sup>, the concern is that voluntary compliance, risk aversion and/or compliance-mindedness may become associated by taxpayers with negative outcomes (less administrative availability), decreasing co-operative compliance’s validity. An additional concern is that tax directors may strategically engage in aggressive behaviour designed to increase their risk rating.

The contrast between these views and those from the early years of the BRR, where researchers reported that most taxpayers either saw benefits from being rated as low risk or, despite feeling that the benefits didn’t outweigh the costs, did not see the process negatively<sup>359</sup>, indicates an erosion of the rating’s benefits from the taxpayers’ perspective.

Regardless of having a positive or negative view of the BRR, most interviewees identify it as highly subjective and feel that risk factors are not properly weighed. This is problematic because strategic-minded taxpayers can ‘game’ the system into assigning them a higher risk rating in order to channel administrative resources onto them; additionally, taxpayers who feel they will be given a higher risk rating because of their business/structural factors, ignoring

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<sup>358</sup> HMRC, *Large Business compliance -enhancing our risk assessment approach*. Page 11.

<sup>359</sup> Freedman, Loomer and Vella, *Analyzing the Enhanced Relationship Between Corporate Taxpayers and Revenue Authorities: A U.K. Case Study*. Page 122.

their behaviour and risk management framework, might see HMRC as procedurally unfair and turn away from voluntary compliance.

## **6.8. Interviews reveal concerns about HMRC's power**

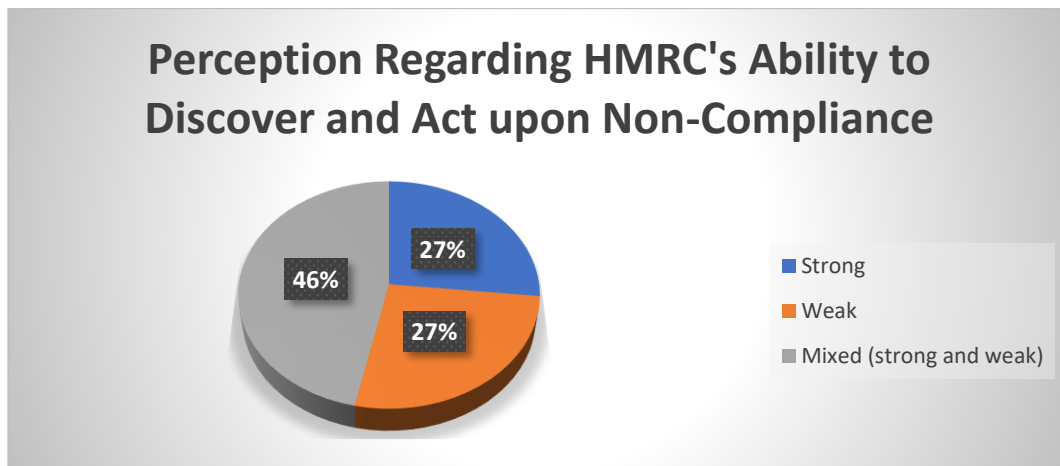
### **6.8.1. Most participants perceived HMRC as weak or partially weak regarding its ability to discover and act upon non-compliance.**

In addition to an erosion of trust in the administration and taxpayer doubts concerning HMRCs ability to be fully responsive, interview findings suggest that co-operative compliance's validity in the UK could be debilitated because HMRC is perceived as weak or partially weak. As explained in chapter four, whilst co-operative compliance relies primarily on voluntary compliance, deterrence and enforcement play an important role for preserving compliance and for driving non-compliant taxpayers to regularise. Even in a co-operative setting, compliance may result from taxpayers' risk aversion and the desire to avoid the negative consequences attached to non-compliance<sup>360</sup>. Thus, provided administrative power is not seen as arbitrary, taxpayers who perceive HMRC as weak are expected to be less inclined to comply voluntarily than those who view it as powerful.

Whilst most interviewees see HMRC's power as legitimate, responses reveal that 73% of them also perceive it, when conceptualised as the ability to discover and act upon non-compliance, as limited:

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<sup>360</sup> See Bergman MS, 'Tax Reforms and Tax Compliance: The Divergent Paths of Chile and Argentina' (2003) 35 J Lat Am Stud 593; Barak A, 'Deterrence and Moral Persuasion Effects on Corporate Tax Compliance: Findings from a Randomized Controlled Trial ' (2012) 50 Criminology 27



*Figure 34 Interviewee perception of the administration's power (UK)*

Many interviewees shared a view of HMRC as weak regarding its ability to identify non-compliance. According to P1:

‘I don’t know how comprehensive their ability to discover is...’

Similarly, for P27

‘...I am not really sure they know where to look...’

A reduced ability to discover non-compliance can affect co-operative compliance because if HMRC cannot identify risk adequately, taxpayers may believe that the administration cannot regulate responsively, and that certainty will not be provided since their risk profile is not assessed adequately and the uncertainty present in their tax positions might not be identified. Moreover, taxpayers sensing that HMRC struggles to detect non-compliance may be tempted to game it by engaging in selective disclosure and exploiting information asymmetry. According to P25:

‘...you’ve got so much data, it’s easy to focus on what people tell you rather than what they don’t tell you...’

Similarly, for P10

... if taxpayers tell them [HMRC] where there may be risk, they are good at that and see it through. Unless it is flagged to them, they don't have the tools to identify it adequately.

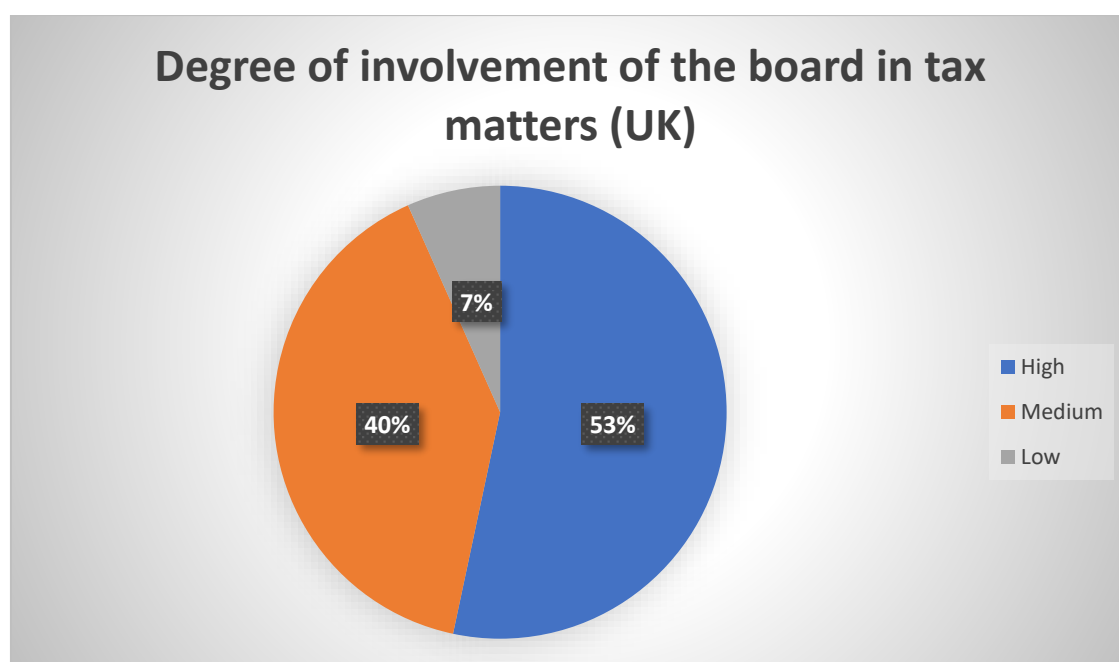
And for P36

‘...I think they struggle because they don’t have the resources. I think they rely on company disclosure of some form or another...’

**6.9. Notwithstanding increased tax risk aversion and compliance-minded norms, an important portion of taxpayers appears to be committed to compliance superficially.**

**6.9.1. While corporate boards appear to be more involved in corporate tax affairs, their involvement often centres on reputational risk.**

Interviews suggest an increase on the interest in taxation among UK corporate boards, considering over 90% of respondents stated that their boards had a high or medium level of involvement in their corporation’s tax matters.



*Figure 35 Board involvement in tax matters (UK)*

Provided this interest was coupled with a commitment to compliance, co-operative compliance’s validity would increase, since there would be high-level support for risk-averse tax strategies and tactics. However, responses suggest that the boards’ motivation is often limited to tackling reputational risk, not

increasing compliance *per se*. Thus, P1 attributed the board's involvement to tax matters' 'increased publicity', P3 stated that the board was 'concerned about reputational risk', for P4 the board intervened to prevent 'significant exposure', and P20 reported that the board was 'very concerned about reputation' above other matters. Hence, using Gribnau and Jallai's terminology, boards appear to be 'extrinsically motivated', rather than 'intrinsically motivated'<sup>361</sup>.

If the board's interest lies solely in reducing exposure and reputational risk, what Holland et.al refer to as corporations addressing the perception that the exposure of their tax practices might threaten the corporation's 'legitimacy'<sup>362</sup>, the 'tone' set by the board could condone low-visibility non-compliance. Such selective disclosure decreases co-operative compliance's validity, since the model is premised on full disclosure and transparency, regardless of the positions' visibility or reputational risk.

Moreover, while HMRC's efforts to bring tax into the boardroom are positive, the concern is that the boards' intervention does not increase compliance where the focus is exclusively on risk, since positions which may not be compliant but which are unlikely to be uncovered by the administration and/or external stakeholders will not be censored. Thus, the effective monitoring and accuracy and disclosure assurance seen by the OECD as the contribution of tax control frameworks to co-operative compliance<sup>363</sup>, may not be satisfied.

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<sup>361</sup> Gribnau H and Jallai AG, 'Good Tax Governance: A Matter of Moral Responsibility and Transparency' (2017) 1 Nordic Tax Journal 70. Page 80.

<sup>362</sup> Holland, Lindop and Zainudin, 'Tax Avoidance: A Threat to Corporate Legitimacy? An Examination of Companies' Financial and CSR Reports'. Page 337.

<sup>363</sup> OECD, *Co-operative Tax Compliance: Building Better Tax Control Frameworks*

### **6.9.2. Responses reveal that board supervision is often passive and that finance units are commonly the tax departments' primary controller.**

Interview findings reveal that UK corporations have undergone changes in their structure and tax team evaluation/remuneration practices which encourage tax risk aversion and, therefore, strengthen co-operative compliance's validity. However, interviews also showed weaknesses in corporate tax control frameworks related to governance: The tax function's evaluation is often conducted by the corporations' finance unit; furthermore, when the board is involved in evaluation, either directly, or through audit committees, its intervention is frequently passive.

These factors are detrimental to co-operative compliance's validity because, as a regulatory policy based on self-regulation and risk control, co-operative compliance presumes that regulatees are willing and capable of controlling tax risk autonomously, leaving the administration to adopt a meta-regulation approach focused on monitoring and regulating corporate risk control procedures. Thus, if taxpayers do not have robust tax risk controls, the model's efficacy is reduced because the administration is forced to revert to vertical enforcement.

Regarding the evaluation of the tax function, interviews reveal that most tax directors are subordinate to their companies' CFOs, something which elevates the potential of a conflict of interests regarding compliance, risk, and tax minimisation: From a finance optic, tax is often seen as an ordinary cost or, alternatively, as a profit-generator (maximising tax incentives such as credits). By contrast, from a tax optic, tax is understood to involve more than a cost, with compliance also being considered. Unless there is consensus in understanding

compliance as part of the equation, profitability concerns imposed or suggested by the financial division might trump compliance-based considerations, thus moving taxpayers away from the compliance-mindedness and risk aversion desired by co-operative compliance.

Regarding boards, responses showed that, although some boards actively question the tax director's positions and strategy, others follow his/her technical guidance without questions, demonstrating a passive approach that weakens control and, therefore, reduces the validity of regulatory models reliant on self-regulation, like co-operative compliance. This finding of board passivity contrasts with previous findings by HMRC/TNS, according to which UK boards were increasingly taking the responsibility of setting their firms' tax strategies over from tax directors<sup>364</sup>. Regardless of their involvement, if boards are passive, their ability to control their corporation's tax risk, which is what the co-operative compliance regulator seeks<sup>365</sup> is severely restricted.

### **6.9.3. Corporate taxpayers do not appear to be particularly influenced by deterrence measures such as the tax avoidance enabler penalties.**

A final finding which supports the notion of an eroding validity for co-operative compliance in the UK's corporate context is that available deterrence measures such as the tax avoidance enabler penalties, applicable from 2017 onwards, are not perceived by corporate tax directors as effective or influential in altering corporate tax behaviour.

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<sup>364</sup> HMRC/TNS/BMRB, 'Exploring Large Business Tax Strategy Behaviour'

<sup>365</sup> HMRC, *Large Business compliance -enhancing our risk assessment approach*. Page 15.

Thus, for P36 and P25, while these penalties might reign in ‘boutique firms, owner-managed businesses and high-net-worth individuals’ (P36), they are superfluous for ‘major corporates and advisory firms’ that were already ‘doing the right things’ and might be counterproductive because they are ‘too widely aimed’ (P25) and risk ‘covering well-intentioned advice’ (P25). Only a minority of participants, like P29, felt that the penalties contributed to ‘tone down’ aggressiveness. These opinions on penalties not acting as drivers of corporate tax behaviour provide a stark contrast with previous HMRC-commissioned research, where businesses had been found to consider penalties, particularly those imposed on senior management, to be heavily influential for their tax strategy<sup>366</sup>.

Whilst co-operative compliance reserves coercive enforcement for taxpayers that are not complying, deterrence plays a key role in preventing taxpayers who are not fully committed to comply from becoming uncooperative or engaging in strategic behaviour. This is particularly important when participation in the co-operative compliance programme is mandatory, like in the UK, and not optional, like in the Netherlands, Ireland, or the US, among others. If taxpayers feel that penalties are weak, misguided, or otherwise ineffective, this deterrence effect is weakened. Thus, interviewee scepticism about the influence of penalties is concerning for co-operative compliance’s validity. However, because interviews took place before the Special Measures regime and its accompanying penalties introduced in the Finance Act 2016 were implemented, interviewees did not have the opportunity to discuss their effect,

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<sup>366</sup> HMRC/TNS/BMRB, 'Exploring Large Business Tax Strategy Behaviour'. Page 20.

so it remains to be seen whether this highly-aggressive and somewhat subjective penalty scheme influences taxpayer behaviour in relation to co-operation<sup>367</sup>.

## **6.10. Conclusion**

This chapter has shown that UK responses evidence the existence of multiple variables favourable to co-operative compliance in the UK. These include personal and social norms showing alignment with the principles of co-operative compliance, risk aversion, or compliance, changes in corporate practices associated to increased risk aversion and tax risk awareness among tax directors and corporations, and positive perceptions about the relationship with HMRC and its trustworthiness. However, responses also show that existing positive factors are being eroded because of negative perceptions of different aspects of HMRC and objections regarding its motivations and its ability to provide legal certainty and responsiveness under the current co-operative compliance programme. Finally, responses also suggest that co-operative compliance's validity may be threatened by weaknesses in the corporations' internal tax control and the possibility that some taxpayers are not fully committed to compliance.

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<sup>367</sup> See Stratton R and Costello K, 'Finance Act 2016 notes: section 161 and Schedule 19: large businesses: tax strategies and sanctions for persistently unco-operative behaviour' (2016) British Tax Review 646 and Freedman J and Vella, J, 'Finance Act 2016 notes: section 161 and Schedule 19: large businesses: tax strategies and sanctions for persistently unco-operative behaviour: further commentary' (2016) British Tax Review 653

## CHAPTER 7

### RESULTS OF COLOMBIAN EMPIRICAL RESEARCH

#### 7.1. Introduction

Following the previous chapter, which presented the results from a series of 16 one-on-one interviews with tax directors working for a sample of the UK's largest corporate taxpayers, this chapter presents the findings obtained from the mirror-study<sup>368</sup> performed in Colombia during the second half of 2016. Participants are identified with an alphanumeric pseudonym, and their employers are not named.

While most of the interview questions were the same used in the UK, Colombian interviewees were not asked about their perceptions regarding CRMs or the BRR, since, Colombia does not have a co-operative compliance programme. As mentioned in chapter one, this presents an ideal opportunity to examine this regulatory model's validity in a context where it remains hypothetical, and contrast findings with those of the UK, where taxpayers have experienced this type of regulation<sup>369</sup> for approximately ten years.

Overall, findings suggest that co-operative compliance's validity in the Colombian corporate context is highly mixed. On the one hand, several factors support co-operative compliance's validity: Responses show alignment between tax director views about the ideal taxpayer-administration relationship and

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<sup>368</sup> The Colombian sample included 16 interviews and 1 pilot. Interviews were conducted in Spanish, with the author simultaneously translating and transcribing into English.

<sup>369</sup> While the UK's large business framework is premised upon mandatory participation and HMRC-administered risk assessments, making it arguably less horizontal and collaborative than other programmes such as the Dutch "Horizontal Monitoring", using CRMs does provide co-operative elements like the possibility to proactively agree the treatment of uncertain tax positions. See chapter eight for this matter.

elements of co-operative compliance, including horizontality, transparency, collaboration, certainty, and business understanding. Similarly, most interviewees' views about their personal professional objectives being centred around reducing tax risk and/or ensuring compliance demonstrate the existence of personal norms favourable to co-operative compliance. Additionally, responses show the presence of compliance-reinforcing social norms according to which large corporations in Colombia are perceived as broadly compliant and having a good relationship with the tax administration. Furthermore, interviews signal that corporations in Colombia are increasingly concerned about tax reputational risk, that public perception is taken into account when devising tax strategies and tactics, that tax teams are devoting more time to compliance than other areas, are having a more collaborative interaction with other corporate teams, and that tax is being considered alongside - as opposed to prior to or after- other variables in the business decision-making cycle. Overall, these variables indicate a shift towards higher risk aversion, increased tax risk control, and/or compliance-mindedness which is positive for co-operative compliance.

However, responses also showed that there are multiple factors which could reduce co-operative compliance's validity in Colombia. First, interviewees displayed significantly low levels of trust in DIAN (Dirección de Impuestos y Aduanas Nacional), and mostly negative or mixed perceptions about its commercial awareness, power, adequacy of interventions, and its staff's attitude and expertise. Second, a substantial portion of interviewees stated that maximising tax savings and profitability remain key drivers of corporate tax behaviour, something which conflicts with the risk-averse, compliance-minded mentality favoured by co-operative compliance. Third, while corporations are

reported to have implemented ongoing processes that have the potential to reduce tax risk appetite and to improve tax risk control, responses show that there are weaknesses in corporate tax governance like the subordination of tax teams to finance teams, frequently using tax-savings-related key performance indicators for tax director remuneration and/or evaluation, low board involvement in tax matters, and the relatively-common use of *flexible*, subjective, approaches to analysing tax risk, which question the validity of a regulatory model based on regulatee self-regulation and tax risk control. Finally, findings reveal the existence of social norms describing corporate tax directors and tax advisors as having a mixed behaviour in terms of compliance and aggressiveness, something which can erode voluntary compliance and thus reduce co-operative compliance's validity.

This chapter segments and analyses the findings described above in detail. Since literature about corporate tax compliance in Colombia is very scarce and, to the extent of the author's knowledge, there is no previously published Colombian research on this thesis' subject matter, these results are a novel addition and present opportunities for further research.

## **7.2. Findings increasing co-operative compliance's validity**

This section presents and analyses those findings which can be associated with an increased validity of co-operative compliance in Colombia because of a.) An alignment between corporate tax officers' personal norms and the principles behind this regulatory approach, b.) The existence of social norms supporting the behavioural assumptions and/or objectives of co-operative compliance, c.) Corporate tax cultures (tax morale and behaviour) and other organisational

factors linked with tax-risk aversion, compliance-mindedness, and/or robust tax risk control, and d.) Positive taxpayer perceptions of the administration in relation to the characteristics that would allow for co-operative compliance to function effectively.

### 7.2.1. Responses about the administration's ideal objectives demonstrate alignment with principles associated to co-operative compliance.

In addition to what they perceive are the motivations behind DIAN's *actual* behaviour (section 7.3.10), interviewees were questioned about what those motivations or objectives *should* ideally be. Investigating taxpayer views on this matter makes it possible to gain a better understanding of the type of regulator that regulatees have in mind and to contrast this to the type of regulator co-operative compliance envisions.

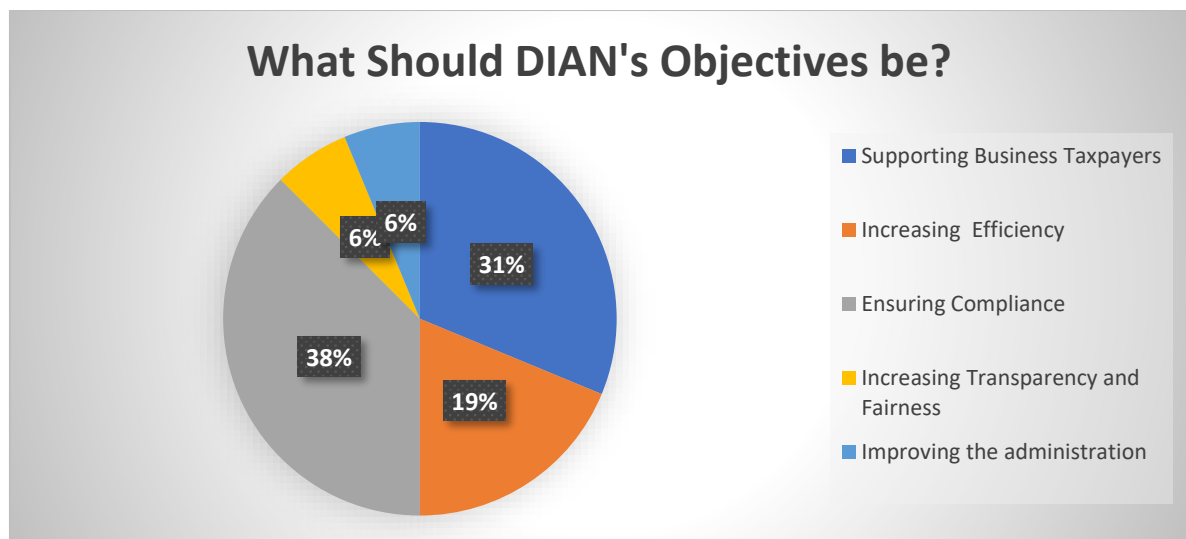


Figure 36 Ideal objectives for the tax administration according to Colombian interviewees

Most interviewees' opinions show a degree of alignment with the role expected of the administration under co-operative compliance. Thus, multiple participants (31%) highlighted the need for the administration to adopt a collaborative,

supportive role in relation to taxpayers. This can be linked to reciprocity, since participants felt the administration would be responding to the taxpayers' intention to comply:

'I think that their main objective [DIAN] should be to become allies of the entrepreneur, especially those that want to pay their fair tax' (P11)

the administration should realise that corporations are not thinking about evading or avoiding but rather contributing, and as such...work in tandem with us (P6)

These excerpts evidence that many interviewees see the regulator as a facilitator and potential partner, rather than an enforcer adversary, something which indicates support for a model like co-operative compliance, which is premised on collaboration and horizontality.

Another objective highlighted was the need for the administration to focus on efficiency and/or transparency (25%), all important aspects of co-operative compliance. Thus, for P11 and P18, compliance should go hand in hand with an effort by the administration to simplify tax rules and procedures. For P24, working to make compliance more efficient should be understood as mutually beneficial:

It should be a win-win situation, where as a taxpayer I know that I am complying...but that the Administration is doing the utmost to facilitate that compliance... (P24)

For those arguing that DIAN should increase compliance efficiency, the administration should seek to improve legal certainty and reduce compliance costs by simplifying tax compliance, streamlining audits, and improving internal governance:

'[the objective should be] ...Improving efficiency, reducing corruption.' (P13)

'It should be an issue of being proactive and efficient...' (P2)

‘...The administration needs to be more efficient...’ (P7)

The belief that the administration should act more efficiently points to an alignment of regulatee interests with co-operative compliance, since this regulatory policy is generally understood to have compliance and collection costs reductions as one of its main advantages. However, as mentioned in chapter five, the experience of countries like the Netherlands has created doubts in relation to this assumption<sup>370</sup>. It is also possible that the interviewees’ interest in efficiency is linked with their negative perceptions about the adequacy of the administration’s interventions and its power - addressed in section 7.3.14. Moreover, this focus on efficiency is not surprising considering the costs of complying with business taxes in Colombia<sup>371</sup>.

Additionally, one interviewee explicitly referred to transparency as an ideal objective (P17). This is also indicative of a higher validity for co-operative compliance, considering this model’s focus on full disclosure as a prerequisite for dialogue and the provision of legal certainty.

For their part, some of the responses (38%) identifying ensuring compliance as an ideal objective mentioned the need for the administration to be responsive and/or to increase business understanding, both distinctive elements of co-operative compliance. For these participants, ensuring compliance requires treating taxpayers differently based on their behaviour (i.e.

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<sup>370</sup> De Widt and Oats, 'Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison', pages 247-248.

<sup>371</sup> According to the World Bank’s “Doing Business” ranking, Colombia, which is ranked 59/190 overall, is ranked 142<sup>nd</sup> when it comes to the ease of paying taxes. In contrast, the UK is ranked 23<sup>rd</sup> in that same index. See <http://www.doingbusiness.org/rankings>.

*responsiveness*) (P1, P9), and/or increasing business understanding. In P1's words,

'Business should be understood, and objectiveness should be the guiding parameter...'

Furthermore, different interviewees defended the need for the administration to ensure compliance uniformly (P3, P14).

Choosing compliance enforcement coupled with business understanding and/or responsiveness as an ideal administrative objective is positive for co-operative compliance's validity because this model relies on in-depth administrative knowledge about the regulatee's profile and the correlated differentiated administrative action as differentiating elements. Moreover, prioritising compliance suggests that taxpayers are compliance-minded, something which is also conducive for co-operative compliance.

### **7.2.2. Responses about the ideal taxpayer-administration relationship coincide with the engagement sought by co-operative compliance.**

In a similar vein to the question analysed in the previous section, participants were asked about how the ideal taxpayer-administration relationship between should be, in order to assess whether regulatory subjects' expectations about the role of the regulator and their interaction with it show alignment with what would be foreseen under co-operative compliance. Responses demonstrate a considerable degree of alignment with the relationship envisioned by co-operative compliance, since participants desire a collaborative engagement marked by direct dialogue, responsive regulation informed by business



compliance. Thus, for P24:

[the parties] should help each other in a win-win scenario’.

These ideals sit comfortably with co-operative compliance, where *collaborativeness* is essential. However, as discussed in chapter four, collaboration can give way to regulatory capture<sup>373</sup>, and this is concerning in contexts like Colombia’s, where corruption is high (see chapter one) and where there is a considerable resource asymmetry between large corporates and the administration. Moreover, even where boundaries are well defined<sup>374</sup>, public (mis)perceptions of inequality and/or opacity might lead to a legitimacy crisis<sup>375</sup>.

Co-operative compliance’s validity is also bolstered by responses highlighting dialogue. Participants like P13, P5, P4, and P6, stated that the ideal relationship involved a frank dialogue with the administration which is ‘open’ (P17) - something which also links to transparency, ‘technical’ (P5), focused on positions (P13), and on business realities (P4). Interviewees linked a productive relationship with maintaining inter-party direct communication, as opposed to having other actors mediate between them. According to respondents, directness would increase efficiency and prevent third-party interference, including that of external advisors:

Ideally the relationship should be direct, with no intermediaries. There shouldn’t be any intervention by external advisors or economic stakeholders that have their own agenda. (P6)

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<sup>373</sup> Picciotto, 'Indeterminacy, Complexity, Technocracy and the Reform of International Corporate Taxation'

<sup>374</sup> Freedman, *Responsive Regulation, Risk, and Rules: Applying the Theory to Tax Practice*

<sup>375</sup> Burton, 'Responsive Regulation and the Uncertainty of Tax Law—Time to Reconsider the Commissioner’s Model of Cooperative Compliance?'

This is surprising, since all interviewees stated their employers hired external tax advisors. Responses suggest that some taxpayers feel that advisors are too adversarial and/or interested in controversy escalating as a mechanism to ensure their continued intervention. Naturally, this does not mean advisors cannot operate well within a co-operative compliance relationship, since their technical expertise is still required. However, for their intervention to facilitate agreements, practitioners would have to adopt conflict resolution and prevention as goals.

Another theme among interviewees was the need for the relationship to be efficient. According to P14, the relationship should involve,

‘More agility, quicker resolution of issues. More efficiency when acting. It’s also about reducing procedural burdens’

Similarly, simplicity as a parameter of efficiency was described as ‘ideal’ (P4). Considering how co-operative compliance is generally thought of as an efficiency-generating policy under the assumption that taxpayer disclosures mean authorities invest less resources on discovering non-compliance, and that the possibility to reach agreements proactively reduces conflict-associated costs, the connection between co-operative compliance and a desire for greater efficiency is not surprising. However, taxpayer expectations of greater efficiency should be tempered because, as described in chapter four, comparative experiences show that gains from lower disputes and greater certainty must be balanced with the costs incurred in developing and maintaining the robust internal tax control frameworks necessary for co-operative compliance.

Another ideal stated by several interviewees which is important for co-operative compliance is the need for the relationship to be supported by administrative business knowledge:

[ideally] I meet up with the account manager from the administration, discuss my business, my profitability... There should be... capable people that understand business... (P4)

‘The relationship should be open, based on good business knowledge.’  
(P17)

Robust business knowledge facilitates co-operative compliance because this policy’s responsive nature requires that the regulator thoroughly understands the regulatee’s circumstances that can be pertinent to the regulation’s subject-matter. Moreover, co-operative compliance often relies on taxpayer-dedicated officers who are assumed to regulate more efficiently because they immerse themselves in the taxpayer’s business and have a thorough understanding of their profile. The problem is that this places a high demand on the administration’s resources and that, as discussed later in this thesis, this means that the administration often fails to fulfil this expectation.

For some participants, the ideal relationship should centre on maximising legal certainty, with the administration being straightforward about its interpretation of the rules and how it will define compliance (P9). Certainty was also linked to uniformity (P13) and eliminating ‘grey lines’ or ambiguity/vagueness, something seen to facilitate tax risk control (P2). This desire for increased predictability in the interpretation and application of the law indicates potential to align taxpayer interests with regulation, since the administrative provision of certainty is a major incentive for attracting taxpayers to co-operative compliance. However, the administration’s ability to increase certainty is limited by the quality of the rules it must apply and interpret and by

the inherent lack of certainty and the indeterminacy of tax law<sup>376</sup>. This constitutes a serious problem in Colombia, where a new tax reform is legislated, on average, every two years<sup>377</sup>.

A final theme among interviewees referred to the administration's power and its ability to implement responsive regulation: According to several participants, for an ideal relationship, the administration ought to boost its technical expertise and investigative capacities. For P23,

An ideal relationship involves a greater degree of investigation, more business knowledge, a higher level of inspectors so that they can show up in the corporation and command respect...

The desire for greater administrative power (ability to detect non-compliance) highlights the fact that power and deterrence are not mutually exclusive with trust and voluntary compliance<sup>378</sup>, and that corporate taxpayers are not necessarily interested in capturing a weak administration, as is sometimes believed by co-operative compliance's critics. As argued by Lederman<sup>379</sup>, co-operative compliance should involve a degree of deterrence, and strong administrative power could strengthen voluntary compliance<sup>380</sup>.

Additionally, the need for the administration to enhance its investigative capacity and expertise can be connected with the concept of responsiveness, another pillar of co-operative compliance, since participants see administrative

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<sup>376</sup> Gribnau, 'Corporate Social Responsibility and Tax Planning: Not by Rules Alone'. Page 230.

<sup>377</sup> This has been the trend since 1995.

<sup>378</sup> Prinz, Muehlbacher and Kirchler, 'The slippery slope framework on tax compliance: An attempt to formalization'

<sup>379</sup> Lederman, 'Report for the European Association of Tax Law Professors 2015 Congress "Tax Penalties as Instruments of Cooperative Tax Compliance Regimes"'

<sup>380</sup> Gangl, Hofmann and Kirchler, 'Tax authorities' interaction with taxpayers: A conception of compliance in social dilemmas by power and trust'

capacity-building as the means to produce targeted regulation and better profile taxpayers (P7), control 'bad taxpayers' and 'address serious corporate flaws' (P10), and be more attuned to 'this country's reality' (P3).

### **7.2.3. A significant portion of interviewees see minimising tax risk and/or ensuring compliance as a leading professional objective.**

Another finding regarding tax director personal norms which is positive for co-operative compliance's validity in Colombia is that a considerable portion of interviewees see compliance and/or risk awareness as their main or one of their main professional objectives.

The importance of enquiring about these goals, understood as personal norms<sup>381</sup>, is twofold: First, tax directors share opinions and practices among occupational peers, so personal standards of conduct are expected to influence and reflect social norms<sup>382</sup>. Second, because of the tax directors' hierarchy, expertise, and because other actors within the corporation show deference to the tax department when determining the organisation's tax affairs<sup>383</sup>, it is safe to assume that the tax director's tax morale is transferred onto the corporation's tax culture and contributes to explain its tax behaviour.

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<sup>381</sup> Oats and Onu, *Social Norms and Tax Compliance* (2014)

<sup>382</sup> Wenzel, 'An analysis of norm processes in tax compliance'

<sup>383</sup> As discussed later in the chapter, most Colombian boards are not overly involved in their corporations' tax affairs and most non-tax departments have grown accustomed to consulting the tax department proactively.



risk, and this synchrony can translate into conservative tax behaviour and disclosure to the authorities designed to reduce contingencies. The following quotes exemplify:

My main objective is that what happens today does not turn into a living hell tomorrow, and that anything bad that happened today will be managed. We know that there's risk, so we try to normalize and prevent future risk by control. (P24)

'My main objective has always been to avoid having any tax problems. I don't want any controversy...' (P16)

'My concern is tranquillity, taking the best decisions without creating contingencies.' (P5)

In contrast, for *tax optimisers*, the objective is to maximise tax savings, as would be assumed under the expected utility model, not under co-operative compliance, where most taxpayers are presumed to intend compliance:

'...I feel very satisfied when I know that my tax strategy and planning were efficient...it's about saving money.' (P11)

'...my concern is giving our investments the greatest possible added value by optimising tax under the law.' (P9)

Since compliance and/or risk management are subordinated to profits and strategic thought is paramount, the tax behaviour of *tax optimisers* and their corporations can disrupt co-operative compliance. These directors are risk-prone and compliance is secondary (or even contrary) to their objective of reducing the impact of taxes on profits and/or cash flows. Compliance is not seen as a worthy main objective, in and of itself. Issues such as selective disclosure are more likely to be present in absence of compliance-mindedness. Thus, it is doubtful that taxpayers would collaborate (or even participate, if participation was not mandatory) if they felt that they could pay less taxes outside the programme.

Participants in the third cluster, *multi-taskers*, believe that their function is maintaining a balance between reducing tax risk and obtaining tax savings. Whilst they share the desire to maximise tax savings with *optimisers*, and therefore could be damaging for co-operative compliance, they could also function under the model because of the concern with compliance they share with *risk mitigators*. According to responses, the “balance” between compliance and tax savings is resolved in favour of compliance, since it tends to be prioritised. Thus, *multi-taskers*’ personal norms appear to be favourable to voluntary compliance and, consequently, co-operative compliance:

We cannot afford the luxury of non-compliance, so we try to have an adequate tax planning, trying to support positions which do not place the corporation under risk ...We do try to optimise, but we are framing that within the context of what “should be” the taxation of a corporation such as this one. (P14)

There are three objectives: First that compliance works like a clock. Second, that we can anticipate everything, how are rules changing. Thirdly, how can I plan ideally? (P13)

...I like compliance and planning...It’s not an issue of saving X money, that is an ancillary issue. Savings will come about naturally if you work well and identify opportunities under the law. (P7)

That most interviewees saw compliance and/or risk reduction as leading goals suggests that the interests of a substantial portion of regulatees coincide with those of co-operative compliance and is favourable for the model’s validity. Nevertheless, the frequency with which tax directors displayed a tax-savings-centred view evidences that the portion of taxpayers (approximately one third) who might not have aligned interests with the regulator is large enough to advise caution regarding the application of a regulatory model premised on the idea that most regulatees are compliance-minded.

#### **7.2.4. Other corporate taxpayers are perceived as broadly tax compliant.**

This section analyses results regarding the existence of social norms indicating pre-existing support for co-operative compliance. Following Wenzel<sup>385</sup>, the author believes that identity and group conformity dynamics are likely to lead tax directors to internalise social norms present in their occupational groups. These norms can induce compliance because reputational loss or shame increase non-compliance costs when non-compliance is perceived to be socially undesirable or not prevalent. Conversely, norms can have a compliance-detracting effect when the non-compliant behaviour of others or social opinions about such behaviour justify or legitimize non-compliance.

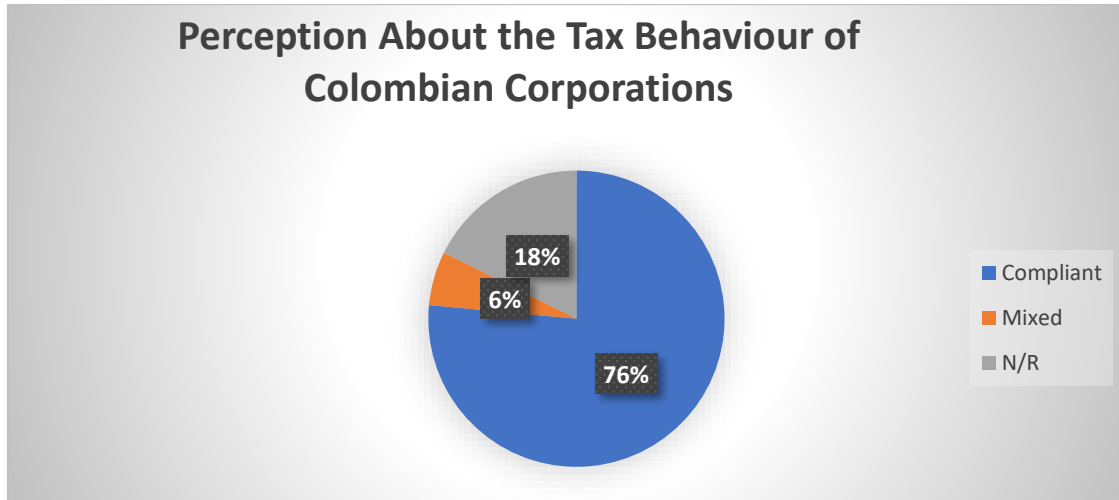
Thus, participants were asked to qualify the tax behaviour of other Colombian corporate taxpayers in terms of compliance. Consistent with their answers to other questions about behaviour, but not about tax morale or motivations (see 7.3.4), most interviewees described large corporations as compliant, indicating that there are descriptive<sup>386</sup>, social norms supporting compliance. The author believes this facilitates voluntary compliance, thus increasing co-operative compliance's validity.

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<sup>385</sup> Wenzel, 'The Multiplicity of Taxpayer Identities and Their Implications for Tax Ethics'. Page 34.

<sup>386</sup> Wenzel, 'An analysis of norm processes in tax compliance'. Page 217.

## Perception About the Tax Behaviour of Colombian Corporations



*Figure 39 Interviewee perceptions about the tax behaviour of corporations in Colombia*

Most participants who stated that other corporations were compliant did not qualify their assessment. Nevertheless, P18 described the average behaviour of corporations as ‘responsible and diligent’, and P1 referred to corporations as ‘serious’. Interestingly, some interviewees highlighted the role of deterrence in the form of penalties and monitoring in motivating perceived compliance:

‘...not complying can be very costly. If penalties didn’t exist, they [other corporations] would change their compliance patterns.’ (P13)

‘I think that they are compliant, I can’t assure it, but I imagine they are because of the amount of controls that exist.’ (P3)

This association is important because it suggests that, while taxpayers are compliant, their compliance (and cooperation) depends, at least partially, on deterrence, so co-operative compliance’s validity would depend, to a certain extent, on the administration and/or the judiciary -where contested penalties would be discussed- being perceived as powerful and/or executing amenability or “culture change” interventions to improve commitment to compliance (see chapter nine).

Responses reveal that tax directors tend to associate compliance with paying tax on time and not engaging in evasion, seeing other tax behaviour,

including non-descript avoidance and aggressive tax planning, as compliant:

‘In the case of large corporations, compliance is quite positive. You rarely hear of a large taxpayer not fulfilling its obligations in time...’ (P2)

‘On average they are compliant. I think that they are not capable of evasion. There might be some avoidance...’ (P5)

‘I think they [corporations] are serious and pay their taxes...They are not evaders at all...’ (P1)

Thus, while a regulatee population widely perceived as compliant could indicate compliance-mindedness and therefore increase co-operative compliance’s validity, there are questions about whether this compliance-mindedness would be equally high if tax-aggressive planning were to be included in the definition of non-compliance.

#### **7.2.5. Most interviewees believe other corporate taxpayers enjoy a good relationship with the administration.**

In addition to evaluating the tax behaviour of other corporations, participants were asked to characterise those corporations’ relationship with DIAN. This assists in determining whether taxpayers are exposed to norms that incentivise or deter them from establishing/maintaining a positive taxpayer-administration relationship, something expected under co-operative compliance. Consistent with the findings regarding the interviewees’ perception of their own employers’ relationship with the administration - discussed in 7.2.12, most interviewees (65%) stated that competitors/peers enjoy a good relationship with DIAN. The author believes that this descriptive social norm can increase co-operative compliance’s validity because potential regulatees face pressure to conform to a perceived group pattern of good taxpayer-administration relationships and are thus more likely to embrace a collaborative, non-adversarial, model like co-operative compliance.

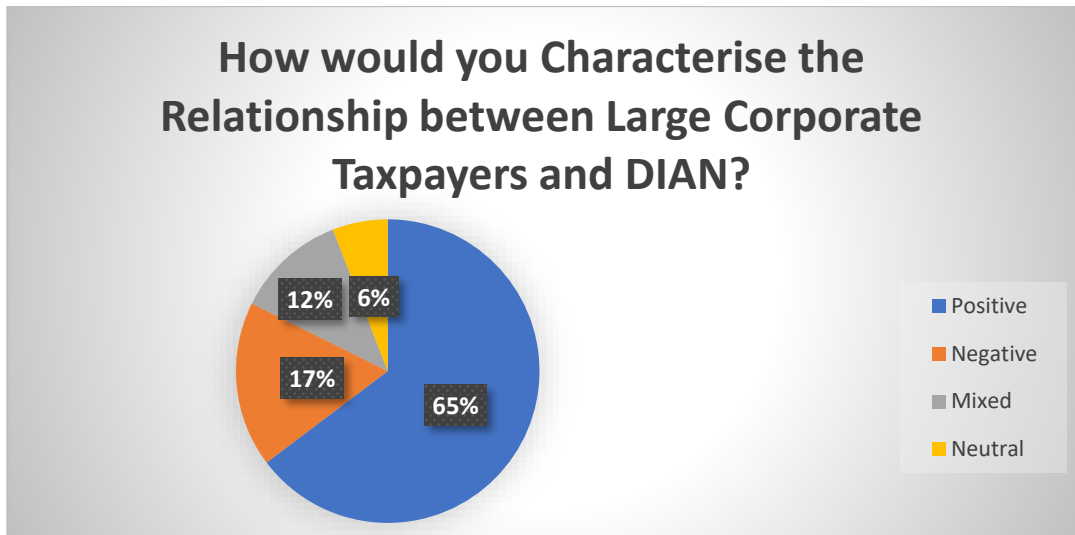


Figure 40 Colombian interviewee characterisation of the relationship between corporate taxpayers and the administration

Those interviewees for whom the relationship between large corporates and DIAN was positive often described it as collaborative. According to P14,

‘It’s a relationship where they help each other, two-way. Corporations end up being a support for the tax inspector.’

However, participants did not agree regarding the parties’ motivation for assisting each other. For some, like P13, mutual support resulted from the large corporations’ compliance-minded attitude:

‘...My experience is that MNEs want to do things well, they do not want to engage in fraud and corruption...’

For others, displaying a more cynical view, the relationship is good because DIAN knows that these taxpayers ‘give the most revenue’ (P24) or because their size allows them to participate in industrial organisations that increase their political leverage (P2). Moreover, for P6, large corporations could also use their ability to lobby and hire well-connected advisors to ensure a good relationship.

Whilst good relationships between corporations and the administration increase co-operative compliance’s validity by fostering a positive environment where the administration trusts taxpayers and provides client-oriented services

– i.e. a ‘synergistic climate’<sup>387</sup>, unrestricted lobbying and excessive closeness in a co-operative compliance framework can also lead to regulatory capture and reduced accountability, particularly in countries with high levels of corruption, like Colombia. P23 referred to this:

...this is not a healthy situation...the tax system is structured so that a small number of taxpayers are the ones that pay and have a direct relationship with the administration, and this pollutes both sides...one has the chance of becoming entangled in a “friends” dynamic and the administration cannot afford this. (P23)

Thus, what some parties might describe as a good relationship involves aspects which can be damaging for the rule of law and which would be detrimental for a proper co-operative compliance relationship.

According to those interviewees who had mixed views about the relationship, its quality varied depending on the taxpayer’s industry sector (P16) and/or on external tax advisors’ intervention and their contacts, something which can be linked with regulatory capture:

...the relationship...is tied up to the role of advisors. If the corporation has an advisor that knows the right people in the government, there is a good relationship. (P6)

Finally, among those who viewed the relationship negatively, contentiousness was an important hurdle. According to P18:

... there is a lot of discussion regarding interpretation where companies don’t share the positions adopted by the authorities and they end up in disputes. The number of disputes won by the authorities does not end up being high in comparison to what they lose and what the taxpayer has had to pay to lawyers and litigation fees... disputes don’t seem to be effective. (P18)

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<sup>387</sup> Wahl, Kastlunger and Kirchner, 'Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the “Slippery Slope Framework”

For P4, conflict is associated with a lack of mutual trust, which leads taxpayers to engage in strategic behaviour aimed at exploiting DIAN's weaknesses:

I don't think that there is a lot of trust between the parties. As such, there are more disputes...entities are often aware of the administration's technical shortcomings and tend to exploit this... (P4)

This last quote evidences the low levels of trust in the administration which will be discussed later in this chapter. Additionally, it shows that strategic behaviour amongst corporate taxpayers does not only involve exploiting the law, but also administrative weaknesses, something which would be a serious concern for co-operative compliance in contexts where there is a resource asymmetry between taxpayers and the administration.

#### **7.2.6. Corporations are increasingly concerned with reputational risk and interviewees view it as a significant driver of corporate tax behaviour.**

Interviewees perceive Colombian corporations as increasingly concerned with tax reputational risk. This shows an increased support for co-operative compliance's validity because of a higher risk aversion among regulatees which manifests itself in three areas: 1. Managing/preventing reputational risk is seen as a main driver of corporate tax behaviour, 2. Board involvement in tax matters is focused on controlling reputational risk, and 3. Reputational risk is occasionally reported as a criterion used to determine a tax position's acceptability. Since the last points will be mentioned in other sections, this section will focus on the first aspect.

Reputational risk was mentioned as a significant driver of corporate tax behaviour by almost 60% of interviewees. P2 and P3 referred to it as 'the most important' driver, P7 stated it was one of the main priorities to be weighed, and P4 felt that, regardless of the different ways in which corporations can respond

to it, 'one must always be aware of the reputational issue'. This heightened concern with reputational risk matches what has been reported in other jurisdictions like the United States<sup>388</sup> or the UK<sup>389</sup>.

While increased concern with reputational risk might not necessarily translate onto more compliant tax behaviour, interviewees reported that companies' tax positions are tailored to prevent negative external exposure and reputational damage that could alienate consumers or other important stakeholders. According to P17:

What matters the most is protecting the brand name. That compliance is under the law, no aggressive planning so that the corporation's name cannot be tarnished... they want to protect their image so that their expansion and consumer perception are not affected.

Similarly, P24 argued that companies are willing to modify their tax behaviour to protect their brand from reputational damage, even if that means paying more than what's legally required:

...Some companies really care about their brand name, so they might even want to over-comply and pay more taxes than they should, to avoid unwanted scrutiny.

While contributing above and beyond what's legally required might be socially responsible or desirable under a corporate social responsibility perspective<sup>390</sup>, overly focusing on satisfying perceived social preferences might decrease participation in co-operative compliance programmes, whenever the public sees

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<sup>388</sup> Mulligan and Oats, 'Tax risk management: evidence from the United States'

<sup>389</sup> Holland, Lindop and Zainudin, 'Tax Avoidance: A Threat to Corporate Legitimacy? An Examination of Companies' Financial and CSR Reports'

<sup>390</sup> See Gribnau, 'Corporate Social Responsibility and Tax Planning: Not by Rules Alone' and Gribnau and Jallai, 'Good Tax Governance: A Matter of Moral Responsibility and Transparency'.

these as illegitimate and/or unfair, regardless of whether the programme is technically sound.

Since reputation requires that the conduct judged by the observer is visible, it would be expected that large and/or publicly-listed corporations are more concerned by reputational damage because of being subject to greater scrutiny from market analysts and regulators<sup>391</sup>. Supporting this, P24 mentioned that,

'some organisations are very careful about their reputation because they are public or listed'.

One concern with the association between being publicly-listed and having an increased risk awareness is that in Colombia, unlike the UK, a significant portion of large corporate taxpayers are not publicly listed, meaning there is reduced scrutiny.

In terms of the relationship with corporate size, P23 felt that there was a direct link between size and increased reputational risk:

In the beginning, when the company was growing, taxes were an issue of compliance only, but with sustained growth we care more about reputational risk...

Since co-operative compliance programmes are generally targeted at large corporate taxpayers, the link between size and risk awareness might be positive for the effectiveness of this type of regulation. However, this would have to be balanced with the greater resources available to these taxpayers, which can cause asymmetries with the administration that may be strategically exploited.

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<sup>391</sup> Lanis R and Richardson G, 'Corporate social responsibility and tax aggressiveness: An empirical analysis' (2012) 31 *Journal of Accounting and Public Policy* 86

According to responses, corporations are sometimes more worried about being seen as opaque, than about disclosing their tax positions. For P11, 'a good organisation should not have any hidden tax issues'. The idea is that not disclosing tax positions, even if these would be positively judged by the public, could damage the taxpayer's goodwill.

Another factor associated with tax reputational risk is governmental participation in the companies' equity. As argued by Hanlon and Slemrod<sup>392</sup> and Xing and Shujun<sup>393</sup>, close government links are expected to increase corporations' risk aversion and their willingness to collaborate with authorities. Responses provide supporting evidence. Thus, for P1, partial state ownership meant that the company needed to adopt an approach to taxes which allowed them to maintain closeness with the government, and for P13, government involvement meant that public relations were a concern and political interests would prevent the company doing whatever was needed to maximise returns, including minimising taxes. Like in other jurisdictions, such as Sweden<sup>394</sup>, these changes in risk profiles could incentivise Colombian government-owned companies to participate in co-operative compliance.

Whilst increased concern with reputational risk might reduce tax-risk appetites and thus facilitate co-operative compliance's introduction, it is possible that strategically-minded taxpayers maintain the same risk profile, 'managing'

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<sup>392</sup> Hanlon and Slemrod, 'What does tax aggressiveness signal? Evidence from stock price reactions to news about tax shelter involvement'

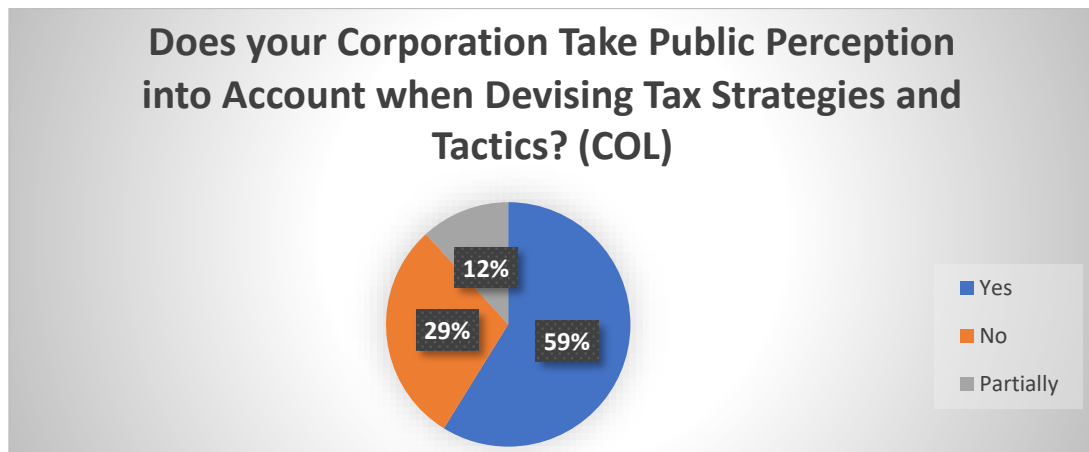
<sup>393</sup> Xing L and Shujun C, 'Determinants of Corporate Effective Tax Rates' (2007) 40 Chinese Economy 49

<sup>394</sup> Björklund Larsen, 'SWEDEN: Failure of a Cooperative Compliance Project?'. Page 22.

their public disclosures of their tax positions by revealing only “plain vanilla” positions or disclosing cryptic or technically-sophisticated information to reduce public interest. Indeed, P18 argued that reputational risk was not such a serious issue, since the public at large would not be interested in ‘things which are complicated’ and would not want to know about corporate tax affairs, since they are considered to be ‘a brick load’.

#### **7.2.7. Most corporate taxpayers take public perception into account when devising their tax strategies and tactics.**

Another finding which indicates that large corporations in Colombia are increasingly tax risk averse, and thus potentially more attuned to risk-based responsive regulation like co-operative compliance, is that most interviewees (59%) stated that their corporations take public perception into account when devising tax strategies and tactics. This can increase in co-operative compliance’s validity because most participants’ corporations concern with tax reputational risk makes them willing to model their tax behaviour around the more conservative, lower risk practices perceived to be desired by the public. This gives them a risk averse mindset conducive to co-operative compliance and strengthens the likelihood of them collaborating with authorities to avoid tax contingencies.



*Figure 41* Colombian interviewee responses about the importance of public perception for corporate tax strategies and tactics

For those who stated that their corporations take public perception into consideration, doing so was seen as necessary to prevent reputational damage and, consequently, prevent economic harm:

In an organisation like this one not taking them [public concerns] into account might mean less resources or a harmful retribution against the company. (P4)

...we do concern ourselves with reputation because we are a global corporation, since any scandal in any country will impact all of us. The cost of a negative image is too high. (P6)

Thus, consistent with behavioural research<sup>395</sup>, concern with public perception is related to exposure and negative visibility and fear that the taxpayer will be stigmatised or shamed. P24 illustrates:

Visibility is essential for us, we take a lot of care of it. Because we are highly exposed to the public, that matters to us just as much as an economic benefit. If I'm sending out a message to investors that I have great profits and ETRs, but at the same time I'm being shamed for my tax positions or my legal standing is volatile, I'm not doing things properly.

Concerns with public perception and reputation might even trump legal considerations, occasionally leading to overcompliance:

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<sup>395</sup> Eisenhauer, 'Ethical preferences, risk aversion, and taxpayer behavior' and Pickhardt and Prinz, 'Behavioral dynamics of tax evasion – A survey'

'Multinational enterprises such as this one check the franchise risk over and above the law...' (P2)

We have a stabilisation agreement<sup>396</sup> and in theory wealth tax shouldn't apply to us. Many corporations [erroneously asked for payment] filed a lawsuit, but we chose to pay and then sue so as to safeguard the company's name. (P13)

Results show that several corporations perceive public interest in corporate taxation as a threat and position themselves defensively, wanting to prevent unfavourable media exposure (P5, P13) or, if this is unavoidable, having the structure to allow them to frame their tax positions as acceptable:

We worry a lot about the role of the media...they tend to activate public scrutiny and they trigger processes whereby other public entities start auditing or asking questions... (P9)

'...we must be sure that if something comes out, we can defend ourselves with no difficulties.' (P1)

As argued previously, a higher risk aversion and/or reputational awareness does not necessarily translate into higher compliance. However, responses suggest that concerns about public image do lead to behavioural changes like avoiding positions that could be judged negatively, or adopting positions that are judged positively by external stakeholders:

Before thinking about tax savings, we think about the company's reputation. We have aborted many planning ideas thinking about our safety... (P5)

Sometimes proposals come in and you think to yourself "oh my god...you would never get involved in anything that is not clean and would harm you reputationally" (P11)

For some in the minority according to whom public perception is not considered, the perceptions were that the Colombian public is not overly concerned with tax,

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<sup>396</sup> These agreements, formerly available under Colombian law, allow qualified investors to 'freeze' or stabilise applicable tax rules and regulation proactively in exchange for considerable capital investments and job creation.

that the concern (where present) would not produce material consequences for taxpayers, or that the public's views should be ignored because they are erratic:

...We perceive that the Colombian public does not assign a great importance to media scandals, they forget quickly, and the brand is affected only temporarily. (P17)

'Because of the type of product we commercialise, consumers are not very concerned with our tax strategy...' (P6)

'...People's perception of tax is a chaotic as road traffic.' (P23)

For others, the public was seen as somewhat irrelevant, not a 'connected' stakeholder (P18), or as an 'outsider' regarding the corporation's tax affairs (P14). Interestingly, for P7, the low importance afforded to public perception is attributable to the primacy of legality:

...There's always criticism, but as long as you can justify your position under the law you are fine. If I comply and my ETR is lower than what the public would want, then it's not my problem.

The media's role in creating or driving public opinion in relation to corporate taxation is somewhat paradoxical. While potentially harmful for co-operative compliance in terms of reducing accountability and facilitating regulatory capture, the reduced media exposure/visibility of tax issues that some interviewees believe exists in Colombia, could incentivise co-operative compliance by allowing taxpayers to participate without fearing media/public criticism. Simultaneously, the threat of media exposure and reputational damage appears to be a powerful behavioural driver that can lead taxpayers to reduce their tax risk and/or to collaborate with authorities. Thus, the interaction between co-operative compliance and media coverage of corporate taxation provides ample opportunities for further research, particularly once the effects of public country-by-country reporting and preferential regime reporting are incorporated into the equation.

**7.2.8. In-house corporate tax teams devote most of their resources to compliance.**

Moving to factors related to the corporations' in-house tax teams, interviews reveal that Colombian corporate tax teams allocate most of their resources - in terms of worktime - to compliance. This indicates an increased validity for co-operative compliance because corporations that are willing to invest in compliance despite the high costs associated with an adversarial model would be expected to find co-operative compliance attractive as an avenue to continue their commitment to compliance with potential cost savings attributable to responsiveness.

As shown below<sup>397</sup>, the average percentage of time dedicated by tax teams to compliance tasks is practically three times as high as that spent on planning and tax disputes:

COMPANY	COMPLIANCE	PLANNING	DISPUTES
A	'Biggest area'	Minor area 1 employee ft	Minor area 1 employee ft
B	'Takes a lot of time'	Fluctuates	'Few'
C	40-50%	40-55%	5-10%
D	50%	35%	15%
E	85%	5% planning, 10% processes and controls	
F	75%	5%	10% disputes+ 10% dialogues
G	60%	20%	20%
H	60%	30%	10%
I	70%	15%	15%
J	70%	20%	10%
K	50%	25%	25%
L	70%		30%
M	50%	30%	20%
N	30%	10%	60%
O	60%		40%
P	50%		50%
Average % time dedicated	58,92%	21,61%	19,47%

*Figure 42 Average functional allocation of in-house tax team resources according to Colombian interviewees*

<sup>397</sup> The figure excludes observations where interviewees did not provide a numerical figure and split evenly percentages that were given as an aggregate.

While the predominance of compliance is partially explained by the time required to familiarise with frequently-changing rules<sup>398</sup>, high amounts of reporting<sup>399</sup>, administrative requests, intra-company reporting, and Sarbannes-Oxley compliance, it also shows compliance-mindedness, since non-compliance-minded taxpayers could choose to spend less resources in compliance and gamble not being detected or even embrace non-compliance if they thought it less costly.

The relatively low amount of time spent on tax planning could mean that corporations are more risk averse and less willing to engage in activities that could increase their tax contingencies. However, there is insufficient direct evidence to support this. Additionally, some responses indicate that the intensity of planning varies depending on the moment of the year and on the existence of business projects that tax directors believe would benefit from tax savings (P11, P17). Finally, as suggested by P17, it is possible that in some companies, while the team predominantly dedicates to compliance, senior tax officers spend most of their time developing planning strategies and managing disputes. Thus, unless the company also commits its senior tax executives to co-operative compliance, the administration might face difficulties in grasping the whole extent of the taxpayers' planning and uncertain tax positions where day-to-day contact only involves junior tax staff.

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<sup>398</sup> Tax reforms are highly frequent in Colombia. Since the year 2000 there have been nine major corporate tax law reforms.

<sup>399</sup> Colombia's tax system relies heavily on self-assessments and third-party reporting. Additional reporting includes transfer pricing, CFCs, permanent-establishment, CbCr, CRS, and FATCA obligations. For example, according to P10, '...each month we have to produce about 900 tax statements'.

Finally, responses suggest that the relatively low amount of time devoted to controversies is often associated to the companies' adoption of a settlement-oriented approach, something which would also increase co-operative compliance's validity, since regulatees would already be accustomed to seeking non-confrontational solutions to differences with the administration. For example, P24's corporation was said to focus on 'trying to solve disputes administratively'. Similarly, for P13:

'We have opted to settle...and come to agreements...become their partners so as not to waste resources, this strategy has worked very well.'

While uncertainty over tax positions remains - 100% of the interviewees categorised Colombia's tax system as 'complex' or 'very complex' and several of them referred to a lack of legal certainty as a consequence of this, taxpayers not satisfied with *capitulating*<sup>400</sup> should still see in co-operative compliance an opportunity to prevent the dispute from arising and to reach mutually-satisfactory positions. Additionally, the significant amount of time spent by tax teams on compliance means that co-operative compliance could remain attractive if it meant greater efficiency in obtaining certainty regarding uncertain positions.

#### **7.2.9. Corporations are shifting from a contentious interaction between tax teams and other corporate units to a collaborative engagement.**

A further finding at the organisational level which is favourable for co-operative compliance's validity in the Colombian corporate context is that 70% of interviewees described the interaction between their companies' tax team and other teams as positive, and only 12% of them felt it was consistently negative.

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<sup>400</sup> See Braithwaite, Murphy and Reinhart, 'Taxation Threat, Motivational Postures, and Responsive Regulation'.

This is favourable for co-operative compliance's validity because a collaborative interaction between corporate teams can facilitate taxpayer risk awareness, internal control, and reduce non-intentional tax compliance, provided the tax team is consulted proactively and is compliance-minded (i.e. not driving other teams to engage in non-compliant transactions). Both risk awareness and risk control frameworks are sought-after regulatee characteristics in a co-operative compliance relationship<sup>401</sup>.

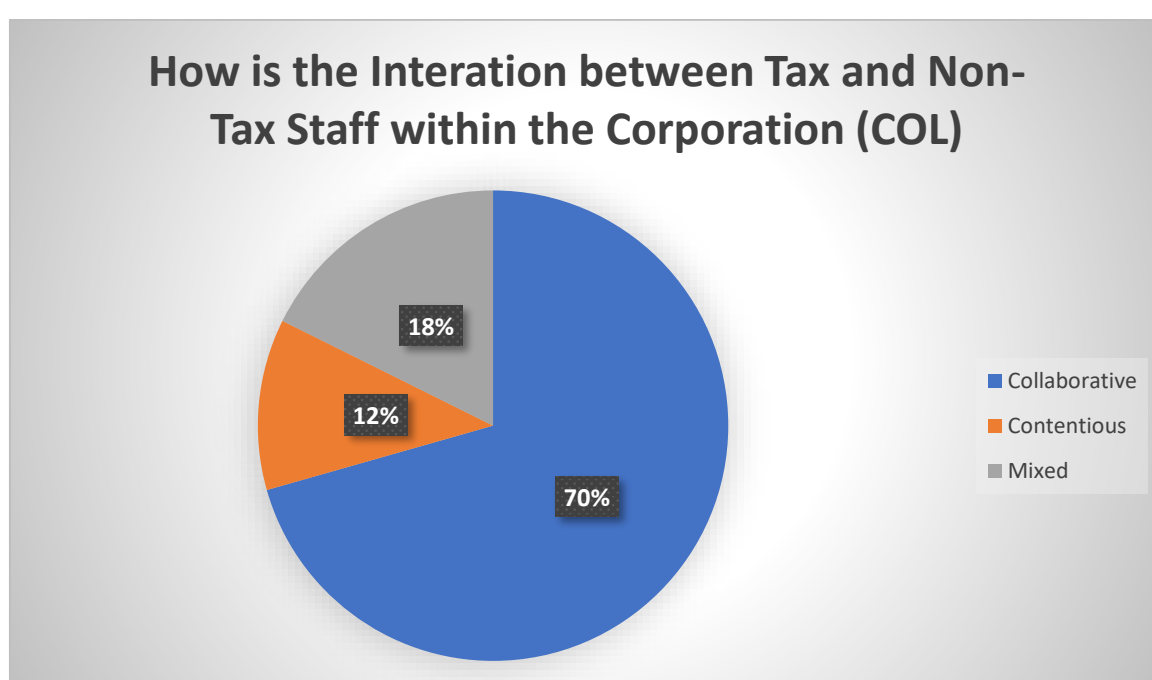


Figure 43 Interaction between tax and non-tax staff in interviewees' corporations (Col)

One of the themes shared by several interviewees is the perception that the interaction between tax and non-tax teams has been improving recently, as tax teams gains more prominence in corporate structures, and because of conscious efforts by tax directors to reduce or eliminate internal frictions:

<sup>401</sup> De Widt and Oats, 'Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison'

‘...we’ve advanced in recent years by showing synergies and letting people know we are their advisors. This didn’t use to be the case five years ago.’ (P9)

we let people know that we are doing our job and we are not paid to be popular, but rather to control risk and think strategically. Some areas really operated as loose wheels, without being clear about taxes, but now that has improved. (P24)

Most interviewees’ teams have achieved a positive interaction by portraying themselves as business partners, rather than enforcers. This shows parallelisms with co-operative compliance, where the administration is portrayed as a collaborator<sup>402</sup>. P23 described a process of trying to enhance relationships with non-tax teams by understanding their concerns and being flexible in relation to their needs:

...we cannot overburden them [non-tax teams] with compliance tasks. We have to find clever ways of helping them and achieve our goal of complying with tax rules. This is a step by step process, every day...one has to meet these people and try to ask them how things are, approach them, not as a “party-spoiling cop”, but as an advisor.

Similarly, for P4,

‘The other areas...understand that we are a business partner so that they can fulfil their goals, we try to be a partner for them.’

Interviews reveal that good relationships between teams allow the tax team to intervene proactively, preventing the materialisation of risky or openly non-compliant positions. P18 illustrates:

Through experience they learn that we can put off fires, but that it’s better to come to speak to us before the structure is set and we’ll come up with something that is more viable and not risky.

Likewise, according to P11,

...we have developed a culture which means that non-tax teams are accustomed to asking us beforehand because they know that’s what they need to do in order to prevent trouble further down the line.

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<sup>402</sup> OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance*

Furthermore, if other teams see the tax team as an ally they can communicate with, it is more likely that the positions discussed by the tax team in co-operative compliance exchanges would be based on a thorough understanding of the business' operational concerns and that agreements reached with DIAN would have a higher likelihood of being successfully implemented.

Since co-operative compliance relies on taxpayer self-regulation and risk control, having regulatees whose practices include internal risk prevention mechanisms, like proactive consultation with the tax department, increases the model's validity.

However, synergies between tax and non-tax teams do not always discourage tax risk-taking. Thus, the tax team may be seen as a savings-maximiser partner, rather than a compliance partner:

Sometimes we are consulted to try and achieve efficiencies, free more resources for each unit's budget, where we both win. Synergy. A lot of it has to do with how you sell tax management... (P1)

Consequently, for them to be favourable for co-operative compliance, frictionless interactions between tax teams and non-tax teams must be coupled with a tax team that has compliance-minded objectives, and which is not risk prone.

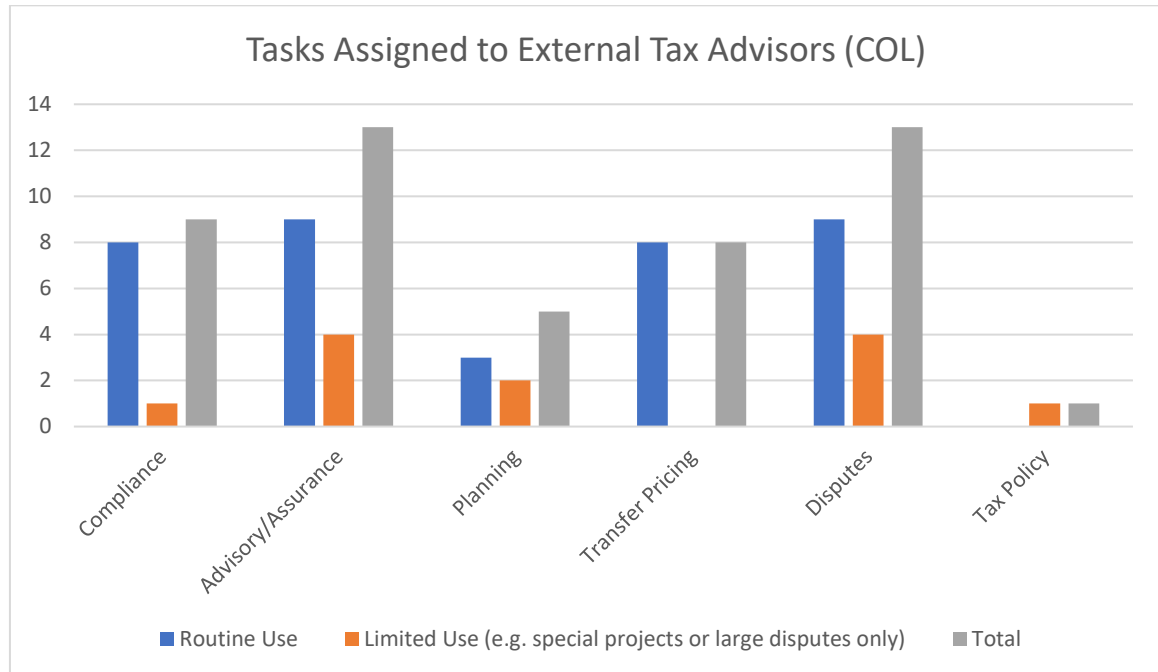
#### **7.2.10. Interviewee corporations rely on external advisors primarily for assurance and dispute management, indicating uncertainty aversion and appetite for reducing contentiousness**

The way in which taxpayers engage with tax advisors is fundamental in understanding taxpayer behaviour<sup>403</sup>. Thus, interviewees were asked about the

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<sup>403</sup> See Hasseldine, Holland and Van der Rijt, 'Companies and taxes in the UK: Actors, actions, consequences and responses'; McGuire ST, Omer TC and Wang D, 'Tax Avoidance: Does Tax-Specific Industry Expertise Make a Difference?' (2012) 87 The

type of tasks that their corporations hire advisors for. Responses reveal that the most common assignments are dispute management and advisory/assurance, followed by compliance, transfer pricing, planning, and tax policy:



*Figure 44 Tasks assigned to external tax advisors in Colombian corporations*

The fact that the most frequently-assigned tasks are assurance and dispute management is positive for co-operative compliance's validity. A marked interest in obtaining assurance, particularly when it entails the cost of hiring an external advisor, shows that uncertainty is a serious concern for taxpayers, who seek reassurance about their interpretation of otherwise uncertain rules and regulations. This concern, leading to the use of advisors as 'insurance against risk'<sup>404</sup>, suggests that corporate taxpayers are risk-averse and willing to invest

Accounting Review 975, and Frecknall-Hughes and Kirchler, 'Towards a General Theory of Tax Practice'

<sup>404</sup> Hasseldine, Holland and Van der Rijt, 'Companies and taxes in the UK: Actors, actions, consequences and responses'. Page 535.

resources to control their tax risk, characteristics expected of regulatees under co-operative compliance.

Moreover, the fact that compliance is the third task most frequently assigned to advisors indicates that many corporations are concerned with compliance itself, so compliance-mindedness is also present among regulatees. Naturally, reliance on advisors does not guarantee a compliant outcome, so the administration would be expected to meta-regulate by examining these advisors' contribution to risk control.

On a separate note, the high frequency with which advisors are hired for dispute management reveals that the taxpayer-administration relationship in Colombia is often contentious. This is surprising considering that most interviewees described their companies' relationship with DIAN as positive (See 7.2.12). Switching to a non-adversarial model like co-operative compliance could give the parties an opportunity to discuss their differences and reach settlements before having to escalate matters to the judiciary, which interview responses reveal is seen as untrustworthy<sup>405</sup> and which can delay conflict resolution significantly<sup>406</sup>. Thus, co-operative compliance's attractiveness as a non-litigious approach increases this model's validity in Colombia.

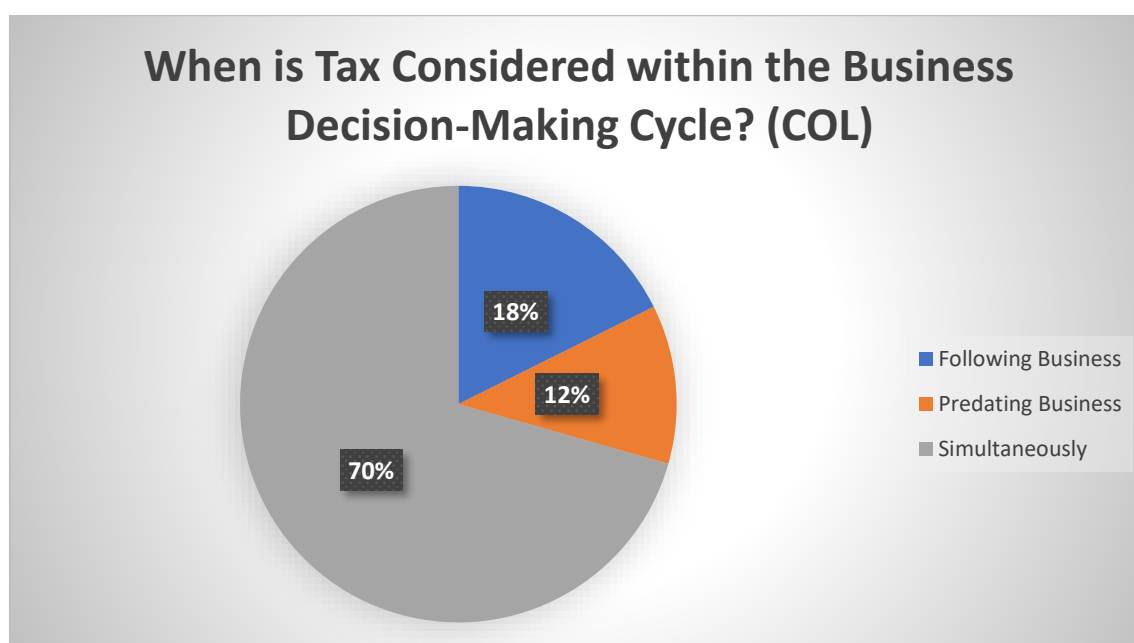
#### **7.2.11. Participants' corporations have shifted towards considering tax simultaneously to other variables in the business-decision-making process.**

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<sup>405</sup> Only 17% of interviewees stated they trusted it.

<sup>406</sup> Whilst the procedure has been streamlined since 2011, new cases may take five years or more to conclude. Older cases can take more than ten years to finish.

Another finding which favours co-operative compliance's validity in Colombia is that most participants' corporations were reported to have experienced a shift towards considering tax simultaneously to other variables in the business case, rather than allowing tax to follow business, which would leave the tax team in a defensive, *ex-post-facto* position, or letting tax drive business cases, what Armstrong et.al call "active planning"<sup>407</sup>.



*Figure 45* Timing of tax considerations within the business-decision-making cycle in Colombian corporations

This is positive for co-operative compliance's validity because it suggests that regulatees are adopting a decision-making process based on tax risk awareness, and purposefully attempt to reduce that risk by a.) preventing non-compliance arising from commercial decisions taken without considering tax consequences, and b.) reducing the possibility of tax driving business decisions, something often associated with tax abuse where the transaction or position lacks commercial substance. Moreover, corporations which consider tax before

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<sup>407</sup> Armstrong, Blouin and Larcker, 'The incentives for tax planning'

taking a business decision are more likely to operate well under co-operative compliance because the tax positions can be discussed and settled with the administration before any contingencies have materialised (*proactiveness*).

The association with more robust tax risk control was evident in the statements of those interviewees reporting tax and business being considered simultaneously, since most explained that the tax department was consulted before approving any business idea:

Every time a new business line is created, it must be accompanied by an ex ante tax impact determination. No business line lifts-off before we know its tax impact. (P2)

We have a model...for developing projects which requires a tax green light following the pre-viability phase, and when the business is about to become real, tax needs to give a green light before the project moves forward... (P9)

'We try to verify the taxes for every business, we don't give them a "go" unless we have cleared their position.' (P11)

As was the case with other questions, several interviewees felt that examining tax and business factors simultaneously constitutes a recent change, since business teams used to act autonomously, forcing tax to act reactively:

...When I arrived here, most things happened commercially and then we had to fix things, that meant living with risk. Now we sit down and model every scenario, we check alternatives and a lot of those end up being black-balled, a lot of things sound nicely in a business sense, but we cannot avail them... (P13)

While interviewees differed on the criteria for analysing a business case's tax viability, several explicitly stated that the main factor is managing tax risk:

We have a "tax culture" inside the organisation which means that people understand that they need to plan in advance so that we don't have to fix things afterwards...We are actively mitigating risk (P10)

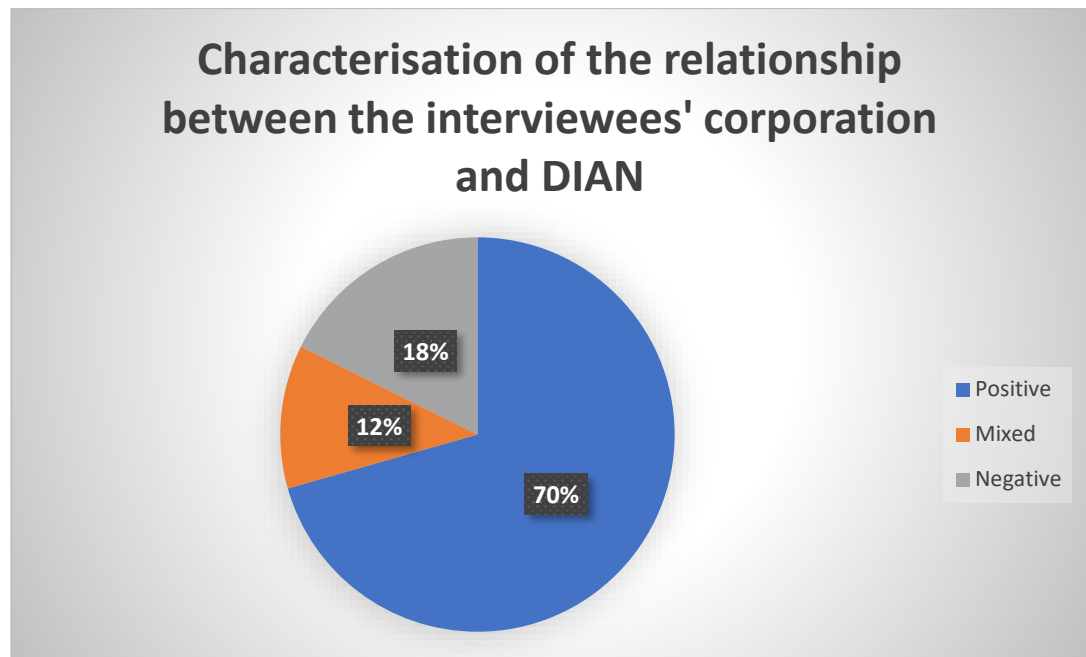
Considering co-operative compliance's focus on real-time discussions, the situation described above enhances the model's validity in Colombia because

most regulatees allow their tax department to monitor and veto commercial initiatives, meaning that dialogues with the administration could focus on providing certainty regarding the tax team's internal assessment, rather than on dealing with risky transactions that have already taken place. Moreover, provided tax teams have rigorous control frameworks, co-operative compliance could centre on meta-regulation, examining the judgement exercised by in-house teams to determine a business case's acceptability.

However, since there are still some corporations willing to allow tax to drive a business decision (e.g. P18 stated that when seeing a 'planning opportunity' the company would 'push commercial to assume a position'), as well as others that, despite their best intentions, have to react to the tax consequences of commercial decisions which were taken without being cleared in advance (P6), the regulator needs to be cautious.

#### **7.2.12. Most interviewees evaluate their corporations' relationship with DIAN positively.**

Despite their negative perceptions about DIAN's commercial awareness, its power, the adequacy of its interventions, the attitude and expertise of its personnel, and its trustworthiness, most interviewees (70%) assessed their corporations' relationship with it positively. This finding is paradoxical, and rather complex to interpret.



*Figure 46 Interviewee categorisation of their employer's relationship with the administration (Col)*

According to several participants, the relationship is 'very good' (P4) or 'very fluid', with positive evaluations reported even where the administration was perceived as 'quite aggressive in terms of collection because of revenue shortfalls' (P18), or where instances of confrontation with specific inspectors took place (P5).

Moreover, various responses indicate that the features which make participants view the relationship as positive coincide with elements characteristic of co-operative compliance. For example, P2 described a similar dynamic to the horizontal dialogue expected under co-operative compliance:

...We have a healthy practice which is that any new structure which has grey areas is consulted with the tax administration previously, so as to have transparency upon implementation.

However, three separate thematic clusters suggest that, rather than to the existence of co-operative compliance elements, this positive assessment is related to instrumental, gaming-like, interactions which might actually be

detrimental to the model's validity. Thus, several responses evidence that, behind the description of the relationship as 'good', there is a feeling that the parties should be distant, and that the relationship works precisely because of that separation. In some cases, this is simply a consequence of the belief that parties should remain independent and that they should maintain a professional approach despite potential disagreements:

[the relationship] is "cool". They come here, they do their thing, we do ours, its amiable. We do not fight. I have this philosophy: you do your task, I'll do mine, and then we will let the judges decide. I like to respect them. (P16)

Nevertheless, for other respondents, the desire for limited engagement arises from a lack of trust that is not conducive for co-operative compliance and could encourage selective disclosure. For example, for P11,

'...the less relationship we have with them, [DIAN] the better. People ask the authorities about everything and you have no idea what they'll reply.'

Therefore, the concern is that some regulatees might adopt a posture towards the administration that, to borrow V. Braithwaite's terminology, appears to be *committed*, but, because it involves elements of *disengagement*, might really be one of *game-playing*<sup>408</sup>.

Additionally, according to several interviewees, while the relationship with DIAN is characterised by dialogue (P10) and collaboration (P24), this is perceived to be the case only because of the large amount of revenue these corporate taxpayers can provide, with the corollary being that where the potential revenue is smaller or non-existent (e.g.in cases of tax losses), the relationship would be negative, or less positive. In P2's words:

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<sup>408</sup> Braithwaite, Murphy and Reinhart, 'Taxation Threat, Motivational Postures, and Responsive Regulation'. Page 139.

‘...probably they care about us because we are big and produce a lot of revenue...’

Furthermore, several participants suggested that their good relationship with the administration was attributable to them having good contacts or connections with the administration. In P10’s words,

‘we have good contacts [with DIAN], so we can be proactive’

The lobbying described involves the intervention of interested politicians or interactions between the corporation and the administration’s senior officers:

I interact heavily with the head of DIAN and so does the Corporation’s President, also with the Minister of Finance, etc. When there are issues, we consult and discuss things. It’s a good relationship. (P1)

...The confederations [industry sector organisations] and the Finance Minister and the Commerce Minister are close, sometimes we work together. We build a relationship to help each other. (P13)

Whilst taxpayer rapport with administrative personnel is positive, and an element of personal connection might incentivise commitment<sup>409</sup>, the concern is that the privileged channels these interviewees rely on could be used to engage in regulatory capture. This is worrying because, as expressed in other questions, many interviewees feel that corruption is already a problem for DIAN, and, as was explained in chapter one, corruption is a systemic problem in Colombia. Additionally, as will be elaborated on in chapter nine, the potential intervention of senior political figures in case-specific tax discussions, which should be first and foremost technical, is highly undesirable.

### **7.3. Findings related to factors that decrease co-operative compliance’s validity.**

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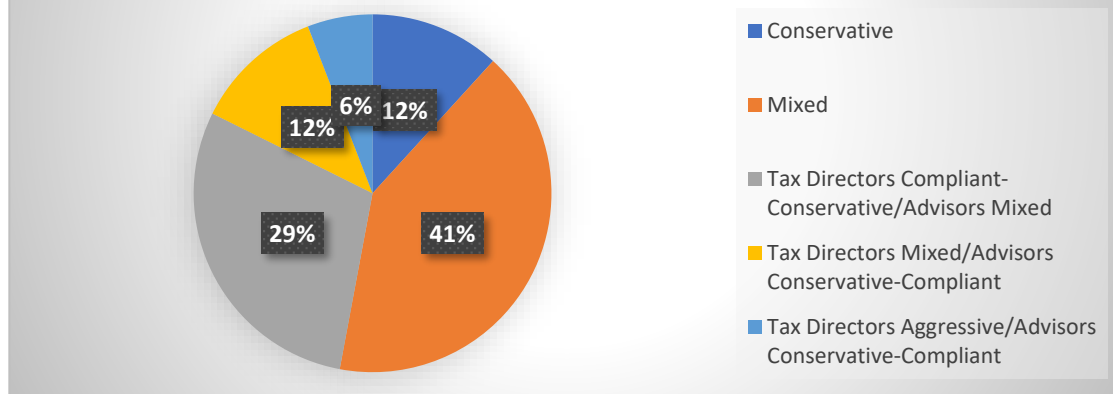
<sup>409</sup> Whait, 'Let's talk about tax compliance: Building understanding and relationships through discourse'

Having examined a series of findings which are positive for co-operative compliance's validity, this section focuses on interview results which point towards a decreased validity for co-operative compliance. While several of the validity-decreasing findings relate to the interviewees' negative perceptions about various aspects of the tax administration (trustworthiness, power, staff attitude and expertise, etc.), findings also suggest the existence of tax risk-prone or non-compliance-minded personal and social norms, and organisational factors that cast doubt on taxpayers' risk control frameworks and their motivation to collaborate with the authorities and/or seek increased tax compliance.

### **7.3.1. Interviewees perceive tax directors and external advisors as having mixed behaviours in terms of tax compliance and tax aggressiveness.**

An initial finding regarding social norms which suggests a decreased validity for co-operative compliance is that 41% of interviewees perceive that their peers and external tax advisors have a mixed behaviour in terms of tax compliance and/or aggressiveness. Only 12% of participants stated that both tax directors and advisors are conservative in their approach to tax compliance, and a further 47% felt that at least one of the two displayed mixed or even consistently aggressive tax behaviour:

## Perception About the Tax Behaviour of Other Corporate Tax Officers and External Tax Advisors (COL)



*Figure 47* Interviewee perceptions about the tax behaviour of tax directors and tax advisors (Col)

The connection between these findings and co-operative compliance is that, due to group identification and social conformity dynamics<sup>410</sup>, tax directors are expected to be influenced by the attitudes and behaviours they see in their peers and consequently mimic them. Ashby, Webley, and Haslam explain:

Paying tax is about hearts and minds as well as carrots and sticks, and those hearts and minds are structured not in a social vacuum, but by group memberships and the values and norms these instil<sup>411</sup>

Similarly, according to Hashimzade, et.al,

The compliance decision is not made in isolation by each taxpayer but is made with reference to the norms and observed behaviour of the general society of the taxpayer.<sup>412</sup>

<sup>410</sup> Wenzel, 'An analysis of norm processes in tax compliance'

<sup>411</sup> Ashby JS, Webley P and Haslam AS, 'The role of occupational taxpaying cultures in taxpaying behaviour and attitudes' (2009) 30 *Journal of Economic Psychology* 216. Page 226.

<sup>412</sup> Hashimzade N and others, 'Social networks and occupational choice: The endogenous formation of attitudes and beliefs about tax compliance' (2014) 40 *Journal of Economic Psychology* 134. Page 137.

Thus, when others in a reference group are seen as tax risk-prone and not being compliance-minded, these characteristics may replicate across the regulatee population. Even if specific tax directors choose to resist social convention, and notwithstanding the impact of non-compliance overestimation biases<sup>413</sup>, the fact that non-compliance and/or aggressive risk-taking are perceived as commonplace, suggests that co-operative compliance's potential validity in Colombia is reduced both because a substantial portion of regulatees might be non-compliant, and because of the possibility that group conformity would drive their peers to imitate that behaviour.

Most participants described the level of compliance and tax risk aversion of both tax directors and advisors as mixed, encompassing aggressive, conservative, and medium risk appetites, and compliance and non-compliance. Interviewees connected behavioural differences to factors such as personality (P10), firm characteristics like ownership and board involvement (P16), industry sector (P17 and P5), or opportunities available (P7). For this cluster of interviewees, aggressiveness and non-compliance are seen to coexist with other types of behaviours.

Interestingly, for 29% of interviewees, while tax directors were generally conservative and/or compliant, tax advisors displayed mixed behaviour. For example, according to P13,

'...most executives worry about compliance. In the case of advisors, there's all sorts of profiles.'

While it is possible that tax directors portray their peers as conservative because of desirability bias, it is likely that tax directors are more risk-averse because

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<sup>413</sup> Traxler, 'Social norms and conditional cooperative taxpayers'

their nexus to a specific taxpayer prevents them from hedging risk like advisors do by having multiple clients. Thus, several participants stated that advisors tend to change their behaviour/attitude as a function of a perceived need to satisfy client preferences and gain/maintain referrals, or even accede to bonuses or premiums contingent on successful tax savings (P23):

I have a friend who says: “if you want an aggressive advisor, you know who to go to”; there’s a bit of everything, some are aggressive, some are moderate, and some are just like the administration. There will always be some that want to twist things around because they feel that’s their added value, they think that’s correct. (P11)

...external advisors, I think their risk profile changes depending on the client that they are dealing with. An advisor can be conservative, aggressive, and compliant (P14)

When adapting to client preferences, practitioners are likely to influence their client’s tax behaviour and morale, but they might misestimate a client’s risk appetite. Thus, according to Schmidt, preparers’ underestimation of client’s preference for conservative tax advice can drive advisors to push otherwise conservative taxpayers onto more aggressive behaviour<sup>414</sup>.

Moreover, considering that interviewees highlighted assurance as one of the main reasons for seeking external tax advice, the concern is that when such advice is provided by professionals that are prone to accommodate their opinion to their perceived client preferences, the ‘enforcer’ function of tax practitioners<sup>415</sup> is eroded, alongside the risk aversion or compliance-mindedness necessary for co-operative compliance.

Finally, a smaller group of interviewees (18%) stated that tax directors

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<sup>414</sup> Schmidt DR, 'The prospects of taxpayer agreement with aggressive tax advice' (2001) 22 *Journal of Economic Psychology* 157. Page 159.

<sup>415</sup> Sakurai Y and Braithwaite V, 'Taxpayers' Perceptions of Practitioners: Finding One Who is Effective and Does the Right Thing?' (2003) 46 *J Bus Ethics* 375

were more aggressive and/or non-compliant than advisors. Possible explanations suggested included the availability of opportunities (P10) and the feeling that not being aggressive was not 'diligent' (P11). Another explanation proposed was the corporations' emphasis on profitability:

[Tax directors are] Aggressive...Tax executives are under too much pressure from management and finance to fulfil profit goals that make tax contribute.' (P18)

If a significant portion of tax directors is willing to change its approach to tax compliance and/or risk opportunistically, and/or an equally significant percentage of tax advisors is willing to embrace tax risk, it is possible that regulatees are adopting a game-playing stance which reduces co-operative compliance's validity. Furthermore, an exclusive focus on profitability increases the chance that regulatees disregard compliance and/or assume greater risks to diminish tax's impact on financial statements. Indeed, previous research suggests that corporations emphasising the role of tax departments as profit centres have lower income statement ETRs<sup>416</sup>, and this might indicate an increased risk appetite and/or a reduced compliance-mindedness contrary to co-operative compliance.

### **7.3.2. Most corporations are perceived to have maximising tax savings as a leading tax objective.**

A second finding related to social norms which indicates a reduced validity for potential co-operative compliance programmes in Colombia is the perception among most interviewees that the main or one of the main tax objectives of other corporations is maximising tax savings, rather than compliance or risk reduction.

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<sup>416</sup>Robinson, Sikes and Weaver, 'Performance Measurement of Corporate Tax Departments'. Page 1062.

While responses varied, 64% of interviewees stated that maximising tax savings was a leading tax objective for corporations. This could be a standalone objective (29%), one associated to compliance but with savings seen as the priority (29%), or with compliance seen as an equally important (6%). Only 18% of participants felt that compliance and risk reduction were the main objective, and only 12% perceived that compliance was prioritised when coexisting with tax savings.

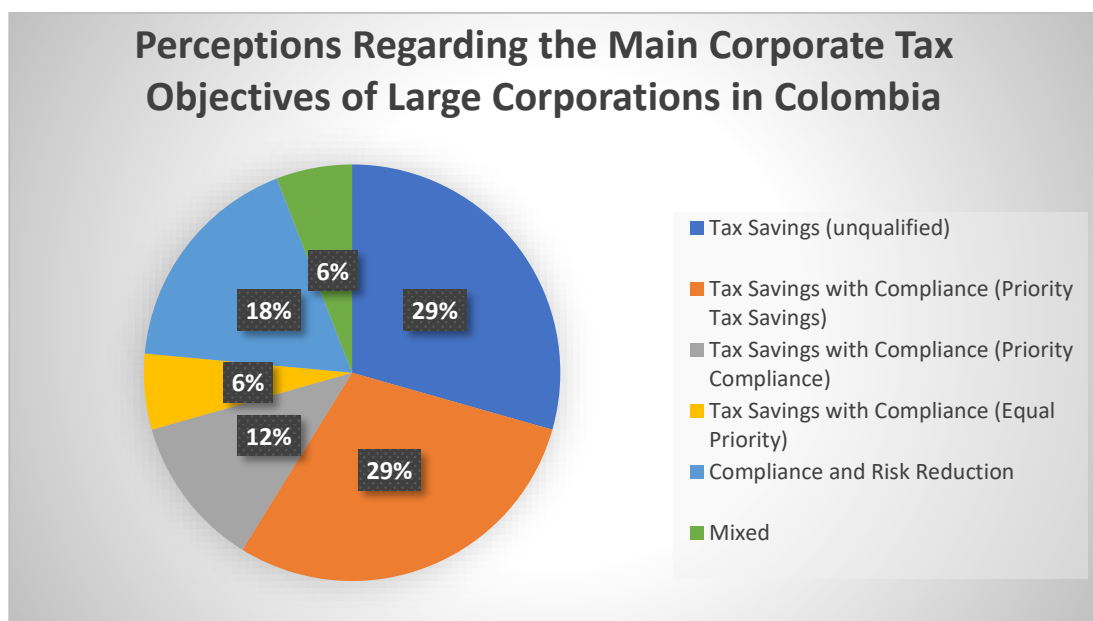


Figure 48 Interviewee perceptions about the main tax objectives of large corporations in Colombia

These findings appear contradictory when contrasted with the fact most interviewees also stated that corporations display a compliant behaviour (section 7.2.4). However, responses indicate that the taxpayers’ understanding of the term “compliance” is responsible for this apparent contradiction, since taxpayers associated compliance with satisfying formal obligations and paying the taxes that were due in accordance with the returns presented (i.e. not *evading*), rather than a more holistic understanding of the term, which would include not engaging in tax abuse.

Thus, most interviewees did not see a contradiction between maximising tax savings, even if that implied dubious transactions, and complying with the law. This “formalistic” understanding of compliance is detrimental to co-operative compliance because it is associated with strategic behaviours like selective disclosure and regulatory capture, and with taxpayer motivational postures based on convenient capitulation or gameplaying<sup>417</sup>, rather than on commitment. To paraphrase Gribnau and Jallai, it appears that many Colombian corporations have ‘extrinsic’, self-interested motivations to comply, rather than deep-seated ‘intrinsic’ motivations showing commitment to the rules<sup>418</sup>.

According to those who stated that corporations concentrate exclusively on maximising tax savings, corporations focus on ‘maximising efficiency’ (P1), ‘reducing rates’ (P10), or ‘optimising tax’ (P17). Thus, corporations would exhibit a tax culture akin to that of the calculating taxpayer characteristic of the expected utility approach (see chapter two):

‘They are always concerned about effective tax rates. They are worried about minimising the tax base.’ (P6)

In these corporations, tax teams would be incentivised to reduce costs, whereas compliance-related achievements would not be recognised:

The tax team for all corporations is all about costs. They will not be congratulated for good things [compliance record]. They only “get heat” when something bad happens. (P16)

For 29% of interviewees, tax savings coexist with compliance, but the former is prioritised over the latter. Thus, what could be construed as legitimate tax

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<sup>417</sup> Braithwaite, Murphy and Reinhart, 'Taxation Threat, Motivational Postures, and Responsive Regulation'

<sup>418</sup> Gribnau and Jallai, 'Good Tax Governance: A Matter of Moral Responsibility and Transparency'. Page 80.

planning, where taxpayers use tax benefits in a way which corresponds to the objective behind their enactment, is not at play, because compliance is often not seen as the primary or even as leading goal. For these interviewees, corporate taxpayers see compliance as a formal duty, secondary to the need to reduce tax expenditure:

One thing is complying; the other is lowering tax rate as much as possible. Most companies attempt to comply with formal obligations, but they are greatly concerned with dealing with tax rates that are very high. (P13)

Other responses revealed what could be called “cosmetic compliance”, where taxpayers strive to appear compliant, but are actually not committed to compliance. For these taxpayers, taxes are a burden that merits an ‘escape’ (P24), and the only reason to appear compliant would be to avoid tax controversies (P5) or prevent reputational damage. According to P18, companies intend:

To pay less taxes. I’d be lying if I said otherwise. Obviously, they try to comply, but they are looking at how to lower the burden and increase profits, certainly within a framework, but yeah...

While a smaller proportion of interviewees (18%) stated that compliance and risk reduction are the corporations’ main objectives, the question is whether this subset of taxpayers would grow if co-operative compliance was implemented, remain static, or even decrease.

Seeing that a substantial portion of interviewees view maximising tax savings as the main tax objective of Colombian corporations, and that minimising tax often appears to be prioritised over compliance suggests a degree of misalignment between co-operative compliance’s assumptions about regulatee tax morale and the social norms present among them. The combination of low tax risk aversion and low compliance-mindedness among

taxpayers reduces co-operative compliance's validity because transparent collaboration, horizontality, and reciprocity, conflict with the strategic behaviour favoured by corporations with a tax culture that prioritises tax minimisation.

### **7.3.3. Interviewees highlighted profitability as one of the main drivers of tax behaviour for Colombian corporations.**

An important finding concerning tax norms that reduces co-operative compliance's potential validity in Colombia is that approximately 60% of interviewees believe that profitability is the main or one of the main drivers of tax behaviour in Colombian corporations. While not negative to co-operative compliance's validity *per se*, an overzealous push to increase the corporation's profitability can lead to a tax culture where tax is seen as an ordinary cost or expense that needs to be minimised, regardless of the way in which this minimisation is achieved, thus decreasing the possibility for voluntary compliance to thrive.

Nevertheless, some taxpayers focused on tax savings might still be compliant; for example, for P13,

‘...the prevalent idea is to pay less taxes, in a good sense of the word, to pay what's fair according to the law at the time.’

Similarly, P18 explained that profit-increasing tax positions were actively sought, but that they were only adopted ‘as long as risk is measured’. However, most participants did not subordinate profitability to managing risk or ensuring compliance.

This view of tax as a simple expense that can be manipulated to achieve

pre-set cost parameters, and which conflicts with contemporary CSR views<sup>419</sup>, was illustrated by P10:

For this type of business, where we have controlled profit margins, some expenses are fixed, and tax is one of those. We have to try to intervene with tax all the time...

As stated by P11, cost optimisation may be linked to changes in tax positions:

'Aggressive positions come from financial optimisation and tax optimisation.'

The pressure to achieve higher profits may exacerbate taxpayers' tax risk appetite, increase game-playing behaviour, and reduce compliance because cost optimisation is expected to be achieved to the exclusion or disregard of other objectives like compliance. According to P5,

'...companies will tell you: "I need for us to pay X tax, I don't care how you do it..."

For several participants, satisfying investors and shareholders means that the firm's tax department is mostly concerned with ETR targets. In P14's words,

'The need for profits is a basic need.'

Prioritising profitability over compliance is negative for co-operative compliance because regulatees are incentivised to reduce their tax burden and this reduction may lead them to increase risk and/or decrease the quality of their collaboration with the administration. While this concerns profitable firms because they have a higher hypothetical tax base to try to reduce aggressively or carelessly<sup>420</sup>, it also impacts taxpayers with poor profitability who are driven

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<sup>419</sup> Ibid; Knuutinen R, *Corporate Social Responsibility, Taxation and Aggressive Tax Planning* (2014).

<sup>420</sup> Chen E, Gavius I and Yosef R, 'The Relationship Between the Management of Book Income and Taxable Income Under a Moderate Level of Book-Tax Conformity' (2013) 28 *Journal of Accounting, Auditing & Finance* 323; Olhoft Rego S, 'Tax-

to aggressive tax-reducing behaviour as a mechanism to confront financial stress<sup>421</sup>.

#### **7.3.4. Most participants' corporations rely on their Finance Department to oversee and/or evaluate the company's tax function.**

An organizational factor which the author believes is detrimental for co-operative compliance's validity is the way in which *in-house* tax teams were reported by interviewees to be overseen and/or evaluated.

According to participants, most companies rely on their senior finance executives (Finance Manager, Finance VP, or CFO) to evaluate the tax team. In other organisations, oversight is undertaken by a combination of internal and external auditors (P3) or shared between finance and audit. Exceptional cases include direct board (P11) or human resources (P13) oversight.

While being monitored and/or evaluated by someone outside the tax department's own structure might strengthen the companies' internal tax risk control frameworks - not having participated directly in the transactions and processes theoretically increases the possibility of an unbiased assessment, entrusting the finance team with the control/evaluation of the tax team increases the possibility of conflicts of interests that are detrimental to compliance.

The concern is that the finance departments' ordinary focus on efficiency/profitability means that tax departments are judged exclusively/primarily in relation to their ability to reduce tax expenses, maintain

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Avoidance Activities of US Multinational Corporations\*' (2003) 20 Contemporary Accounting Research 805

<sup>421</sup> Lanis and Richardson, 'Corporate social responsibility and tax aggressiveness: An empirical analysis'

desired cash flows, or earn non-operational income via tax benefits, rather than in relation to their compliance or risk management. Focusing on profitability may increase tax risk appetite and drive tax departments to pursue whatever means are available to reach a desired bottom line. This effect can be enhanced where tax teams are subordinated to executives that a.) are not necessarily experts in tax law, and b.) prioritise immediate profits or cash flows and disregard associated contingencies, even if these are financially larger.

Moreover, if the tax team is being pressured by the finance function to be a 'profitable' -or minimally expensive- unit, it is foreseeable that co-operative compliance's non-adversarial engagements, which require disclosure and reaching settlements voluntarily, would not be favoured because of fear of being perceived by the financial department as being too generous with the administration or not sufficiently contested by the tax team.

In contrast, relying on a combination of external and internal audits to evaluate the tax team, adopted by a minority of interviewees' corporations, may enhance tax risk control frameworks and facilitate co-operative compliance, because risk management and compliance are impartially assessed and given additional importance. Several questions regarding auditors remain open for future research: 1. How do auditors balance the legal perspective versus the financial reporting perspective when analysing taxpayers' tax positions? 2. How much of the evaluation refers to the degree of tax risk assumed? And 3. When the evaluation is negative, what corrective measures are adopted?

**7.3.5. Responses reveal a relatively-high use of tax-savings-centred key performance indicators for tax team evaluation and/or remuneration.**

Another finding related to agency issues and incentives is that, according to interviewees, the use of tax-related key performance indicators is widespread (60%), and most of these incentivise tax savings, rather than compliance or tax risk reduction:

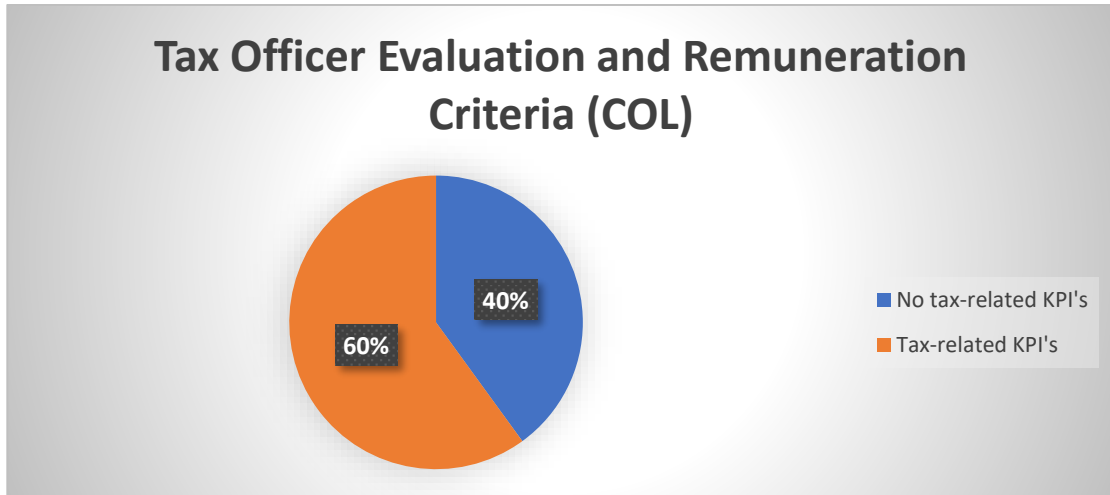


Figure 49 Colombian interviewees' corporate evaluation and remuneration criteria

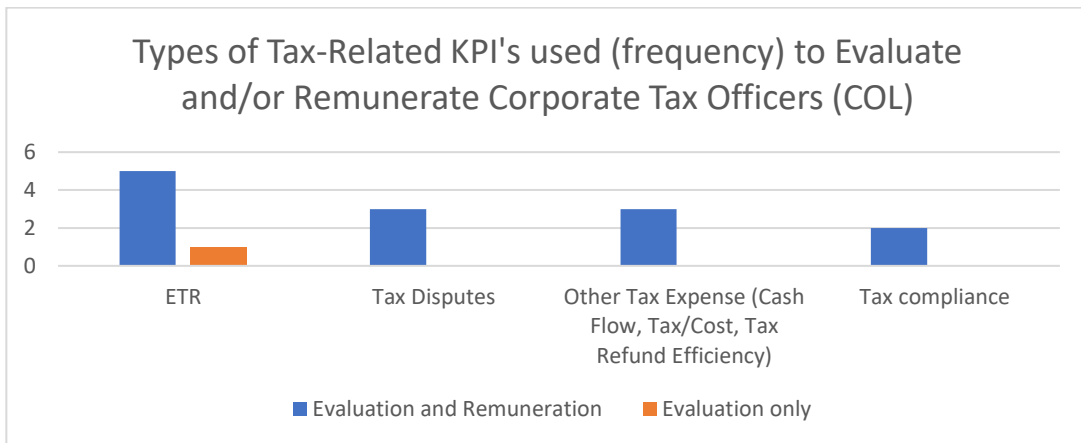


Figure 50 Types of tax KPI used to remunerate/evaluate tax directors in Colombian corporations

These practices decrease co-operative compliance's potential validity in Colombia because they incentivise long-run reductions in cash and/or income

statement ETRs<sup>422</sup>. These reductions, whilst not intrinsically problematic, can instil in tax directors a tax-minimisation-centred culture that recklessly disregards or actively resists compliance. Moreover, as discussed in 7.3.9, when the administration is seen as primarily interested in increasing revenue, tax directors face a conflict of interests that leads them to antagonise the administration, rendering the collaboration necessary for co-operative compliance impossible.

According to interviewees, ETR-focused performance indicators refer both to income statement tax expense and tax cashflows, and tend to impact staff bonuses and salaries:

'My remuneration is tied to optimisation as KPI's...the KPI is based on ETRs.' (P11)

'The benchmark is the ETR. It is tied up to remuneration via a variable bonus.' (P1)

These findings of frequent use of KPIs encompassing both cash and income statement ETRs contrast with what Armstrong, Blouin, and Larcker<sup>423</sup> reported in the US, where KPIs were found to be associated with income statement ETR reductions, but not with cash ETRs.

An important point related to the discussion in 7.3.4 is that interviewees associated the focus on ETRs and/or tax cash flows with the companies' senior financial management and their quest for efficiency. According to P4:

Our goals are based on KPI's determined by the Finance VP; some might include ETR and total tax over revenue or costs. We might use different benchmarks to evaluate the tax function through the cash flow generated by tax

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<sup>422</sup> Minnick and Noga, 'Do corporate governance characteristics influence tax management?'. Page 717.

<sup>423</sup> Armstrong, Blouin and Larcker, 'The incentives for tax planning'

This is consistent with the findings about profitability as a main driver for corporate tax behaviour analysed in 7.3.3. Moreover, it connects to existing literature, according to which variable compensation tied to after-tax earnings or equity prices might drive managers to seek to reduce tax payments and instruct tax departments accordingly<sup>424</sup>.

While the extended use of tax-savings-inducing benchmarks represents an obstacle for co-operative compliance's potential validity in Colombia, interviews suggest that this might change with time, since some companies have started to shift their KPIs away from tax savings or stopped using tax-related indicators as evaluation/remuneration tools. Thus, that 40% of interviewees' corporations do not use tax KPIs might indicate a move away from a profit-centred view of tax. P13 provided an example:

[the corporation has] no specific ties between remuneration and tax goals. Our role isn't linked to generating savings, it's more about day to day compliance.

Similarly, for P10:

We measure compliance, penalties and interests, closed disputes, and businesses set in operation without observations. We do not have remuneration tied to ETRs...

### **7.3.6. Corporate boards were mostly reported to have little or no involvement in their company's tax affairs.**

A further organisational-level finding which suggests a reduced validity for co-operative compliance in Colombia is that most (63%) interviewees stated that their corporations' boards are not overly involved in the company's tax matters.

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<sup>424</sup> Taylor and Richardson, 'Incentives for corporate tax planning and reporting: Empirical evidence from Australia'; Olhoft Rego S and Wilson R, 'Equity Risk Incentives and Corporate Tax Aggressiveness' (2012) 50 Journal of Accounting Research 775

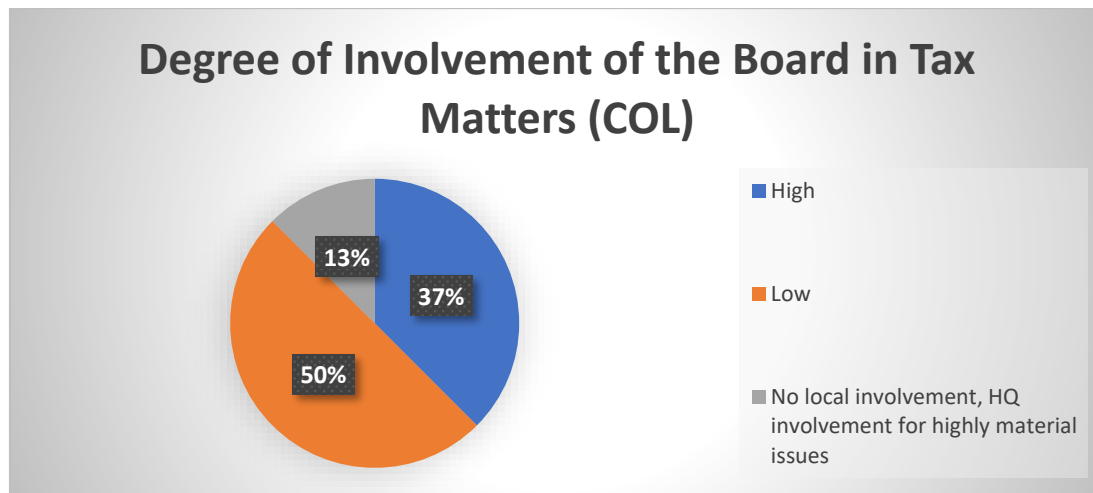
Reduced board involvement can decrease co-operative compliance's validity in two ways: 1. By weakening the companies' internal tax risk control framework and 2. By signalling both to the rest of the company, and to the authorities, that tax compliance is not a priority for the corporation. Uninvolved boards, or those adopting a passive attitude, fail to perform the role of internal regulators of the tax department, reducing the risk awareness and the quality of self-regulation expected from regulatees. The board's importance for tax control is explained by Lanis and Richardson:

...appropriate decision systems that separate the management (initiation and implementation) and control (ratification and monitoring) of important decisions at all levels of the corporation are necessary. The board of directors is one such decision system: it is a significant corporate governance device used to ratify and monitor the corporation's most important decisions and to hire, fire, and compensate top-level managers...<sup>425</sup>

Internally, low involvement may weaken the tax team's authority, reducing its ability to prevent non-compliance and control tax risk. Externally, the tax administration is less likely to see the organisation as fully committed to maintaining a robust tax control framework and might also doubt about whether the company's tax team will be given the resources and authority to uphold the taxpayer's end of the bargain in terms of disclosing uncertain tax positions and ensuring agreements are implemented.

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<sup>425</sup> Lanis R and Richardson G, 'The effect of board of director composition on corporate tax aggressiveness' (2011) 30 *Journal of Accounting and Public Policy* 50. Page 54.



*Figure 51* Board involvement in tax matters (Col)

50% of participants stated that their corporation’s board had little involvement in tax matters. Only 37% of interviewees reported high involvement; moreover, the remaining 13% stated that their local boards were not involved and that their HQ’s boards involved themselves only when highly-material issues were at stake. This is surprising considering the increasing importance of taxes for boards that has been reported elsewhere<sup>426</sup> and the impact that taxes have on corporate finances.

According to those who stated the board had little involvement, the board’s concern is limited to sporadic, end-of-year, reports regarding the tax impact on profits, highly-material issues, or issues affecting board members directly. Remarkably, one interviewee declared never having received tax instructions from the board (P3). The following quotes illustrate:

[involvement] is not very high. The board is involved only in issues that have organisation-wide effects, particularly when the board itself will be “hurt” by a tax issue; for example...dividends... (P1)

<sup>426</sup> Klassen KJ, Lisowsky P and Mescall D, 'The role of auditors, non-auditors, and internal tax departments in corporate tax aggressiveness' (2015) 91 *The Accounting Review* 179

...the board doesn't really get involved, they don't set out guidelines...they don't go beyond the strict economic question of ETRs and the impact of tax on profits. (P18)

Occasionally, low board involvement might not be attributable to low interest in tax, but rather to a presumption that the board only intervenes when there are difficulties:

'Tax discussions are not that frequent not because tax is not a key issue, but more in the sense that as long as things work, no alarms are raised.' (P6)

Reduced board interest is occasionally compounded by the fact that, in some MNE subsidiaries, there is no involvement by the local (Colombian) board and the HQ's board intervenes only whenever there are 'large issues' (P16) or matters of 'impact' (P17). Thus, low visibility or small-scale non-compliance might never be discussed by the board and thus go unchecked. Additionally, co-operative compliance would be orphaned in terms of local senior-level support.

Finally, even if the administration still desires to engage with a corporation with an uninvolved board, it might find it complicated to connect with taxpayers at a very senior level because of a lack of support/interest from the board, particularly since discussing the outlines of a non-adversarial compliance programme would not necessarily be seen as a heavy impact or highly material issue by boards accustomed to intervene only when major contingencies are looming or when the taxpayer is publicly confronted (e.g. P1).

### **7.3.7. Approaches to risk among interviewees' corporations were often revealed to vary between cases and reliant on subjective criteria.**

Co-operative compliance's responsiveness entails tailoring administrative responses to the taxpayers' risk of non-compliance. Additionally, co-operative compliance's focus on metaregulation and the recent need for participants to

justify the trust placed on them by having robust tax control frameworks<sup>427</sup> mean that strengthening taxpayer risk awareness and control is fundamental for co-operative compliance's validity. Mulligan and Oats explain the connection between risk management and taxpayer compliance behaviour:

The need to address risk management at all in a tax context arises due to the inherent indeterminacy of tax laws, which in turn gives rise to uncertainty in relation to their interpretation. Where there is uncertainty, there is a risk to be quantified and managed, which ultimately links risk management with degrees of tax aggressiveness and attitudes to the law.<sup>428</sup>

Bearing this in mind, another interview finding pointing to a lower validity for co-operative compliance in Colombia is that most interviewees' companies were reported to control tax risk using a *flexible*, highly subjective, case-by-case basis, approach, where tax directors use their *instinct* or *gut* to assess a tax position's risk. Only a minority of corporations rely on structured procedures aiming to judge positions under an *objective* framework - what could be called a *Rigid* approach, or on combining these frameworks with subjective assessments -a *Combined* approach.

The following quote illustrates the *flexible* approach:

...I think you need to trust your instinct, understand operations fully and then you can know where flaws might be present...Experience tells you that you cannot rely only on a given methodology, but also trust your instinct (P23)

While understandable, relying heavily on the tax directors' *instinct*, without necessarily combining this analysis with structured procedures has the potential to weaken self-regulation and internal tax risk controls because the parameters

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<sup>427</sup> OECD, *Co-operative Tax Compliance: Building Better Tax Control Frameworks*.

<sup>428</sup> See Mulligan and Oats 'Tax risk management: evidence from the United States'. Page 682.

and heuristics used in analysing a specific position might not be uniformly replicated when addressing similar cases, particularly if a different tax officer is performing the analysis, because the administration and/or auditors or those overseeing the in-house tax team's work cannot understand which factors were used in the assessment and the weight assigned to them in order to judge the soundness and rigour of the risk control, and because the absence of a framework means that taxpayers cannot adjust parameters for future cases systematically. An administration trying to engage co-operatively with a taxpayer that does not follow the same guidelines for analysing each tax position may struggle to trust them to self-regulate and/or to keep implementing agreed upon procedures and positions. Moreover, not having a standard system to assess positions can be seen by external stakeholders as opaque and unaccountable, damaging the model's legitimacy.

### **7.3.8. The administration is widely perceived as not being trustworthy or being partially trustworthy.**

Moving on to interviewee perceptions of the administration, a key finding is that most interviewees (81%) do not see DIAN as trustworthy, or only trust it partially. This is highly problematic for co-operative compliance because trust between taxpayers and the administration is essential for voluntary tax compliance. As argued by Wahl, Kastlunger, and Kirchler:

‘Participants are generally more voluntary compliant to trustworthy authorities than to untrustworthy authorities.’<sup>429</sup>

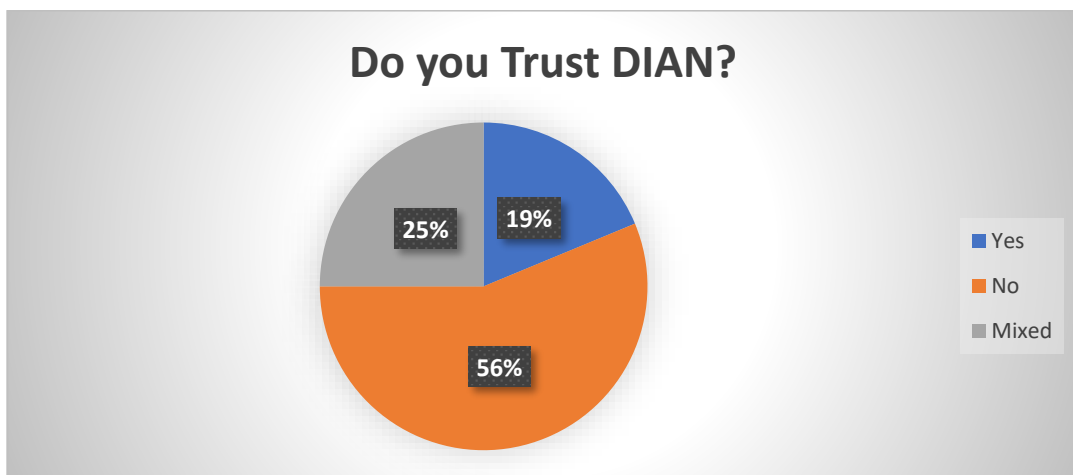
Moreover, inter-party trust is essential for co-operative compliance to function effectively, both so that taxpayers and the administration see each other as

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<sup>429</sup> Wahl, Kastlunger and Kirchler, 'Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the "Slippery Slope Framework"'. Page 393.

partners, and for them to feel confident in performing their obligations based on the expectation of reciprocity. Therefore, discovering critically low levels of trust in the administration among regulatees places serious doubts on co-operative compliance's validity in Colombia.

Most interviewees stated that they did not trust DIAN; 25% of them felt that DIAN could be trusted partially, and only 19% fully trusted it. This seems paradoxical since most respondents stated that their corporations' relationship with DIAN, and that of other large corporations, was positive. However, it is not contradictory considering that most interviewees showed that the relationship with the administration was positive not because of being procedurally fair, honest, or motivated by the public interest, but rather because it gave them preferential treatment based on their revenue potential, the intermediation of well-connected advisors or high-level contacts, or because the administration was seen as maintaining distance from the taxpayer.



*Figure 52 Interviewees' trust in the administration (Col)*

Among those not trusting DIAN, the perception of the administration as corrupt was a repetitive theme:

...If I am not clear about something, the last thing I want to do is to ask the administration about it. There's a lot of corruption, and that does not leave them in good standing. (P10)

'[do you trust DIAN?] No, look at the corruption in the institution...' (P16)

'The level of corruption is high...' (P18)

As noted by Torgler, one of the factors behind tax non-compliance in the Latin American context is the level of trust assigned by taxpayers to the State and public officials, particularly in relation to corruption, since 'corruption generally undermines the tax morale of the citizens who become frustrated'<sup>430</sup>. Moreover, when connected to a high perception of corruption among public entities in general, this factor has been associated with a tax climate that is detrimental to tax compliance in Latin American countries, including Colombia<sup>431</sup>.

The perception of DIAN as corrupt, while not shared by all interviewees, is probably associated to the high indexes of perceived corruption reported by different organisations in relation to Colombia<sup>432</sup>. Moreover, the fact that in a separate question 82% of interviewees stated that they do not trust or only partially trust the judiciary in tax matters points to a wider phenomenon of generalised distrust in public authorities that can damage voluntary compliance because it deteriorates institutional legitimacy<sup>433</sup>. Additionally, this perception can have a significantly negative effect on co-operative compliance because of the model's vulnerability regarding regulatory capture. The concern is that the

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<sup>430</sup> Torgler, 'Tax morale in Latin America'. Page 139.

<sup>431</sup> Batrancea L, Roux Valentini Coelho Cesar AM and Ramona-Anca N, 'Unearthing The Purports Of Trust In Authorities And Power Of Authorities In The Latin American Tax Climate' (2014) 3 *Annals-Economy Series* 119

<sup>432</sup> Refer to chapter one.

<sup>433</sup> Schnellenbach J, 'Tax morale and the taming of Leviathan' (2006) 17 *Constitutional Political Economy* 117

combination of low trust and a high perception of corruption erodes taxpayer cooperation. In the words of Bird, Martínez-Vázquez, and Torgler,

‘A state in which corruption is rampant is one in which citizens have little trust in authority and thus a low incentive to cooperate’<sup>434</sup>

For Alon and Hageman<sup>435</sup>, *generalised* trust (trust in those outside familial/client networks) facilitates tax compliance by weakening corruption’s harmful impact; thus, a situation like the one reported by Colombian interviewees, where low trust combines with high perceptions of corruption can be especially damaging for voluntary tax compliance, because, in the absence of trust, there are fewer social norms to counter the compliance-reducing effect of a high perception of corruption.

Corruption was not the only explanation given for the negative evaluation of DIAN’s trustworthiness. Thus, in line with the results regarding taxpayer perceptions about the administration’s objectives (See 7.3.10), P18 stated that DIAN was not trustworthy because it was not motivated by ensuring compliance of the law, but rather by maximising yield:

‘their spirit is always centred in collection regardless of the facts or the law, they don’t want to understand, but to collect...’ (P18)

For P17, mistrust arose from a combination of the administration’s perceived variability in legal interpretation and their strategic approach to taxpayers, both factors which collide with co-operative compliance’s partnership and certainty-enhancing objectives:

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<sup>434</sup> Bird RM, Martinez-Vazquez J and Torgler B, 'Tax effort in developing countries and high income countries: The impact of corruption, voice and accountability' (2008) 38 Economic analysis and policy 55. Page 61.

<sup>435</sup> Alon A and Hageman A, 'The Impact of Corruption on Firm Tax Compliance in Transition Economies: Whom Do You Trust?' (2013) 116 J Bus Ethics 479

we feel that they [DIAN] are not trustworthy...when the government wants to, they involve us, but when they don't want to, they isolate us. [There is] Too much uncertainty regarding interpretation and legal changes.

Other issues mentioned were arbitrariness (e.g. P2), previous negative experiences, or lack of confidence in the administration's technical abilities.

Since co-operative compliance's validity is low in a context where regulatees do not trust the administration, the question is whether introducing co-operative compliance could be justified as a mechanism to bolster inter-party trust, regardless of how low pre-existent trust levels were. As explained chapter one, a high perception of corruption is a structural factor of the Colombian context, and, absent society-wide changes, this can continue eroding trust in all institutions, including DIAN. Moreover, in a context where corruption is a problem, co-operative compliance could fall prey to regulatory capture if adequate governance checks and balances were not introduced simultaneously. Ironically, the limits placed on administrative discretion and overzealous scrutiny could stifle the relationship by making it inefficient and complicating the provision of legal certainty.

Distrust related to the administration's organisational weaknesses can be addressed by improving its resources and behaviour as part of a shift towards co-operative compliance. For example, the higher level of responsiveness required by co-operative compliance could justify training specialist officers and enabling them to act as taxpayer-specific points of contact and/or sector experts, thereby increasing administrative commercial awareness and technical knowledge. These increases in administrative know-how could change the opinion of those taxpayers who currently do not trust the administration because of what they perceive as technical shortcomings. Similarly, a carefully monitored



a separate group of interviewees argued that motivation varies depending on the public servant in question, or that the organisation does not have clear objectives.

This reduces co-operative compliance's validity for two reasons: First, feeling that the administration pursues agendas other than ensuring compliance might erode or prevent the formation of trust, an emotion which is essential for co-operative compliance's parties to collaborate voluntarily and without trying to *game* the system - the administration can also game the system by obtaining disclosures and not fulfilling its commitment of providing legal certainty. If taxpayers do not feel that the other party can be trusted to act in accordance to its ideal role (ensuring compliance), they are unlikely to reciprocate. Second, for those who feel that DIAN does not have a defined objective or that its agents do not share a common objective, the administration might appear as arbitrary and/or unreliable, something which is not acceptable in a partner. Thus, the concern is that a collaborative co-operative compliance relationship is less likely to materialise because taxpayers may not cooperate with an administration perceived as misguided or disorientated.

In relation to yield maximisation, interviewees did not voice a problem with collection itself. Indeed, tax collection is a public-interest objective when resulting from ensuring compliance. However, interviewees argued that DIAN sought to obtain revenue even where it was not legally mandated, and/or that its zeal to collect makes it behave erratically and abusively. Participants felt that the administration was not interested in voluntary compliance, challenged them

regardless of the technical/factual circumstances, and behaved strategically.

Hence, the problem relates to procedural unfairness<sup>438</sup>:

'Tax authorities here act more emotionally than rationally...Their motivation depends on the State's revenue needs, not on adequate legal interpretation.' (P17)

...lack of revenue brings about discussions that should not take place technically-speaking, they are anxious about bringing in revenue...and sometimes that leads to mistakes... (P13)

Their main concern is...to satisfy their collection goals...I don't see a culture of sitting down with me and going over positions, they are just interested in assessing and challenging...They don't concern themselves with voluntary compliance, it's all about coercion. They don't want to train and support. (P18)

Nevertheless, it is possible that participating in co-operative compliance could allow taxpayers to regain trust in the administration, provided the program led them to see it as a collaborator, and DIAN's staff saw the administration's goal as ensuring compliance, even if this meant not satisfying pre-set yield targets.

#### **7.3.10. Most interviewees have a negative or partially negative perception of DIAN's staff's attitude and/or professional expertise.**

Another finding which casts doubts on co-operative compliance's validity in Colombia is the interviewees' negative or mixed assessments of DIAN's staff's attitude and/or professional expertise. Since co-operative compliance relationships involve a close, person to person, relationship between the corporation's *in-house* tax team -specially its Director- and assigned revenue officers, the success of the relationship depends partially on these individuals' perception of each other.

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<sup>438</sup> Stalans and Lind, 'The meaning of procedural fairness: A comparison of taxpayers' and representatives' views of their tax audits'; Tyler and Blader, 'The Group Engagement Model: Procedural Justice, Social Identity, and Cooperative Behavior'

Most (67%) interviewees stated a negative opinion about DIAN's officers' expertise and/or attitude, perceiving difficulties handling sophisticated business transactions, tax investigations, and international tax. Additionally, 27% of interviewees felt that revenue officials' attitude and expertise varied depending on the unit to which they were attached, or their personality. This decreases co-operative compliance's validity because regulatees perceiving the regulator's attitude towards them as negative and/or who believe that its knowledge of the matter being regulated is lacking, are unlikely to trust it and see it as the responsive, respectful partner that is expected under co-operative compliance.



Figure 54 Colombian interviewees' perception about the administration's attitude and professional expertise

In a context where authorities are interested in boosting voluntary compliance and collaboration, the administration must satisfy taxpayers' aspirations for procedural fairness, including treating them with a helpful and respectful attitude.

According to Gangl et.al,

'...tax authorities' major task is to be perceived as service-oriented and respectful'<sup>439</sup>

<sup>439</sup> Gangl, Hofmann and Kirchler, 'Tax authorities' interaction with taxpayers: A conception of compliance in social dilemmas by power and trust'. Page 18.

Co-operative compliance does not require the administration to satisfy whatever preference taxpayers have, or to behave in the way which pleases them most. Indeed, the author coincides with Tuck<sup>440</sup> in believing that the regulator should not be thought of as an ordinary service provider and the taxpayer as a customer. However, co-operative compliance's horizontality does lead taxpayers to expect that they will be treated non-confrontationally, provided they collaborate fully. Additionally, taxpayers expect administrative assistance, under the understanding that this would advance the mutually-shared goal of tax compliance, and that the costs of doing so should offset the expenses that would have otherwise been incurred if DIAN had to discover and prosecute non-compliance unilaterally.

Several interviewees perceived an administrative attitude characterised by the unwillingness to recognise that taxpayer positions might be correct, and/or a desire to pursue confrontation regardless of the context:

'Some inspectors...don't have arguments, but only need to show off, regardless of whether they are right...' (P10)

'...you end up in odd disputes because they don't have the tax knowledge, they are stubborn and want to collect regardless of whether they are right...' (P18)

'they try to defend their interpretative position without worrying about evidence and understanding our viewpoint' (P6)

Additionally, most interviewees felt that DIAN's personnel lack adequate technical knowledge, particularly regarding the complex tax rules and transactions relevant to large corporations:

'Their attitude is one of ignorance regarding specialised topics such as transfer pricing.' (P23)

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<sup>440</sup> Tuck, 'The Changing Role of Tax Governance: Remaking the Large Corporate Taxpayer into a Visible Customer Partner'

'They are not very well prepared technically. They are professional, but given the international context and its evolution, they tend to sit in the past.' (P2)

'they investigate but the operation is too complex, and they do not know where to look... ' (P17)

For interviewees like P4 and P10, poor technical know-how leads revenue agents to rely on previous cases or on internal administrative guidance, ignoring each case's distinguishing features, applying unsuitable procedures, and reaching outcomes which often conflict with applicable rules.

Interestingly, a group of interviewees stated that the attitude and expertise of revenue officials fluctuates depending on the administration's organigram, as well as individual revenue officer profiles:

There's a bit of everything. There's good ones which want to understand the reason behind differences...and try to reach a medium point... otherwise, it's about "digging" to augment the taxpayer's burden. (P6)

It is subjective, it depends on each region. Some administrations have academics which can go and lecture; in some others, people are just sitting on their desk and they cannot change their tunnelled vision... (P7)

The attitude of tax officers depends on the section of the administration that they belong to. Those in LBU [Large Business Unit] are very amiable, others are not. (P18)

Most interviewees' belief that revenue officials lack tax knowledge raises the concern that if co-operative compliance was introduced in Colombia, it could be difficult to find agents capable of acting as corporation-specific points of contact and of reaching timely agreements on technically-sophisticated uncertain positions. Moreover, strategically-minded taxpayers could game DIAN into believing they were fully compliant by exploiting its technical shortcomings. Thus, co-operative compliance's validity is reduced because the administration does not appear capable of acting responsively. Additionally, a confrontational

and biased attitude casts doubts over the parties' ability to trust each other and collaborate, two preconditions of co-operative compliance.

Nevertheless, co-operative compliance could be used as an opportunity to increase tax, industry-specific, risk, and communication training and thus change existing perceptions about tax knowledge. Similarly, if the administration underwent a cultural transformation prior to implementing co-operative compliance, it is possible that a shift towards a more collaborative attitude took place, thus strengthening the model's validity.

#### **7.3.11. Taxpayers displayed an overwhelmingly critical opinion regarding DIAN's business understanding/commercial awareness.**

Almost 80% of interviewees stated a negative opinion of DIAN's commercial awareness/business understanding. As a species of responsive regulation<sup>441</sup>, co-operative compliance seeks to tailor administrative responses to the regulatees' characteristics and behaviour regarding the matter being regulated (business profits, in the case of corporate income taxes). Therefore, to produce targeted responses, the regulator must understand the factors that resulted in each taxpayer's computation of the tax payable. Thus, DIAN's understanding of the taxpayer's business is directly linked to its ability to maintain the type of dialogue<sup>442</sup> required to provide legal certainty to those willing to cooperate, or alternatively adequately enforce the law against recalcitrant taxpayers. Consequently, negative perceptions of DIAN's business understanding reduce co-operative compliance's validity.

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<sup>441</sup> Refer to chapter four.

<sup>442</sup> See Gribnau, 'Taxation, Reciprocity and Communicative Regulation'.

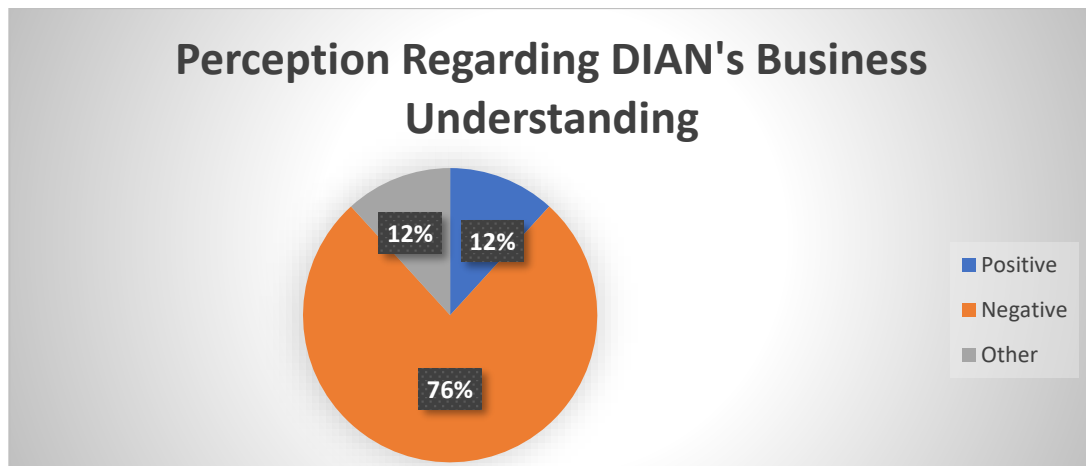


Figure 55 Colombian interviewees' perception about the administration's business understanding

Most (76%) participants expressed a negative view about DIAN's business understanding; only two interviewees assessed it positively, with one of them being more optimistic about future, rather than current competencies:

'I believe that every time they try to grow a bit more, but they are still not experts in each industry sector' (P2).

Among those with a negative perception, the prevailing view was that most inspectors were unable to understand their businesses because they lacked industry-specific knowledge, both regarding business operations, and sector-specific accounting and tax provisions:

They don't understand it at all...I try to sit down with them and explain our business in broad terms, but they don't understand... we don't demand that they know the minute technical details, but that they know the basics. (P18)

'...they don't understand the specific accounting difficulties and exceptions for our industry sector.' (P6)

...They come here to learn, when they are supposed to be auditing. They should have more training or mentoring so that they don't come here to improvise. (P10)

An inadequate understanding of the taxpayer's business makes co-operative compliance inefficient because time is spent trying to 'explain business operations rather than having in-depth tax discussions' (P9). Furthermore,

legality and legal certainty are endangered because this limited understanding may lead the administration to 'commit mistakes' (P5).

Interestingly, P13 and P23, mentioned taxpayer-provided administrative training as a possible solution:

'...we'd educate them on its operation, making their work more interesting. They wouldn't need to incur in greater costs, just change their focus.' (P23)

it is up to the taxpayer to approach the authorities and explain their business to them so that they can reach fair conclusions. We should talk to them, show them how it works. (P13)

Whilst cost effective and collaborative, this raises the problem of controlling the training so that boundaries are preserved, and regulatory capture is prevented. This is a real concern, considering the findings regarding administrative lobbying discussed in section 7.2.12 and co-operative compliance's difficulties with public legitimacy.

Another alternative is for DIAN to hire personnel with previous in-house experience. As argued by P16, this would enable it to acquire and disseminate know-how:

The only one who understood it [the business] and "checked-mated" us was someone who had worked at [P16's corporation] ...he started to explain to all of them how things worked...cross-tabulating and cross-checking things. He became very aggressive. Some learnt from him.

Administrative deficient business understanding is problematic for co-operative compliance in a context where taxpayers exhibit different degrees of risk aversion, flexible approaches to risk management (see 7.3.8), and are expected to adopt heterogenous tax positions that the administration would struggle to regulate.

These shortcomings might prompt risk-prone, strategic-minded, taxpayers to believe that the probability of detecting non-compliance is low and, consequently, increase their tax-aggressiveness<sup>443</sup>, or adopt *game-playing* postures<sup>444</sup>, both contrary to co-operative compliance.

Finally, perceived administrative poor business understanding might erode voluntary compliance among compliance-minded taxpayers because of the effect this might have on their assessment of the quality of the 'service' provided by the authority. Indeed, according to Prinz, Muehlbacher, and Kirchler, there is a connection between the perceived quality of the authorities and taxpayer willingness to cooperate on account of the effect of 'persuasive power'<sup>445</sup>. Thus, taxpayers frustrated with DIAN's perceived lack of commercial awareness could judge the administration's performance negatively, deem it less persuasively powerful, and consequently reduce voluntary compliance. As with trust, the question is whether the implementation of co-operative compliance could be used as a platform for administrative capacity-building, and whether this would improve business understanding and increase the model's validity.

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<sup>443</sup> Beck and Lisowsky, 'Tax Uncertainty and Voluntary Real-Time Tax Audits'. Page 682.

<sup>444</sup> Braithwaite, Murphy and Reinhart, 'Taxation Threat, Motivational Postures, and Responsive Regulation'

<sup>445</sup> Prinz, Muehlbacher and Kirchler, 'The slippery slope framework on tax compliance: An attempt to formalization'. Page 21.

### 7.3.12. Most interviewees perceive DIAN's ability to discover and/or act upon instances of non-compliance as weak or partially weak.

As explained in chapter three, taxpayers' assessment of the administration's power is important in determining taxpayer behaviour, both from an enforced<sup>446</sup> and from a voluntary compliance perspective. Indeed, power is one of the two crucial elements in explaining taxpayer compliance under the *Slippery Slope* framework. Under this theory, power refers to the taxpayer's perception of the administration's ability to detect and punish non-compliance<sup>447</sup>.

Having an authority perceived to be powerful is important for co-operative compliance because taxpayers need to feel assured that non-compliance will be detected and punished, so that co-operators do not face a relative disadvantage<sup>448</sup>. Accordingly, interviewees were asked about their perception about DIAN's ability to detect non-compliance, and to act upon said discovery:

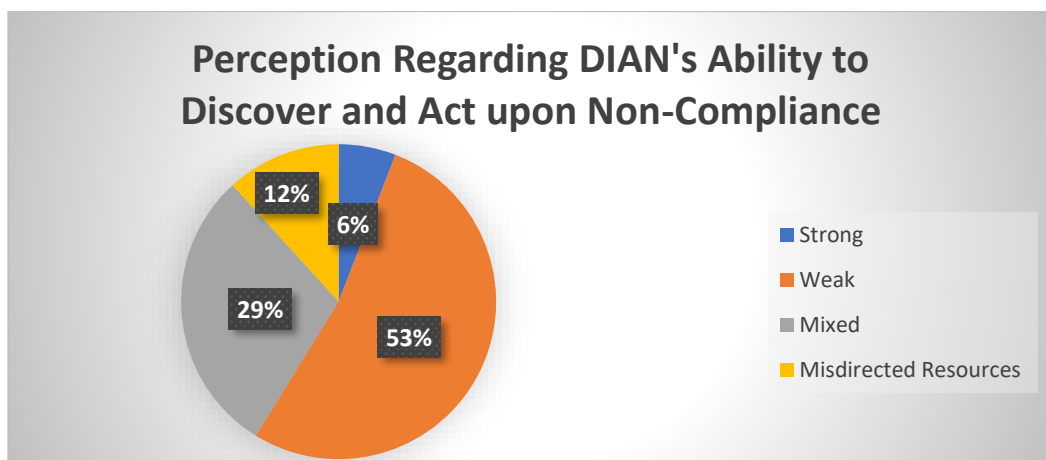


Figure 56 Interviewees' perception about the administration's power (Col)

<sup>446</sup> Kleven HJ and others, 'Unwilling or unable to cheat? Evidence from a tax audit experiment in denmark' (2011) 79 *Econometrica* 651, and Murphy, 'Enforcing Tax Compliance: To Punish or Persuade?'

<sup>447</sup> Kirchler, Hoelzl and Wahl, 'Enforced versus voluntary tax compliance: The "slippery slope" framework'. Page 212.

<sup>448</sup> Gangl, Hofmann and Kirchler, 'Tax authorities' interaction with taxpayers: A conception of compliance in social dilemmas by power and trust'. Page 22.

Most (53%) interviewees stated that DIAN was *weak* on both accounts, 29% of them felt that DIAN's power varied, 12% argued that DIAN had the means to be powerful but failed to use them adequately, and only 6% believed that the administration was *strong*. This suggests that co-operative compliance's validity in Colombia is lower because of the harmful effect that the perception of the administration as powerless or relatively powerless has on voluntary compliance, which is at its highest precisely when both perceptions of administrative trustworthiness and power are elevated. As stated by Wahl, Kastlunger, and Kirchler,

'a combination of high trust and high power evokes the highest voluntary tax compliance'<sup>449</sup>

In a context where trust in the administration and the judiciary (in tax matters) is considerably low and the administration is perceived as powerless, taxpayers are unlikely to see their intrinsic compliance-mindedness reinforced by deterrence, and strategic-minded or compliance-averse taxpayers are unlikely to be influenced to adopt a cooperative behaviour<sup>450</sup>.

Among those who felt that DIAN was weak, the administration was deemed incapable of targeting non-compliant taxpayers because of poor commercial awareness, lack of expertise, or being unwilling to focus on those who do not comply, choosing instead to 'prosecute' those seen by interviewees as generally compliant but easily targeted, i.e., large corporations:

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<sup>449</sup> Wahl, Kastlunger and Kirchler, 'Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the "Slippery Slope Framework"'. page 394.

<sup>450</sup> Kogler and others, 'Trust and power as determinants of tax compliance: Testing the assumptions of the slippery slope framework in Austria, Hungary, Romania and Russia'

I think they are very slow to grasp things... they need more internal training so that they know where to go. They need their employees to have a better understanding. (P10)

'I think that tax inspectors need to come out...and become more aware of how corporations work...' (P17)

'...Here they go after the compliant ones and let the evaders go ...' (P3)

The danger with these perceptions is that taxpayers who face administrative scrutiny and/or intervention, but see themselves as compliant, view administrative behaviour as arbitrary, inequitable, and unresponsive, thus engendering a feeling of procedural unfairness which is highly damaging for trust and reciprocity<sup>451</sup>. P14 illustrates:

...corporations such as this one feel aggrieved because we are challenged even when we do our best to interpret and comply and...we can see that those that don't try to comply are not challenged. (P14)

Regulatees who feel unfairly persecuted by administration are less likely to cooperate fully or accept co-operative compliance as a valid regulatory system, unless they could be convinced that the program's inception would be accompanied with increased enforcement against non-compliance.

Moreover, some responses suggest that taxpayers perceive that DIAN persists on a "cops and robbers" mentality, something which would also reduce co-operative compliance's validity since it is contrary to this regulation's philosophy<sup>452</sup>. In P5's words:

[DIAN] are not trying to apply the law, but rather to catch a "thief". It's weird. I don't know if their staff development is the most adequate, they are raising "cops", not tax investigators.

Other participants reported a *mixed* perception of DIAN's power, stating that it

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<sup>451</sup> Feld and Frey, 'Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation'

<sup>452</sup> Walsh K, 'Understanding taxpayer behaviour - new opportunities for tax administration' (2012) 43 Economic and Social Review 451. Page 452.

displayed both weaknesses and strengths in discovering and acting in relation to non-compliance. For some, like P16, DIAN is powerful only in one dimension; for others, like P7, DIAN's performance in both dimensions is highly variable, with detection and prosecution working well in some cases, but not others:

... our tax authority nowadays has good tools which would allow for good tax control. However, their internal disorder does not allow them to produce adequate results... (P2)

When they find [non-compliance] they are happy, if they find [non-compliance] they prosecute it. [however] They would find about 10% of non-compliance, they don't have tools. (P16)

As explained by Lederman<sup>453</sup>, co-operative compliance still relies on penalties and coercive enforcement because of the role of deterrence in maintaining compliance and eliminating non-compliance among recalcitrant taxpayers. Thus, the concern when a large portion of regulatees see the administration as weak is that non-compliance could increase among those taxpayers who are not fully committed, as well as those who are openly resistant. Additionally, in the case of the former, participation in co-operative compliance could increase the risk of selective disclosure or other strategic behaviour.

Although insufficient administrative resources would be a probable culprit for administrative weakness, particularly in emerging markets or developing nations, some of the responses reject this hypothesis. Thus, a cluster of interviewees stated that DIAN possesses the tools to detect non-compliance, but fails to use them objectively because of bias that leads them to target compliance-minded taxpayers who could otherwise be assisted to prevent mistakes:

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<sup>453</sup> Lederman, 'Report for the European Association of Tax Law Professors 2015 Congress "Tax Penalties as Instruments of Cooperative Tax Compliance Regimes"'

they have all the tools...they could investigate adequately; however...they are always thinking about evaders and avoiders - which do exist, and I'm not excusing them - and, as such, they have no interest in understanding us and inviting us to correct our practice if there is something wrong... (P6)

This perception of the administration as being unwilling to assist taxpayers in complying is particularly damning for co-operative compliance because it means taxpayers believe that the exchange is not reciprocal, since they do not receive guidance and/or support to compensate their full disclosure.

Lastly, some interviewees, including P11 and P7, stated that DIAN does not adjust its interventions to taxpayers' self-regulation:

...they regulate and oversee the compliant ones, but they have nothing on the evasive ones or the ones that engage in unholy operations. Too much control on those who actually have a good degree of control. (P11)

If the administration is perceived as incapable of responding to taxpayer-specific risk profiles, circumstances, and behaviour, co-operative compliance's validity is reduced because the promise of responsiveness central to this model is not seen to be satisfied.

### **7.3.13. Most tax directors have a negative or mixed perception about the adequacy of the administration's interventions.**

A final finding detrimental for co-operative compliance's validity in Colombia is that most interviewees (82%) displayed a negative or mixed perception of the way in which DIAN exercises its power (intervenes) in relation to their corporations':

## Participant Perceptions Regarding the Degree of DIAN's Intervention on their Corporation

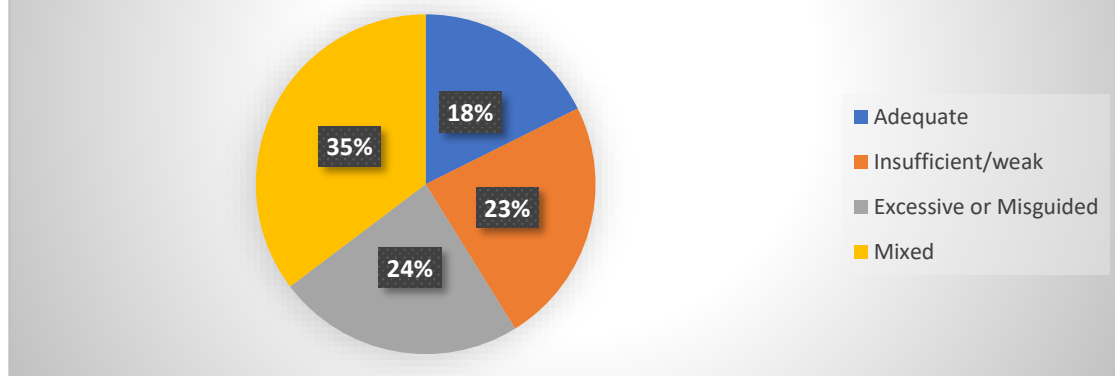


Figure 57 Interviewee perceptions about the administration's interventions on their corporations (Col)

Most participants stated that DIAN's behaviour varied greatly, depending, among others, on the inspectors involved (P10), whether administrative personnel was offered variable compensation based on findings (P11), whether the subject matter of the interventions was complex (P24), or the degree of commercial exposure and potential revenue involved. The perceived lack of uniformity in the treatment received and the interventions' pertinence can lead to an erosion of trust and/or to a shift in the perception of DIAN's exercise of power from *persuasive* or *legitimate* power, towards *coercive* power<sup>454</sup>. Both situations damage voluntary compliance and, therefore, decrease co-operative compliance's validity.

For a second cluster of interviewees, administrative interventions are excessive or misguided; not attuned to the taxpayer's specific circumstances and behaviour, mistakenly centred on compliant taxpayers, or based on

<sup>454</sup> Kirchler, Kogler and Muehlbacher, 'Cooperative Tax Compliance'. Page 90.

prejudice against corporations of a specific size, industry sector, or volume of tax payable. In these cases, and contrary to co-operative compliance's expectations, taxpayers do not perceive the administration as being responsive.

P14 illustrates:

In some cases, it [the intervention] is excessive, there are a lot of challenges which are generic, where you can see that they did not analyse your specific situation.

Furthermore, if taxpayers feel that the administration's behaviour bears no relation to their behaviour, then the essential trust and reciprocity link between the administration and the taxpayer at the heart of co-operative compliance is broken.

Similarly, where taxpayers perceive the administration to be biased, a feeling of procedural unfairness is likely to present itself<sup>455</sup> and prevent co-operative compliance relationships from flourishing. The following quotes demonstrate:

...this is an organisation which is highly investigated. We belong to the XXXX [omitted for confidentiality] sector and because of this sole fact we are being stigmatised. We are an international company, and this leads to a different administrative reaction. We generate VAT refunds and sometimes tax losses, and this means that we are inspected intensively...They always go for the big guy (P7)

...tax inspectors visit us often, we have a permanent high level of auditing because we have produced tax losses for several periods. The auditors try to review item by item so as to reduce the amount of tax refunds...They are always trying to find something that we "cheated on", trying to deconstruct every minute detail, and that means that as a corporation we feel persecuted: What else do you want to see, when is it going to end?! (P17)

Finally, another cluster of interviewees stated that DIAN's interventions were insufficient or weak, with DIAN perceived as lacking trained specialists (P16)

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<sup>455</sup> Murphy, Tyler and Curtis, 'Nurturing regulatory compliance: Is procedural justice effective when people question the legitimacy of the law?'

and business understanding (P2), not performing 'in-depth investigations' (P23), or lacking 'a coherent and consistent structure' for those investigations (P4).

Altogether, the combined perceptions of administrative bias, lack of responsiveness, and inadequate resources indicates that co-operative compliance's validity is reduced because convincing the regulatees to collaborate with an administration most of them perceive as arbitrary in its exercise of power and/or incapable of using the tools it has been given to ensure compliance is likely to be difficult.

#### **7.4. Conclusion**

This chapter has shown that there are findings positive for co-operative compliance's potential validity in Colombia. These include coincidences between tax director personal norms about the ideal taxpayer-administration relationship and co-operative compliance's values, compliance-minded and risk-averse tax director personal norms, social norms favourable to compliance, stronger and more compliance-centred corporate tax teams, changes in the role of tax within the business decision-making process, and an increased corporate tax risk awareness.

Nevertheless, these factors are overshadowed by multiple variables that indicate co-operative compliance has a reduced validity in Colombia. First, there are highly negative taxpayer perceptions about the administration's trustworthiness, its business understanding, the expertise and attitude of its officials, the administration's responsiveness and the adequacy of its interventions, and/or its power. Second, Colombian corporations frequently

focus on maximising tax savings regardless of compliance or tax risk, and display governance practices and approaches to tax risk which often are not conducive for reducing risk. Finally, there are social norms which suggest that significant portions of Colombian tax directors and tax advisors are not compliance-minded or are tax-risk prone.

Thus, co-operative compliance's validity in Colombia is currently limited. Therefore, if the model was to be implemented there, it would be unlikely to be effective unless actions were taken on multiple fronts to address the issues highlighted above.

**PART III**  
**NORMATIVE PROPOSALS AND CONCLUSIONS**

## CHAPTER 8

### COMPARATIVE ANALYSIS OF THE COLOMBIAN AND UK EMPIRICAL FINDINGS

#### 8.1. Introduction

This chapter compares the findings obtained from the UK and the Colombian samples to determine what shared trends and contrasts reveal about co-operative compliance's validity among large corporate taxpayers in both countries. As was explained in chapter two, these taxpayers provide an interesting basis for comparison because they operate transnationally and must respond to global competitive pressures and business practices that encourage harmonisation but simultaneously deal with tax administrations implementing different regulatory approaches – in the UK, co-operative compliance, social norms, and other country-specific *macro* factors.

Findings reveal that, despite the presence of shared trends concerning organisational variables and tax director personal norms that are favourable for co-operative compliance's validity, there are multiple dimensions where this type of regulation is revealed to have a higher validity in the UK than in Colombia. This is the case with social norms referring to compliance and tax professional and corporate objectives regarding taxation, regulatee perceptions about the administration's capabilities and attitude, and the taxpayer-administration relationship.

While both samples exhibited various similarities regarding taxpayer perceptions of the administration and certain features of corporate tax governance that are negative for co-operative compliance's validity, responses suggest that co-operative compliance faces deeper difficulties in Colombia than

in the UK. Whereas negative findings in the UK are centred on an erosion of trust in HMRC and on mixed opinions about its ability to deliver on co-operative compliance's promises regarding legal certainty, responsiveness, and horizontality, Colombian views about DIAN's trustworthiness, attitude and capabilities are predominantly negative, rather than mixed, and many of the features that the administration would be required to have for an effective implementation of co-operative compliance are deemed to be non-existent or critically weak.

Lastly, while both samples show tax governance weaknesses that are damaging for co-operative compliance's validity, these were considerably more acute in the Colombian sample, which displayed additional issues with the incentives given to tax executives, less strict risk management procedures and lower board involvement in tax matters.

## **8.2. Comparative analysis of findings regarding personal norms**

A comparison of responses regarding corporate tax directors' personal norms shows that, regardless of operating in different contexts, these actors' personal norms exhibit a considerable alignment with co-operative compliance's values and objectives. While the alignment exhibited by UK interviewees was consistently higher than that of Colombian participants, seeing that actors who are crucial in determining a corporation's tax approach and its engagement with the administration have ideas about taxation compatible with co-operative compliance suggests that this type of regulation is potentially valid in different jurisdictions because it connects with the regulatees' professional objectives and

their focus on risk, and because its model of tax administration and taxpayer-administration relationship matches their ideals.

The coincidences in personal norms between tax directors based in very different countries indicate that there are forces which encourage the convergence and harmonisation of ideas about tax compliance and the role of tax directors. This can be connected to the fact that tax directors operate in a closely-knit professional community where participation in industry/academic organisations facilitates norm diffusion, where working for multinationals exposes employees to standards that are expected to be implemented globally, and where international education and networking increase these professionals' exposure to ideas and initiatives developed elsewhere. Additionally, soft law and the standards of multilateral organisations like the OECD contribute to this phenomenon.

### **8.2.1. Interviewee views about the ideal taxpayer-administration relationship show alignment with co-operative compliance's principles**

Both countries' interviewees displayed personal norms about the ideal taxpayer-administration relationship which show alignment with the engagement envisioned by co-operative compliance. Participants shared a desire for certainty under a relationship based on business understanding and wish to relate to the administration from a level standpoint, wanting it to be adequately resourced (e.g. P23COL, P4UK), and well informed (e.g. P20UK, P27UK). While each sample focused on a different dimension (UK, proactive dialogue, and Colombia, directness), both seek an efficient relationship. The model's validity is supported in both contexts because regulatees share the aspiration for the taxpayer-administration relationship to focus on providing legal certainty,

personalised support based on a thorough understanding of the taxpayer's business and their unique profile, reducing compliance costs, and for the two parties to treat each other as equals. These aspirations coincide with key elements of co-operative compliance: Legal certainty, responsiveness, horizontality, and efficiency.

However, the samples showed some differences which indicate that co-operative compliance's validity is higher in the UK because the tax morale of tax directors there is more closely aligned to this model's premises than that of their Colombian peers.

First, unlike their UK peers, who view the relationship as inherently reciprocal and based on mutual commitments, Colombian interviewees have a more unilateral view, seeing the administration, and not taxpayers, as having various obligations and needing to make several changes. Thus, whereas Colombian participants emphasised the need for the administration to be 'technical' (P5COL), 'direct' (P6COL), and constructive (P20COL), UK interviewees characterised the taxpayer-administration dialogue as needing taxpayer 'honesty' (P10UK), 'openness' (P36UK), and 'full disclosure' (P1UK). This could impact horizontality, since co-operative compliance aims for a partnership, not a shift from a paradigm where the administration commands the taxpayer to another where a vertical structure persists but with the roles reversed.

While both samples saw trust as an important element, Colombian interviewees emphasised the administration's need to trust them and overcome what they saw as 'bias' (P13COL, P10COL), while UK tax directors consistently

referred to 'mutual trust' (P10UK, P18UK). Although the Colombian interviewees' insistence on the administration being the only party that needs to work on trust is not surprising considering the participants' highly critical views about its trustworthiness, co-operative compliance's shift towards justified trust suggests that implementing this model in Colombia could be difficult because regulatees might not share the principle that they must prove their trustworthiness to the administration. Moreover, these differences could also relate to how the respective legal systems balance taxpayer and administration rights and obligations. For example, while HMRC's charter of taxpayer rights combines rights and obligations<sup>456</sup>, Colombia's statutory catalogue of taxpayers' rights contains no taxpayer obligations<sup>457</sup>.

Another point that strengthens co-operative compliance's validity in the UK is that, having experienced co-operative compliance, some of the interviewees there (e.g. P1UK, P23UK) refer to it as ideal, suggesting that this model can match taxpayers' expectations, both before and after its implementation.

Finally, another context-specific difference is that several Colombian interviewees insisted on the importance of strengthening DIAN in order to have an ideal taxpayer-administration relationship. Responses did not only refer to improving investigations and responsiveness, but also to wanting to see a more imposing administration that would strengthen compliance through deterrence and power. P23COL's response illustrates:

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<sup>456</sup> See <https://www.gov.uk/government/publications/your-charter/your-charter>

<sup>457</sup> See Law 1607 of 2012 (COL) Art 193.

‘An ideal relationship involves a...higher level of inspectors so that they can show up in the corporation and command respect...’

While UK responses to other questions also highlighted views of HMRC as weak or partially weak, that Colombian interviewees felt that administrative power needed to be boosted for an ideal relationship suggests that resource limitations are perceived as more serious there. Although the “imposing” authority sought in the Colombian sample does not seem to match co-operative compliance’s non-adversarial, horizontal philosophy, it can be seen together with statements by UK interviewees according to which differences with HMRC are welcome as long as they take place in a context of trust (e.g.P16UK), as an indication that taxpayers in both countries are not necessarily interested in a subservient administration, contrary to what critics of co-operative compliance might believe<sup>458</sup>.

### **8.2.2. Participant beliefs regarding the objectives that should drive the tax administration coincide with co-operative compliance’s characteristics**

Continuing with coincidences regarding tax director personal norms, responses show that the samples’ views about the objectives that should drive administrations, including providing certainty, ensuring compliance, supporting taxpayers, and acting responsively, concur with co-operative compliance’s principles. Thus, both countries regulatees’ could be amenable to co-operative compliance because the goals of the administration under this model and the means chosen to fulfil them match their aspirations.

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<sup>458</sup> Picciotto, 'Indeterminacy, Complexity, Technocracy and the Reform of International Corporate Taxation'.

As with interviewee views about the ideal taxpayer-administration relationship, while the samples' coincidence in highlighting administrative objectives which match co-operative compliance's approach is positive for this regulation's validity, there are differences between the groups that suggest the interviewees' ideological alignment is stronger in the UK than in Colombia.

Whereas UK respondents focused on the administration having risk-based responsiveness as an objective (e.g. P17UK), Colombian interviewees centred on the administration's need to be efficient and uniform in providing certainty (e.g. P14COL). While the UK sample's strong focus on risk-based responsiveness supports co-operative compliance by allowing the administration to centre on providing certainty and supporting taxpayers in maintaining and improving their ability to self-regulate, the lower importance afforded to tax risk by Colombian interviewees indicates that co-operative compliance could struggle to operate there efficiently and improve compliance because the regulatees' risk awareness might not be enough to allow taxpayers to implement robust risk control structures and justify trust. Indeed, implementing co-operative compliance in such a context would require a focus on regulatee capacity building and culture change. This would entail centring on a low tier of co-operative compliance and collaborative vertical enforcement before proceeding to horizontal enforcement (see chapter nine).

Additionally, whereas UK participants highlighted the importance of mutual understanding and trust for building a personal relationship (P10UK) that is 'comfortable' (P20UK) and leads to a 'favourable environment' (P16UK),

essentially a *synergistic tax climate*<sup>459</sup>, Colombian interviewees were more interested in enhancing efficiency. This is somewhat surprising since several of the UK interviewees' objections with HMRC's co-operative compliance programme, such as excessive delays in administrative responses and/or CRM rotation, are related to inefficiency. However, participants may have presumed that a more collaborative relationship would be more efficient.

Finally, the Colombian sample's focus on efficiency was often associated with perceptions of the administration as corrupt, something never mentioned by UK interviewees. For example, P23COL mentioned that for an ideal relationship the administration needed to 'clean up the house'. While this suggests that Colombian regulatees do not approve of corrupt practices, and this is positive for co-operative compliance's validity in terms of preventing regulatory capture, the fact that corruption is perceived as significantly present means that there is a considerable risk in implementing co-operative compliance in Colombia because the model's horizontality, its responsiveness, and interparty proximity could be exploited by corrupt parties.

### **8.2.3. Tax Directors show compliance-minded and/or risk averse personal norms in relation to their professional objectives**

Findings indicate that most corporate tax directors in both samples possess professional objectives that prioritise reducing tax risk and/or ensuring compliance. These personal norms are favourable for co-operative compliance's validity because synchrony between the regulatees' professional objectives and those of the regulatory approach reduces the likelihood of conflicts of interest

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<sup>459</sup>Wahl, Kastlunger and Kirchler, 'Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the "Slippery Slope Framework"'

where taxpayers might disregard or resist regulation if it is seen to conflict with goals that they prioritise. Additionally, if co-operative compliance can be seen by tax directors as a valuable work tool, they can steer their employers towards a committed participation. Moreover, risk-averse tax directors can be expected to enhance their organisations' risk awareness and control frameworks and engage in greater disclosure to obtain greater certainty and reduce contingencies.

Consistent with the other findings, while both samples show support for co-operative compliance, the Colombian sample displayed a weaker normative alignment than that of the UK. UK interviewees were heavily concerned with risk management, assurance, and predictability, and ensuring compliance was seen as a way of managing tax risk - avoiding surprises- and providing certainty to employers. Additionally, responses indicate that their concern with tax risk is not short-term, since several participants referred to the importance of maintaining a set of tax positions which is 'sustainable' (e.g. P36UK, P23UK). In contrast, while most Colombian interviewees shared this approach and focused on reducing risk and increasing compliance, responses showed that a significant minority (33%) prioritised maximising tax savings over any other objective. This suggests that "creative" or "cosmetic" compliance and strategic behaviour are a concern in Colombia and that, because of its higher risk appetite, the regulatee population there may be less amenable to co-operative compliance than the UK's. This could be particularly troublesome considering that, as will be explained in 8.3.1, Colombian corporations were perceived to be more focused on approaching their taxes with a view to maximise profitability than their UK counterparts.

### **8.3. Comparative analysis of findings regarding social norms**

Unlike findings concerning tax director personal norms, interview responses concerning social norms are mainly negative for co-operative compliance's validity in Colombia but positive in relation to the UK. While most corporations are perceived to be compliant in both countries, a high percentage of UK interviewees perceived mixed levels of tax aggressiveness, but Colombian interviewees relied on a narrow view of compliance which did not contemplate tax aggressiveness. Whereas most UK tax directors and external tax advisors were perceived to be compliant, albeit with a degree of mixed behaviour being reported, most Colombian participants viewed these actors as having a mixed behaviour. Finally, the view of most corporations as having compliance-minded and/or risk-averse objectives displayed by UK interviewees contrasted markedly with the fact that most corporations in Colombia were perceived as having maximising tax savings as their main objective.

Social norms which describe the behaviour and/or tax morale of reference groups as compliant and/or risk averse are positive for co-operative compliance's validity because they suggest regulatees share these values/behaviours and/or because group conformity and competitive benchmarking incentivises their adoption or maintenance. In contrast, regulatee perceptions of their peers as non-compliant and/or tax aggressive, reduce co-operative compliance's validity because they indicate that regulatees are not compliance-minded and/or risk averse and, even if this is untrue - for example, because of heuristics that lead to an overestimation of non-compliance in other taxpayers, group conformity will push regulatees to adopt the behaviour seen as

prevalent in their peers or to disengage from complying with a system that is perceived to be broken.

### **8.3.1. Most interviewees perceive other corporations as compliant, but samples differ regarding tax aggressiveness**

Most interviewees in both countries perceived that other corporations comply with their tax obligations (87% UK, 76% COL). This would suggest the existence of compliance-inducing descriptive social norms<sup>460</sup> favourable for co-operative compliance's validity because group conformity with social norms could induce non-compliant taxpayers to maintain or adopt an equally-compliant behaviour.

However, a deeper analysis of what taxpayers understand by “being compliant” shows that this norm is only slightly positive for co-operative compliance in the UK and too indeterminate to be positive or negative in Colombia. Since “compliance” is a subjective term, when taxpayers assess a party as being compliant, they might be referring to behaviours which the administration or the judiciary might label as non-compliant<sup>461</sup>. Thus, the UK interviewees' high perceptions of compliance were countered by the fact that 60% of them felt that corporations displayed mixed levels of tax aggressiveness. Additionally, some of these interviewees felt taxpayer aggressiveness had decreased in the recent past, with taxpayers trying to ‘remedy’ their tax positions (P11UK), and the harmful competition brought about by aggressive tax positions being replaced by a ‘level playing field’ (P17UK). In contrast, Colombian respondents displayed a narrow understanding of compliance as not defaulting

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<sup>460</sup> Wenzel M, 'Motivation or rationalisation? Causal relations between ethics, norms and tax compliance' (2005) 26 *Journal of Economic Psychology* 491

<sup>461</sup> Freedman, *Responsive Regulation, Risk, and Rules: Applying the Theory to Tax Practice*. Pages 631-632.

from taxes due (i.e. evasion) and made no references to tax aggressiveness. This focus on evasion-like behaviour might obscure the existence of tax abuse or risky, compliance-borderline behaviours and disguise their acceptance. This suggests that UK corporate taxpayers are more aware than their Colombian peers that there are behaviours other than evasion which could be problematic. This awareness can be associated with the increasing pre-eminence of the concept of tax abuse in the UK's and EU's legal systems and the tone of public criticism directed at corporate tax behaviour there.

Thus, while weakened by the perception of mixed aggressiveness - which may not be a long-term concern since interviewees reported it as decreasing, the UK has social norms of compliance that are favourable for co-operative compliance. In Colombia, while high perceptions of compliance could be favourable for co-operative compliance's validity, the fact that tax aggressiveness is not assessed, and the narrow scope afforded to compliance raise serious doubts as to whether this norm is a positive or negative indicator.

### **8.3.2. The two samples displayed significant differences in the perception of the main tax objectives of other corporations**

One of the main differences between samples refers to the perceived tax objectives of large corporations. Most UK interviewees felt that other corporations were compliance-minded, having certainty, stability, and sustainability, tax risk management, and compliance as their main tax objectives. Unlike them, most Colombian interviewees stated that maximising tax savings was a leading tax objective for corporations. Only 18% of Colombian interviewees thought that compliance and risk reduction were main objectives,

and only 12% thought compliance was prioritised over tax savings when these goals coexisted.

This suggests that regulatees in the UK have and/or are incentivised to adopt tax objectives which match co-operative compliance's premise of a compliance-minded and risk-averse taxpayer, thus increasing these regulatees' amenability to this type of regulation and strengthening its validity. In contrast, the high value afforded to tax minimization by Colombian regulatees is likely to clash with co-operative compliance's ethos, because taxpayers embrace or would be likely to embrace risk and/or non-compliance, seeking to reduce tax expenses or increase profits.

This difference appears to be related to contextual factors, since UK responses indicate that the perception of corporations having compliance-minded and/or risk-averse objectives is linked to reputational concerns in a context of heightened public/political scrutiny over corporate taxation that is not present in Colombia. The downside is that taxpayers concerned solely with reputational risk might condone low-visibility, non-compliant tax positions. Nevertheless, even if the motivation for risk aversion or compliance is not commitment to the rules, the objectives perceived in the UK support a level of self-regulation that is still better for co-operative compliance than the absence of risk awareness or openness to risk perceived by many Colombian interviewees.

### **8.3.3. Tax directors and external tax advisors were perceived to be more compliant and less aggressive in the UK than in Colombia.**

Another difference concerning descriptive social norms which suggests that co-operative compliance's validity is higher in the UK than in Colombia is that, while

most UK participants (69%) believe that other tax directors and external tax advisors exhibit a broadly compliant tax behaviour, most Colombian interviewees stated that one or both actors display mixed behaviour, both regarding compliance, and tax aggressiveness. Only 11.7% of Colombian interviewees felt that advisors and directors were consistently conservative and/or compliant.

Additionally, UK interviewees referred to a shift towards higher compliance and lower aggressiveness. This was associated with reputational risk and the environment becoming less accepting of tax avoidance. Ironically, whilst contributing to increase co-operative compliance's validity by strengthening descriptive social norms of compliance and/or risk aversion, this environment is also shown in other interview questions to originate the political and public pressure that participants believe is driving HMRC to act arbitrarily and/or to fail to provide legal certainty, thus weakening interparty trust and co-operative compliance's sustained validity.

These findings suggest that co-operative compliance's validity is higher in the UK because two of the main actors who determine corporate tax behaviour are expected to have a compliance-minded and/or risk averse approach to taxes that should steer their employers/clients tax behaviour and their engagement with the administration towards low-risk and compliance. In contrast, Colombian tax directors are less likely to collaborate with and fully disclose their corporation's tax affairs to the administration if they sense that tax directors and

advisors, who belong to their occupational network and are easier to identify with<sup>462</sup>, are not complying and/or if their approach to taxes is seen as aggressive.

While both samples coincided in noting that advisors varied their behaviour to suit what they believed their clients preferred<sup>463</sup>, UK participants felt most advisors' behaviour had become more conservative but Colombian interviewees did not report any such change, and most of them felt that external tax advisors displayed a mixed behaviour regarding compliance and aggressiveness. Thus, it is possible that Colombian advisors could condone or incentivise non-compliance and/or tax risk-taking contrary to co-operative compliance.

Considering that Colombia lacks equivalent legal provisions, it is possible that the UK's enactment of the Single Accounting Officer (SAO) regime and multiple anti-avoidance provisions impacting practitioners (e.g. the tax avoidance enabler penalties and the disclosure of tax avoidance schemes) have contributed to behavioural changes. Previous studies showed corporate taxpayers felt the SAO regime impacted their risk ratings with HMRC<sup>464</sup> and HMRC has suggested making this link an explicit component of the BRR<sup>465</sup>. However, responses to other questions suggest that the impact of the avoidance-enabler penalties has been limited, since several interviewees

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<sup>462</sup> Ashby, Webley and Haslam, 'The role of occupational taxpaying cultures in taxpaying behaviour and attitudes', and Hashimzade and others, 'Social networks and occupational choice: The endogenous formation of attitudes and beliefs about tax compliance'.

<sup>463</sup> Doyle E, Frecknall Hughes J and Summers B, 'An empirical analysis of the ethical reasoning of tax practitioners' (2013) 114 J Bus Ethics 325

<sup>464</sup> Freedman, Vella and Ng. *HMRC's Relationship with Business*. Page 49.

<sup>465</sup> Sauvage L, 'HMRC's new business risk review' (2018) 14 Tax Journal

considered these penalties 'superfluous' (e.g. P25UK) or useful only for other types of taxpayers (e.g. P36UK).

#### **8.3.4. Participants in both samples view other corporate taxpayers' relationship with the administration as positive or partially positive**

Most participants in both samples perceived other corporations' relationship with the administration as positive or partially positive. This coincides with the interviewees' views concerning their own corporations. Social norms according to which relationships with the administration are seen as predominantly positive can enhance co-operative compliance's validity by increasing the administration's trustworthiness and legitimacy among regulatees and portraying it as a reliable partner, and also by inducing taxpayers to adapt their behaviour to achieve or maintain an equally positive relationship, provided regulatees are seen to behave in a manner aligned to co-operative compliance<sup>466</sup>. However, if the relationship is perceived positively despite regulatee or regulator behaviours which are contrary to co-operative compliance, the social norm becomes negative for the model's validity.

Thus, the UK's social norm is positive for co-operative compliance's validity because the relationship, judged positively based on the presence of co-operative compliance elements like mutual understanding and responsiveness, was sometimes seen as the outcome of generalized compliant or risk averse taxpayer behaviour, and because the relationship was perceived as comparatively better than that with other administrations. However, for a significant portion of participants, whilst positive, the relationship was

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<sup>466</sup> For a sceptical view, see Posner, 'Law and social norms: The case of tax compliance'.

deteriorating because of flaws in the model's implementation, mainly associated with CRM turnover and technical competence, and/or HMRC's attitude becoming aggressive and non-collaborative due to political pressure. Thus, while co-operative compliance's responsiveness and philosophy are credited for improving the relationship, problems with its implementation are seen as capable of deteriorating it significantly.

In comparison, in Colombia, perceiving other corporations' relationship with DIAN as positive has a mixed effect on co-operative compliance's validity. While some respondents felt that the relationship was positive because corporations displayed compliant behaviour or because the parties collaborated with each other, and this is positive for co-operative compliance, others stated that it was positive due to factors negative for co-operative compliance, including the regulatees' lobbying ability and their revenue-generating potential translating into preferential treatment. Like the interviewees' perception of their own companies' relationship with the administration (see 7.5.1), the concern is that a tradition of interparty proximity not grounded on low risk or high compliance could translate into regulatory capture.

#### **8.4. Comparative analysis of findings regarding organisational variables**

The comparison of interview responses concerning organisational variables reveals that large corporations in the UK and in Colombia share similar trends in most of the corporate factors studied. Most of these similarities are positive for co-operative compliance because they indicate that regulatees are increasingly aligned with this model's risk-averse mentality and attempting to improve their internal tax control frameworks and reduce non-compliance's

likelihood. Responses suggest that generally, the strength of validity-favourable findings is higher in the UK than in Colombia. However, not all findings are positive for co-operative compliance, since both samples displayed tax governance weaknesses attributable to the primacy of the finance function over the tax function within the organisations, and problems with the tax control exercised by corporate boards. Colombian corporations exhibited weaker structures than UK corporations in these two aspects, indicating a lower validity for co-operative compliance. Additionally, the relative lower validity of co-operative compliance regarding Colombian corporations is compounded by flexible assessments of tax risk and by agency issues derived from the way in which tax directors are remunerated and evaluated.

The degree of similarities between the samples points to a high level of harmonisation among large corporations that can be explained by the fact that these organisations usually operate transnationally and are often part of corporate groups that develop common practices for their units globally. Additionally, these taxpayers' participation in global capital markets subjects them to international reporting and compliance regulations like Sarbanes-Oxley, which influence their governance structures and their risk awareness. Finally, competitive benchmarking and scrutiny by investors and analysts also create convergence.

#### **8.4.1. Taxpayer norms show a decreased tax risk appetite and higher reputational risk awareness**

One of the main similarities in relation to organisational variables is the existence of an increased corporate tax risk aversion. Interviewees from both samples

(with a predominance of UK participants) stated that reputational risk has become a primary driver of corporate tax behaviour, driving companies to avoid positions that could cause reputational damage.

Regardless of differences in its definition and assessment, risk is used by tax directors in both countries for classifying a tax position in the spectrum of tax behaviours (as 'avoidance', 'planning', 'abuse', etc.) and for determining its acceptability. While not under strict causality, a decreased risk appetite can facilitate risk-based responsive regulation like co-operative compliance because it can lead to greater risk awareness and internal controls and reduce the possibility of accidental and intentional non-compliance by taxpayers seeking to avoid franchise-damaging tax contingencies.

However, since responses show that concern with risk is tied up to reputation, it is possible that low-visibility non-compliance persists, and that co-operative compliance is exploited by non-committed companies appearing to comply. Additionally, an increased risk aversion may not translate into effective behavioural changes if the ability of taxpayers, the administration, and/or other stakeholders to detect risk is limited. This is particularly problematic in Colombia since large corporations face less scrutiny from investors and analysts, a lower proportion of them are publicly-listed, and corporate taxation is less mediatic than in the UK, meaning that taxpayers who may be risk averse continue to embrace risky positions because they estimate the probability of disclosure and/or controversy as low.

#### **8.4.2. Public perception has acquired an increased importance in devising corporate tax strategies and tactics**

Consistent with an increased risk aversion, most participants from both samples stated that public perception had become an important factor in the corporate tax decision-making process. This was particularly acute in the UK, where all participants stated that public perception was fully or partially considered by their corporations, whereas 29% of Colombian interviewees said it was not. Corporate concerns about the public's perception of tax have been previously reported, among others, by Freedman, Loomer, and Vella<sup>467</sup>. However, the magnitude of these concerns appears to have increased, particularly in relation to press coverage<sup>468</sup>.

An increased corporate concern about public perception is favourable for co-operative compliance's validity because taxpayers concerned about public perception are more likely to adopt a more conservative behaviour and/or to collaborate with the administration to prevent negative exposure. Both countries' responses show that directors are worried about trying to satisfy the expectations of a public whose understanding of tax they perceive as highly erratic, and this drives them to adopt a more conservative tax behaviour and censor high-risk positions. Nevertheless, an excessive focus on the public's perception without a commensurate commitment to compliance can lead to undesirable consequences when taxpayers discard legally valid positions which are unpopular but were intended by the legislator, when they over-comply, or when aggressive or non-compliant behaviour is maintained if it is perceived to be undetectable or difficult to scrutinise.

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<sup>467</sup> Freedman, Loomer and Vella, *Analyzing the Enhanced Relationship Between Corporate Taxpayers and Revenue Authorities: A U.K. Case Study*. Page 118.

<sup>468</sup> Compare to Freedman, Loomer and Vella 'Corporate tax risk and tax avoidance: new approaches'. Page 90.

Responses suggest that the lower importance given to public perception in Colombia might be associated to the Colombian context being characterised by a lower brand-sensitivity than the UK's. Additionally, this difference can relate to a higher social visibility of corporate taxation in the UK and to the threat of critical media exposure, something which was not feared by most Colombian interviewees.

The media's role is sensitive because it can bolster co-operative compliance by instigating more conservative tax behaviours and increased risk awareness but, simultaneously, can jeopardise co-operative compliance by placing undue pressure on the administration, eroding interparty trust due to data leaks, encouraging a reduced ability/willingness to provide legal certainty, and making the model less attractive for taxpayers by portraying it as illegitimate or inequitable. Thus, the interest in satisfying public opinion that might drive companies to adopt more risk-averse behaviours and/or to cooperate with the administration, might drive them to retreat if the relationship is seen as too vulnerable to political risk<sup>469</sup>, legal challenges, or public criticism.

#### **8.4.3. Tax is being considered alongside other variables in the business-decision making process**

Additional evidence of transnational corporate trends favouring co-operative compliance's validity comes from the majority in both samples' stating that corporations are now considering tax simultaneously to other variables within the business decision-making cycle, rather than considering tax after business plans have already been implemented or allowing pre-conceived tax schemes

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<sup>469</sup> Black and Baldwin, 'Really Responsive Risk-Based Regulation'

to drive business decisions. This is conducive for co-operative compliance because tax departments have a greater opportunity to control tax risks proactively, including by discussing them with the administration, and because tax teams can ensure that there is commercial substance behind decisions with tax consequences, thus preventing tax abuse. These changes show improved self-regulation capabilities among taxpayers.

According to responses, most tax teams analyse business cases before their implementation and decide to approve or reject it by 'greenlighting' the transaction. Since this practice reduces accidental non-compliance, it strengthens corporations' internal tax control frameworks and, consequently, can increase co-operative compliance's validity. However, because a minority of respondents from both samples accepted that their corporations occasionally allowed tax to predate business decisions, particularly regarding international relocations, corporate reorganisations, financing, and intragroup transactions, it is important for administrations to be vigilant in relation to these areas, where the risk of intentional non-compliance is higher.

Participants from the two samples stated that considering tax simultaneously represents a change from the recent past, where tax-driven business decisions or reacting to commercially driven, non-consulted transactions, would have been common. This change, which is likely to be associated with a shift in global attitudes against abusive tax behaviour, is made possible operationally because in-house tax teams are enjoying increasingly collaborative interactions in both countries' corporations.

Finally, when seen in conjunction with evidence of similar changes in other jurisdictions like the US<sup>470</sup>, this suggests that large corporations have undergone similar transformations regardless of operating in different countries.

#### **8.4.4. Both samples report an increasingly collaborative interaction between corporate tax and non-tax teams**

Another area featuring transnational corporate trends favourable to co-operative compliance is the interaction between corporate tax and non-tax teams, which was revealed to have become predominantly collaborative, leaving behind a more confrontational approach. This is favourable for co-operative compliance's validity because collaboration increases the tax teams' risk awareness and ability to prevent and/or control tax risk arising from different corporate operations, improves the quality of taxpayers' disclosures, and heightens the likelihood that agreements with the administration will be effectively implemented. Improved tax control frameworks can facilitate mutual trust and greater risk awareness contributes to better-focused co-operative dialogues.

Both samples' participants coincided in seeing the improved interaction between tax and non-tax teams as a recent change stemming from a conscious effort by senior management and tax teams to improve the relationship. Responses indicate that this was achieved by mirroring the collaborative dynamic present between regulators and regulatees under co-operative compliance: Tax teams rely on dialogue, portray themselves as partners offering support rather than as enforcers, and focus on proactive rather than reactive action. Being accustomed to these dynamics increases the regulatees'

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<sup>470</sup> Mulligan E and Oats L, 'Tax professionals at work in Silicon Valley' (2016) 52 Accounting, Organizations and Society 63

amenability to co-operative compliance and therefore increases this model's validity in both jurisdictions.

#### **8.4.5. In-house tax teams are increasingly focused on compliance**

Continuing with organisational factors favourable to co-operative compliance's validity, both samples reported that most of their internal tax departments' resources are devoted to compliance, rather than other tasks like tax planning and/or tax controversies. This is positive for co-operative compliance's validity because it suggests that regulatees prioritise compliance and because taxpayers might have more resources available to support self-regulation.

Considering that regulatee responses to other questions showed that they highly value compliance efficiency, a heavy allocation of resources to compliance heightens co-operative compliance's attractiveness, provided this regulatory approach fulfils its promise of reducing compliance costs by preventing tax disputes and providing legal certainty, reducing the intensity of tax investigations, and narrowing the scope of tax positions under discussion.

While UK teams spend on average 45% of their time on compliance, Colombian teams devote 58% to it. While this difference could be attributable to the high volume of filing and reporting required in Colombia and/or to the UK's higher use of automated systems and/or compliance outsourcing, several UK participants reported that co-operative compliance has contributed to reduce their compliance workload. This supports the idea that this type of regulation may reduce compliance costs.

The comparatively lower amount of resources allocated to tax disputes can also be positive for co-operative compliance's validity since interviewees

state that companies in both countries have adopted a settlement-oriented approach, something which matches co-operative compliance's non-adversarial philosophy. Furthermore, UK responses suggest that co-operative compliance effectively leads to a reduction in tax disputes.

Nevertheless, the samples also shared an aspect which is negative for co-operative compliance: Both samples' tax directors argued that, unlike that of their teams, their time is spent mainly on tax planning and disputes. Thus, it is possible that, rather than a reduction of tax planning, this activity continues under the tax directors' personal supervision. The concern is that these executives engage in planning that is aggressive or non-compliant but that is not disclosed under co-operative compliance either because its isolation from the broader tax team steers it away from internal risk controls, or because senior staff focus on using sophisticated schemes that reduce the likelihood of the administration discovering their inherent uncertainty. Therefore, it is essential that co-operative compliance programmes fully involve tax directors and their senior staff.

#### **8.4.6. UK tax director remuneration and evaluation practices reduce incentives for risk-taking and non-compliance, whereas those in Colombia prioritise maximising tax savings**

Corporate practices for remunerating and/or evaluating tax directors differ between samples, pointing to a higher validity for co-operative compliance in the UK than in Colombia. While most UK interviewees' corporations have shifted away from the use of tax-related KPIs or focus them on improving the predictability of tax outcomes and reducing tax contingencies, most Colombian corporations use tax-related KPIs and favour indicators focused on tax

expenses like ETRs, tax cash flows, or tax refund efficiency. While the proportion was reported to be growing, only a minority of Colombian interviewees stated that their companies use KPIs oriented towards reducing tax disputes or contingencies.

This difference is consistent with the findings about the tax objectives of corporations discussed in 8.3.4, since the Colombian corporations' prioritisation of profitability drives them to incentivise tax executives to minimise taxes and, conversely, the UK companies' focus on reducing tax risk leads them to encourage tax directors to be risk-aware and to reduce contingencies.

The UK companies' shift away from tax-expense KPIs and towards pre-tax indicators or non-tax minimisation indicators is positive for co-operative compliance's validity because it reduces the incentive for tax directors to engage in aggressive tax practices that may be non-compliant and because it encourages risk aversion and higher collaboration with the administration to reduce contingencies. In contrast, the practices described by most Colombian interviewees are negative for co-operative compliance's validity because they encourage risk-taking<sup>471</sup> that may lead to/or disregard non-compliance. The tax-minimisation mentality favoured by these KPIs creates a conflict of interest between taxpayers and the administration that damages collaboration and makes the relationship adversarial. However, since Colombian interviewees mentioned a growing trend towards de-linking tax savings from

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<sup>471</sup> See Taylor and Richardson, 'Incentives for corporate tax planning and reporting: Empirical evidence from Australia'

remuneration/evaluation of tax executives, it is possible that this factor's negative impact on co-operative compliance is eventually reduced.

#### **8.4.7. Corporate practices for supervising in-house tax departments are not positive for co-operative compliance's validity**

Both samples shared similar tax governance weaknesses related to the supervision of in-house tax departments that are negative for co-operative compliance's validity. According to interviewees, in-house tax departments are most often supervised and evaluated by the companies' finance departments. This is negative for co-operative compliance because the positive impact of having an outsider exercise control is reduced by the conflict of interest that is likely to arise between finance departments' prioritisation of profitability and the tax departments' ideal of focusing on compliance. Subordination to finance units increases the likelihood of tax departments adopting tax risks to reduce the tax burden, something contrary to co-operative compliance's desired regulatee mentality. Additionally, finance departments may object to co-operative compliance whenever collaboration with the authorities entails higher tax payments, incentivising selective disclosure and litigiousness.

Whereas this factor's negative impact is mitigated in the UK by the fact that the supervision of tax departments is occasionally shared by internal audit committees and by companies seeing risk reduction as an important tax objective, governance difficulties are exacerbated in Colombia because of the companies' focus on tax minimisation, a remuneration/evaluation system which encourages tax directors to adopt tax risks (see 8.4.6), and by interviewees there not mentioning the existence of audit mechanisms like those mentioned by their UK peers.

#### **8.4.8. The samples show differences regarding the involvement of corporate boards in their companies' tax affairs.**

An area where the Colombian sample showed organisational variables negative to co-operative compliance and the UK sample showed mixed results is the boards' involvement in their companies' tax affairs. Whereas 93% of UK interviewees reported their boards had a medium or high degree of involvement, 50% of Colombian interviewees stated that their boards showed little involvement and a further 13% stated that local boards were not involved at all, with HQ boards intervening only for highly material issues.

Boards provide a layer of control above senior executives<sup>472</sup> that is important for internal tax governance and which can arbitrate conflicts between tax and non-tax teams. While boards are not expected to participate in day-to-day, tactical, decisions, they play an important role in determining the corporations' tax culture by formulating and/or approving the company's tax strategy and setting the tone about the company's approach to taxation and its interaction with authorities. However, having an involved board does not guarantee a less aggressive and/or more compliant behaviour, since this depends on whether the board is compliant-minded, risk-averse, and if it shares co-operative compliance's premises<sup>473</sup>.

Thus, lower levels of involvement suggest that co-operative compliance's validity in Colombia is lower than in the UK because regulatees have weaker internal tax controls which complicate building trust with the administration and

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<sup>472</sup>Armstrong and others, 'Corporate governance, incentives, and tax avoidance'.

<sup>473</sup>Richardson, Taylor and Lanis, 'The impact of board director oversight characteristics on corporate tax aggressiveness: An empirical analysis' (2013).

self-regulating satisfactorily. Additionally, lacking a clear commitment from the top of the organisation to its collaborative engagement with the administration could weaken the relationship because tax teams might feel orphaned and non-tax teams would not receive a command to enhance their collaboration with tax teams and to collaborate with the administration. Additionally, the administration would miss a contact with enough seniority to commit the organisation to company-wide changes or to promote the model<sup>474</sup>.

While the UK's high board involvement, evidenced in previous studies<sup>475</sup>, appears to be connected to a higher risk aversion, its effect in relation to compliance is mixed because responses show that the boards' interest is primarily managing reputational risk and preventing negative publicity, not compliance itself. Therefore, boards might not censor non-compliance if they believe it will not be publicised. Additionally, several interviewees noted that the board behaved passively when confronted with tax positions, deferring to the judgment of the tax director without challenging it. Thus, the higher involvement of UK corporate boards can be positive or negative for co-operative compliance depending on the board's motivation and whether it supervises actively or passively.

### **8.5. Comparative analysis of findings regarding taxpayer perceptions of the tax administration and of the taxpayer-administration relationship**

A final group of variables to compare refers to the interviewees' perceptions of the tax administration and of their employer's relationship with it. Whereas the

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<sup>474</sup> See Netherlands Tax and Customs Administration, *Horizontal Monitoring Within: The medium to very large businesses segment*.

<sup>475</sup>Freedman, Vella and Ng, *HMRC's Relationship with Business*. Page 30.

UK sample displayed a combination of results which are positive, mixed, and negative for co-operative compliance's validity, Colombian responses were almost entirely negative. Most Colombian interviewees showed lower levels of trust in the administration than their UK peers, felt that administration's interventions were inadequate - whereas UK interviewees felt the opposite, had more negative views of the administration's staff's attitude and know-how, and its power, and shared equally negative perceptions about the administration's motivations and its business understanding.

While some of these findings are associated with contextual differences like the low level of trust in public authorities in Colombia or the high degree of political activism in the UK regarding corporate taxation, many of the results can be linked to the impact that experiencing (UK) or not experiencing (COL) co-operative compliance has on regulatees. In Colombia, where co-operative compliance is absent, many of the negative views held by interviewees relate to experiencing a confrontational, vertical enforcement regulatory approach that is not responsive. In the UK, while co-operative compliance's implementation has assisted in improving regulatee perceptions of the administration's interventions, the quality of its relationship with taxpayers, its trustworthiness, and mitigated the negative views held in relation to its power and the attitude and know-how of its staff, perceived difficulties with the programme have contributed to a deterioration of trust in HMRC and negative views about the administration's attitude and its business understanding.

### **8.5.1. Most interviewees rate their employers' relationship with the administration positively, but the justifications differ considerably between samples**

Most participants perceived their employers' relationship with the tax administration positively. Although the proportion of interviewees that held this opinion was practically identical (73% UK, 70% COL), the reasons behind this positive evaluation are considerably distinct in each country and, consequently, so is the effect on co-operative compliance's validity.

In the UK, this finding is favourable for co-operative compliance's validity because most regulatees feel that the relationship is positive because of improvements associated to co-operative compliance directly (e.g. P1UK), or to elements of it, particularly real-time dialogue about tax positions. Different interviewees believe that the relationship with HMRC is transparent (e.g. P27UK), and that considerable effort has been put in to build inter-party trust (e.g. P10UK). Nevertheless, multiple participants are also concerned that trust and the positive relationship with HMRC are being eroded because of problems with the co-operative compliance framework such as CRM turnover and inadequate business understanding, the BRR's being perceived as subjective and non-responsive<sup>476</sup>, and/or HMRC's unwillingness or inability to provide legal certainty. While not always held by a majority, these complaints are concerning for co-operative compliance's sustained validity in the UK because they refer to some of its core elements and, with the exception of the BRR, where HMRC launched a consultation aimed at redesigning the process and linking it with tax

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<sup>476</sup> As shown in chapter six, the author's supplementary quantitative analyses suggest that the interviewees' perceptions about the BRR's structural parameters not being adequate indicators of taxpayer behaviour are empirically supported.

control frameworks, because they suggest that policy measures aggravate or, in the best case, fail to address the model's flaws.

In contrast, Colombian responses have a mixed effect on co-operative compliance's validity because, while some interviewees did refer to factors which could be positive for co-operative compliance, like the importance of dialogue, proactiveness, and responsiveness, a large percentage of participants associated the relationship being positive with elements unfavourable for co-operative compliance: For some, the relationship was positive only because the regulator kept distant (e.g. P11COL), something which is detrimental for voluntary compliance<sup>477</sup>. For others, the engagement was positive because they received preferential treatment from DIAN, either because of the administration's dependence on the revenue they generate (e.g. P10COL), or because of these taxpayers' ability to use political power, trade association leverage, or networking to influence the administration into providing them better treatment or specific outcomes (e.g. P13COL). This is negative for co-operative compliance because it shows that the relationship is vulnerable to regulatory capture - something particularly dangerous in a context where corruption is thought to be present - and because taxpayers may believe that administrative responsiveness is not based on compliance or risk, but rather on revenue-generating potential.

While the interviewees' view of the UK's relationship as positive, especially in comparison to that in other jurisdictions where the administration is

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<sup>477</sup> See Braithwaite, Murphy and Reinhart, 'Taxation Threat, Motivational Postures, and Responsive Regulation'

seen as coercive or arbitrary, reinforces regulatees' motivations to remain within co-operative compliance, despite its flaws, the Colombian interviewees' opinion of their relationship with DIAN as positive because of factors like political leverage and regardless of their highly negative views of its capabilities and qualities suggests that taxpayers might have less incentives to support a change in regulatory approaches.

### **8.5.2. The levels of trust in the administration were significantly lower in Colombia than in the UK**

One of the findings that shows a strong contrast between samples is the interviewees' opinion about the tax administration's trustworthiness: While 70% of UK interviewees felt that HMRC is trustworthy, only 19% of Colombian participants felt the same way about DIAN.

Considering co-operative compliance's reliance on mutual trust as a driver for collaboration, reciprocity, and horizontality, the Colombian directors' critically-low levels of trust indicate that co-operative compliance would be very difficult to implement effectively because the taxpayers' drive to comply voluntarily would be eroded by the feeling that the other party in the relationship cannot be expected to reciprocate, is not an equal<sup>478</sup>, and by the perception of procedural unfairness associated with low levels of trust. Additionally, the connection between reciprocity and trust suggests that Colombian taxpayers would be more likely to engage in strategic behaviour like selective disclosure because they could view the administration's perceived untrustworthiness as a justification. In contrast, the high level of trust placed on HMRC by interviewees

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<sup>478</sup> Feld and Frey, 'Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation'.

is positive for co-operative compliance's validity because it reinforces taxpayers' intrinsic motivations to comply and enables them to view the administration as a partner.

Differences in the levels of trust between the samples can be associated with the existence of a co-operative compliance programme. This is evident in UK responses, and previous studies like that of Freedman, Vella, and Loomer suggest that taxpayers felt HMRC's shift towards a co-operative framework led to improvements in the relationship as early as 2009<sup>479</sup>. The differences also appear to be linked with contextual factors including a wide distrust in public authorities in Colombia versus high levels of trust in them in the UK (evidenced by the fact that only 17% of Colombian trusted the judiciary in tax matters whereas over 60% of UK interviewees did), and the perception of corruption, which was exclusive of Colombian responses.

Although co-operative compliance could improve trust in the administration in countries where vertical enforcement prevails, and this represents an opportunity in Colombia, it is doubtful that co-operative exchanges could function well with such low levels of trust to begin with. It is unclear whether co-operative compliance could generate enough trust to be self-sustainable, particularly in face of the foreseeable implementation difficulties for an administration with more limited resources, which would require a significant cultural transformation, and in a setting where social and personal norms are not necessarily tax risk averse and/or compliance minded. Moreover, the erosion of trust evidenced in several UK responses shows that, while co-

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<sup>479</sup> Freedman, Loomer and Vella, 'Corporate tax risk and tax avoidance: new approaches'. Page 86.

operative compliance can engender trust, it also creates higher expectations, so perceived flaws in its operation or changes in the administration's approach can severely damage the trust built by the model. Indeed, in addition to the challenge of improving low levels of trust, there is a subsequent challenge in preserving that newly-gained trust.

### **8.5.3. Most interviewees in both countries believe that the tax administration is not primarily motivated by ensuring compliance**

Another finding regarding perceptions of the administration shared by both samples and which is strongly negative for co-operative compliance's validity is that most interviewees (60% UK, 86% COL) believe that the tax administration is being driven by motivations other than ensuring compliance, which several of these participants view as the ideal 'public interest' goal. These include yield maximisation or appeasing the public and/or politicians.

While a significant proportion of both samples stated that the administration has yield maximisation as a primary objective, the percentage of Colombian interviewees (60%) holding these views is larger than that of UK interviewees (46.6%). A possible explanation is that, unlike the high levels of trust in HMRC and the feelings of horizontality and procedural fairness engendered by co-operative compliance, the command and control style of regulation favoured by DIAN, and critically low levels of interparty trust, make it easier for regulatees to feel that the administration prioritises revenue, even if this means behaving arbitrarily and/or exceeding its legal powers. Revenue collection is compliance's natural outcome; interviewees do not criticise administrations wanting to collect revenue, but rather that, in wanting to maximise it, they go beyond or against the law, acting arbitrarily, in a

confrontational, coercive manner. This perception is damaging for co-operative compliance because it questions the administration's trustworthiness since it is not seen to pursue public interest goals, and because it is viewed as engaging in non-collaborative, non-responsive, procedurally unfair behaviour, focusing on extracting revenue and not on collecting the tax due under the law.

In contrast to the Colombian sample's concern with revenue maximisation, UK interviews were characterised by the feeling that HMRC is trying to satisfy political preferences and/or media/public pressure, an idea which was not present in Colombian responses. This difference is likely to be associated with corporate taxation's lower public visibility in Colombia, which translates into reduced media coverage and less political exposure, other than generic policy discussions when a tax reform is looming. In the UK, corporate taxation and taxpayer-administration co-operation have frequently been at the heart of political discussion, and debates initiated by the Parliamentary Public Accounts Committee were sternly criticised by several UK interviewees<sup>480</sup>.

Perceiving that the administration pursues publicity as an agenda reduces co-operative compliance's validity because it erodes taxpayers' trust in the administration, and regulatees may view the administration acting arbitrarily rather than responsively. Additionally, taxpayers believing that co-operative compliance is not supported by the political establishment and/or the media, can experience concerns about confidentiality, public legitimacy and reputational

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<sup>480</sup> Political pressure on HMRC may worsen following the new round of parliamentary inquiries by the Treasury Sub-Committee in relation to the conduct of tax enquiries and the resolution of tax disputes. See <https://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/treasury-sub-committee/inquiries/parliament-2017/conduct-tax-enquiries-resolution-tax-disputes-17-19/>.

damage, and the model's sustainability which might drive them to retreat from participating.

The interplay between political debate and the technical implementation of co-operative compliance, explored further in chapter nine, is a fascinating subject because co-operative compliance's weaknesses in terms of public legitimacy require a level of public discussion to be addressed, and the model's horizontality and collaborative approach make impartial scrutiny important to prevent regulatory capture, but at the same time the administration needs to feel free to pursue its engagement with taxpayers knowing it is only answerable for departures from what is legally and technically correct, but not based on popularity.

**8.5.4. While most UK interviewees perceived the administration's interventions were adequate, most Colombian interviewees expressed mixed or negative views.**

Another dimension where the samples displayed significant differences pointing to an increased validity for co-operative compliance in the UK and a decreased validity in Colombia is views regarding the adequacy of the administration's interventions (e.g. audits, information requests, etc.). Whereas most UK participants felt that HMRC's interventions are adequate, most Colombian interviewees had mixed or negative opinions about DIAN's interventions

In the UK, positive responses referring to elements typical of co-operative compliance like risk-based responsiveness, dialogue, mutual understanding and interparty respect, suggest that co-operative compliance can enhance the legitimacy of administrative power, even where administrative resources are considered inadequate (e.g. P16UK). While some participants referred to a

deterioration of HMRC's interventions because of problems with legal certainty and political interference, these views remain a minority. The question is whether this minority will eventually grow and threaten the model unless these problems are tackled.

In contrast, most Colombian interviewees complained about DIAN's lack of responsiveness, describing it as 'biased' (e.g. P7COL) towards large taxpayers or specific industries, regardless of their behaviour, and accusing it of not directing its resources at those seen as persistently non-compliant. Participants referred to DIAN as 'aggressive' (e.g. P11COL), 'contentious' (P17COL), 'arbitrary' (e.g. P2COL), and stubborn, and felt prosecuted (P17COL). Unlike the UK, where insufficient resources were not seen as making HMRC's interventions inadequate, Colombian participants connected the administration's perceived lack of technical knowledge and commercial awareness with negative outcomes such as 'superficiality' (P23COL) and 'unpredictability and incoherence' (P4COL). Thus, Colombian responses show that, in addition to taxpayers' negative views of the administration's power, the administration is perceived as procedurally unfair, not trusting regulatees, and unsupportive. These views weaken voluntary compliance, thus limiting co-operative compliance's validity.

Although implementing co-operative compliance could contribute to improve perceptions of the administration's exercise of its power, and in that sense the situation evidenced in Colombia offers an opportunity, the scale of the changes the administration would need to undergo and the magnitude of the regulatees' negative opinions suggest that implementing this type of regulation there would be vastly challenging. Additionally, the fact that a portion of UK

interviewees felt that HMRC's interventions had not improved despite co-operative compliance or that they were inadequate because of failures in providing legal certainty and responsiveness indicate that implementing co-operative compliance may not always improve the quality of the administration's interventions or that, even when there are improvements, these may not be successfully maintained.

#### **8.5.5. Perceptions about the administration's staff's attitude and/or professional expertise are predominantly mixed or negative**

Both samples' assessment of the administration's staff's attitude and expertise revealed views that are not positive for co-operative compliance's validity.

While the samples' views were predominantly not positive, the largest cluster of UK responses (50%) voiced mixed opinions, whereas the largest cluster in Colombia (62.5%) expressed entirely negative views. Thus, even though co-operative compliance's validity is weakened in both countries because most interviewees do not perceive the administration's know-how and attitude positively, the damaging effect is larger in Colombia because there are fewer positive or mixed views to balance negative perceptions.

That significant portions of both samples felt that their administration's attitude and know-how was not consistently positive is damaging for co-operative compliance's validity because regulatees who view the administration as arbitrary and/or unfair are unlikely to trust it and commit to voluntary compliance, and because perceiving the regulator as having limited technical expertise makes regulatees question the administration's ability to regulate responsively and can encourage them to exploit this vulnerability via selective disclosure.

The larger percentage of negative Colombian opinions suggests that the taxpayers' detachment from the administration is greater there than in the UK, where co-operative compliance appears to have contributed to positive views of HMRC's attitude and/or know-how, or to views where negative aspects coexist with positive ones. Colombian responses can be linked to the existing adversarial tone resulting from vertical enforcement, to low levels of trust in DIAN, and to multiple interviewees' perception of it as unable to handle complex transactions and being biased against them. This is not surprising considering context-specific factors like an elevated perception of corruption in public authorities and an administration endowed with lower resources (relatively speaking) that may not always be enough to satisfy large corporations' expectations of technical expertise. Additionally, negative perceptions about the administration's attitude can be tied to the perception of it being driven by a desire to maximise collection at all costs, discussed in 8.5.3.

The largely negative or mixed views displayed in the UK were not expected in a jurisdiction where co-operative compliance operates. However, responses connect administrative bias with political pressure and a hostile environment where HMRC adopts a "hard line" approach to appease public attitudes towards corporations, which are portrayed by the media and politicians as suspicious and non-compliant. This shows that co-operative compliance is vulnerable to external influences and that the administration's responses do not necessarily correspond to taxpayers' behaviour. Thus, unless the programme is protected from political intervention (see chapter nine), its validity may be reduced in jurisdictions where corporate taxation is a politically-charged topic.

Thus, while findings suggest that the regulatees' perception of the administration can be better in contexts where co-operative compliance operates, they also indicate that negative perceptions can still be present after implementation and that mismatches between the regulatees' expectations about co-operative compliance and the reality they perceive can be as damaging as operating under a vertical enforcement model.

#### **8.5.6. The majority in both samples did not have a positive view of their administrations' business understanding**

Another finding where interview perceptions about the administration point to a negative panorama for co-operative compliance's validity in both samples is that most interviewees did not perceive the administration's business understanding positively. As with perceptions about the administration's attitude and know how (see section 8.5.5), mixed views prevailed in the UK, whereas negative ones did so in Colombia.

Perceiving that the administration' business understanding is poor is detrimental to co-operative compliance's validity because regulatees feel that the administration cannot act responsively if it does not have the knowledge necessary to profile them and calibrate its responses and/or that it will not be able to provide legal certainty after disclosure because it does not comprehend the full extent of the taxpayer's tax positions.

In Colombia, negative perceptions can be connected to the administration's relative lack of resources for hiring specialists and maintaining industry-specific teams, and an administrative culture where inspectors are trained to uphold an exegetic understanding of the law, rather than a contextual one. This issue, identified among others by P23COL, can be a serious obstacle

for co-operative compliance because providing legal certainty entails balancing the rule of law with the need to consider broader issues like the taxpayer's conduct during the relationship and what that means in terms of trust, reciprocity, or responsibility, what Gribnau calls 'de-juridification'<sup>481</sup>. It goes without saying that the solutions presented by the administration need to be within legal boundaries and that understanding that co-operative compliance involves non-legal as well as legal norms does not mean condoning any form of corruption or deals without solid legal foundations,

In the UK, while perceptions were not as critical, responses show that a significant portion of taxpayers are dissatisfied with HMRC's commercial awareness, despite the administration having ten years of co-operative compliance's disclosures, profiling, and taxpayer-CRMs' frequent interaction to enhance its taxpayer knowledge. This questions whether co-operative compliance's theoretical advantage in reducing interparty information asymmetry is verifiable. Moreover, the situation does not appear to have improved since 2014, when research by Freedman, Vella, and Ng showed that, although most interviewed corporate taxpayers felt that CRMs understood their business well, HMRC was seen as having serious issues with commercial awareness, particularly at the specialist level<sup>482</sup>. Responses show that perceptions have worsened, since many interviewees felt that the CRMs' business understanding was also inadequate.

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<sup>481</sup> Gribnau, 'Cooperative compliance: Some procedural tax law issues'.

<sup>482</sup> Freedman, Vella and Ng, *HMRC's Relationship with Business*. Pages 20-23.

Thus, while UK responses show that co-operative compliance may improve the administration's business understanding in comparison to an environment where non-responsive, vertical enforcement prevails, they also evidence that adopting this type of regulation may be insufficient to reach acceptable levels of administrative commercial awareness, particularly if there are difficulties with resourcing taxpayer-dedicated officials.

#### **8.5.7. Most interviewees in both countries view the administration as weak or partially weak**

A final finding regarding regulatee perceptions of the tax administration that is negative for co-operative compliance's validity in both countries refers to the taxpayers' opinion about the administration's power, understood as the ability to discover and act upon non-compliance. Like the findings discussed in 8.5.5 and 8.5.6, while both samples' majorities coincided in not perceiving the administration as strong, views were less negative in the UK than in Colombia, with 46.6% having a mixed perception (weakness in one dimension only or mixed in both), and 26.6% evaluating HMRC as weak, against Colombia's 29.4% mixed views, and 52.9% purely negative evaluations.

Whereas UK interviewees often perceived HMRC as weak regarding non-compliance detection, but not regarding its ability to act following detection, Colombian interviewees felt that DIAN was weak on both accounts. While the UK's perception is less negative than that of Colombia, the interviewees' view of HMRC's ability to discover non-compliance as weak, even after multiple years of co-operative compliance, questions whether the model has failed in delivering its promise of giving the administration greater regulatee insight, and whether its

introduction in countries like Colombia would improve administrative capabilities in this regard.

Co-operative compliance's responsiveness means that where there are doubts as to the administration's ability to discover non-compliance, there are doubts as to its ability to profile taxpayers correctly, to metaregulate, and to ensure all uncertain tax positions are discussed. Furthermore, a perception of weakness can impact co-operative compliance negatively by reducing the deterrence which might otherwise incentivise non-compliance-minded taxpayers to collaborate<sup>483</sup> and increasing the risk of selective disclosure. While recent research has linked excessive enforcement with decreases in voluntary compliance<sup>484</sup>, co-operative compliance has a better chance to succeed where voluntary compliance is strengthened by the belief that the administration will act sternly against non-cooperation.

Possible explanations for the UK sample's higher perception of administrative strength regarding action upon non-compliance include differences in administrative capabilities and the interviewees' perceiving that HMRC tends to prevail in litigation, since HMRC's approach means that it only litigates those disputes where it believes it has a very high likelihood of succeeding<sup>485</sup>. Additionally, the existence of multiple penalties associated to forms of tax behaviour other than evasion and a high level of trust in the judiciary might create the idea that discovered non-compliance will be penalised. In

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<sup>483</sup> See Osofsky, 'Some Realism About Responsive Tax Administration'.

<sup>484</sup> See Mendoza JP, Wielhouwer JL and Kirchler E, 'The backfiring effect of auditing on tax compliance' (2017) 62 *Journal of Economic Psychology* 284

<sup>485</sup> See HMRC, *Resolving Tax Disputes: Commentary on the litigation and settlement strategy* (2017)

contrast, in Colombia, a limited array of penalties and perceiving the judiciary to be untrustworthy might have the opposite effect.

## **8.6. Conclusion.**

The comparison between samples shows that there are transnational trends regarding tax director personal norms, as well as various organisational variables, that are positive for co-operative compliance's validity because they evidence a degree of ideological alignment between regulatees and the regulation, and between different aspects of the taxpayers' tax culture, the core values behind co-operative compliance, and its desired regulatee profile.

However, both samples share tax governance weaknesses related to the tax departments' subordination to finance departments and to the boards' exercise (or failure to exercise) an adequate tax control role which are negative for co-operative compliance. These flaws are magnified in Colombia where, unlike the UK, findings revealed remuneration and/or evaluation practices which incentivise tax executives to adopt tax behaviours contrary to co-operative compliance's ethos.

Furthermore, a comparison of the findings regarding social norms suggests that co-operative compliance's validity is lower in Colombia because the tax behaviour of tax directors and advisors is perceived to be mixed or aggressive, corporations are seen as prioritising maximising tax savings over compliance and/or risk reduction, and corporations are judged to be compliant under a narrow definition of the concept which does not account for behaviours other than evasion. This contrasts with UK views of corporations, tax advisors

and tax directors as broadly compliant, focused on risk reduction and compliance, and with mixed, but not uniform tax aggressiveness.

Similarly, while the UK sample balanced negative perceptions about the administration's capabilities and its attitude with positive views about the administration's interventions and about the taxpayer-administration relationship, Colombian interviewees held consistently negative perceptions of the administration and their positive views on its relationship with taxpayers were often associated with factors that are damaging for co-operative compliance.

Finally, comparing the findings indicates that having co-operative compliance in place does impact this type of regulation's validity, but not unidirectionally: While UK responses frequently associated co-operative compliance with improvements in the taxpayer-administration relationship, and even to changes in corporate tax culture including greater risk awareness, risk aversion, and reduced contentiousness, problems in its operation were also shown to have a significant negative impact on taxpayers' perception of the administration. Thus, while co-operative compliance's implementation in contexts like Colombia's, where vertical enforcement prevails, can assist in changing highly negative views about the administration and improve voluntary compliance, mismatches between the parties' expectations and the reality of the model's execution after implementation can erode those positive developments.

## CHAPTER 9

### NORMATIVE PROPOSALS

As shown in Part II, evidence from the UK supports the theoretical contention that co-operative compliance can improve the taxpayer-administration relationship by making it less contentious and more targeted. Results also showed that this model's experience is also associated with positive perceptions of different aspects of the administration, including its trustworthiness, which contribute to enhancing voluntary (non-enforced) compliance. Additionally, co-operative compliance's core elements were shown to coincide with Colombian and UK taxpayer ideals about the taxpayer-administration relationship. However, results also showed various issues that are eroding taxpayer trust in HMRC and in the model in the UK and the presence of different factors that could prevent co-operative compliance from having a positive outcome if implemented in Colombia under the current circumstances. Thus, this chapter presents a series of policy proposals designed to facilitate co-operative compliance by addressing the flaws evidenced in the UK, capitalizing on aspects which interviewees found positive, and/or which attempt to make co-operative compliance more aligned with the characteristics observed in taxpayers and their environment so that it could be applied in different jurisdictions.

#### **9.1. Co-operative compliance programmes should be designed to match the parties' previously-agreed upon expectations about the relationship**

Co-operative compliance can increase taxpayer trust in the administration and voluntary compliance. However, as evidenced in this thesis, mismatches between what the administration can provide and the regulatees' expectations can weaken that trust and may endanger the progress achieved in enhancing

compliance. Thus, it is vital for the regulation's success that parties agree about what the relationship can and cannot provide and about its costs and benefits before committing to it. Indeed, most of the UK interviewees' assessments of the taxpayer-administration relationship as negative or partially negative and the opinions of those who felt trust in HMRC was being eroded were closely related to gaps between taxpayers' expectations and the reality they perceived. Among others, there were clashes between the expectation of timely provision of legal certainty and HMRC's perceived unwillingness or inability to make decisions and between the expectation of horizontality and trust, and the perceived bias and suspicion felt in the administration's attitude.

The failure to match expectations can also be related to the perception of the programme's costs against its benefits. For example, for P11UK, there was frustration with co-operative compliance because '...it takes us a lot of resources to deal with real-time [disclosure and dialogue] and we don't see the benefits'. As discussed in De Widt's analysis of the Dutch Horizontal Monitoring, this can also affect the administration, since co-operative compliance has proven to be more resource-intensive than was initially thought<sup>486</sup>. While co-operative compliance can boost efficiency by reducing tax disputes, relying on more voluntary disclosures, and using improved knowledge about taxpayers to streamline discussions, it is not meant to reduce administrative staff costs. Training and maintaining taxpayer-dedicated staff is expensive and, while highly-compliant taxpayers will only require limited supervision, other taxpayers, particularly outside the scope of co-operative compliance, may need intensive

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<sup>486</sup> De Widt, *Dutch Horizontal Monitoring : The Handicap of a Head Start*. Page 4.

interventions. Thus, what co-operative compliance can do is allocate resources to taxpayers who cannot regulate themselves adequately, not reduce the need for staff. This is important to understand, both in a context of austerity in developed nations, and in emerging or less developed jurisdictions where resources are limited.

Matching both parties' expectations regarding the relationship has been understood to be crucial for the engagement's success in Denmark, where one of the programme's initial phases involves the parties signing a covenant and matching expectations<sup>487</sup>. Similarly, agreeing on mutual expectations before initiating the relationship is a crucial step in the Netherland's 'Horizontal Monitoring Meetings', one of the preliminary steps in Horizontal Monitoring<sup>488</sup>.

Since mismatches can occur both in relation to expectations about the ideal relationship and regarding what the parties thought would occur based on past engagements that were evaluated positively, measures should be taken to prevent this misalignment both prior and during the relationship:

- a.) **Engage in extensive consultations and focus on understanding regulatee behaviour and tax morale prior to launching:** When implementing co-operative compliance, empirical research on taxpayer tax morale and behaviour should be combined with extensive prior consultation and dialogue with taxpayers and practitioners. This can assist in making both parties' expectations about the relationship clear, allowing policymakers to adjust the characteristics of the programme to

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<sup>487</sup> Boll and Brehm, 'Corporate experiences with Cooperative Compliance in Denmark'

<sup>488</sup> Netherlands Tax and Customs Administration, *Horizontal Monitoring Within: The medium to very large businesses segment*. Page 23.

satisfy them or, alternatively, if this is not realistic, for the parties to agree on an alternative set of expectations that can be effectively matched. Doing this - and repeating it periodically - contributes to prevent an erosion of trust like that experienced by P23UK, according to whom aspects of the taxpayer-administration relationship were 'regrettable' because they were not 'the way in which they were set up to be'. Additionally, in-depth empirical research on taxpayers' tax morale and behaviour would contribute to build up administrative know-how necessary for calibrating responsiveness parameters. This is particularly useful in contexts like Colombia's, where a long-standing tradition of vertical enforcement and limited responsiveness has led to poor levels of knowledge about taxpayer's behavioural, organisational, and ideological characteristics beyond compliance history.

Sweden's experience serves as a reminder that insufficient initial consultation and a failure to communicate with the regulatees prior to launching the model risks failing to meet their expectations and stakeholders turning their back on co-operative compliance<sup>489</sup>. The need to socialize the proposed model with stakeholders and obtain their feedback is particularly important in jurisdictions like Colombia, where a long-seated tradition of adversarial regulation means that, when faced with a new type of regulation, actors could have substantially different preconceptions about the model's costs and benefits that would have to

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<sup>489</sup>Björklund Larsen, 'SWEDEN: Failure of a Cooperative Compliance Project?'. Page 45.

be harmonized with what the country's legal system, administrative resources, and other factors allow for.

b.) **Introduce the programme gradually:** Consultations and research on regulatees should be supplemented with pilots prior to the decision to launch co-operative compliance programmes so that there is an opportunity to assess in a real-life context the degree to which both parties' expectations can be fulfilled, anticipate obstacles, learn from those aspects which work positively, and calibrate policy accordingly. This is particularly relevant in jurisdictions like Colombia, where, as shown in this thesis, personal and social norms evidence a reduced risk aversion and/or compliance mindedness, and weaknesses in corporate governance that suggest weaker internal risk management and self-regulation. Additionally, because regulation there has traditionally been adversarial and vertical, profound changes in administrative culture would be required. Nevertheless, the possibility to test the parties' reaction to the policy and detect problems and positive experiences before full implementation benefits all types of jurisdictions. For example, before introducing its co-operative compliance programme, which is cited as positive, the Danish administration implemented a three-year pilot with a reduced number of companies<sup>490</sup>. Other jurisdictions which relied on relatively small pilots for their programmes include France and Slovenia<sup>491</sup>.

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<sup>490</sup> Boll and Brehm, 'Corporate experiences with Cooperative Compliance in Denmark'. Page 7.

<sup>491</sup> Cicin-Sain, 'A New Approach of The Croatian Tax Administration towards Taxpayers Based on Cooperation instead of Repression: A True Change in Attitude'. Page 856.

Moreover, using pilots can assist in adjusting administrative policy, even where co-operative compliance will not be implanted fully. For example, in Norway, following a successful two-year pilot, the administration opted not to switch to a formal co-operative compliance framework, but rather to maintain elements of its Central Office's collaborative approach and combine them with more-adversarial practices seen to enhance risk assessment and non-compliance management<sup>492</sup>.

Co-operative compliance does not need to be rolled out to the entire segment of large or very large taxpayers to prove successful. As experiences like Denmark's show, co-operative compliance can succeed even if directed at a reduced number of taxpayers, provided that the most important corporations, be it in terms of profit, employees or other tax impact indicators, are included. Thus, in jurisdictions where cultural adaptation will be more complicated and where resources might be more limited, co-operative compliance could be piloted or implemented at an initial stage with only 20 or 30 selected taxpayers which have a material impact on the total revenue and the tax system's administration. The downside to having limited-access programmes is reduced legitimacy, since the more exclusive the programme, the more likely it will be perceived as preferential and inequitable.

- c.) **Update the programme as needed:** Even where the parties originally agreed on the relationship's features, changes outside their control can derail co-operative compliance's dynamics by altering the benefits/costs

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<sup>492</sup> Brøgger and Aziz, *The setting for collaboration about tax compliance in Norway*

equation or the treatment received/given by the parties. Therefore, the administration should heed Black and Baldwin's call for responsive regulation to be "really responsive"<sup>493</sup>, obtaining constant regulatee feedback, performing periodic empirical research to detect problems with the relationship, and addressing issues promptly.

Updates might introduce complexity and uncertainty while participating actors adapt. This might impact co-operative compliance negatively in the short term; however, the medium and long-term impact of not undertaking the necessary changes is likely to be higher. The need for reviewing tax administration policies frequently is explained by Végh and Gribnau as follows:

Building and maintaining a robust tax administration is a very challenging task in practice. It requires constant adaptations to evolutions in the external environment which are triggered in particular by amendments to (tax) legislation, globalisation, changes in business models, and technological and social developments.<sup>494</sup>

The danger with remaining static is that the regulator cannot respond to changing circumstances or address problems which have arisen with the model. If this happens, regulatees may become fatigued of the relationship and change their posture from commitment to resistance, gaming, or disengagement<sup>495</sup>.

The problems identified by UK interviewees did not only stem from perceived changes like the decreased provision of legal certainty and a less

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<sup>493</sup> Baldwin R and Black J, 'Really responsive regulation' (2008) 71 *The modern law review* 59. Also, Black and Baldwin, 'Really Responsive Risk-Based Regulation'.

<sup>494</sup> Végh G and Gribnau H, 'Tax Administration Good Governance' (2018) 27 *EC Tax Review* 48. Page 1.

<sup>495</sup> See Braithwaite, Murphy, and Reinhart, 'Taxation Threat, Motivational Postures, and Responsive Regulation'.

trusting attitude towards taxpayers, but also from the absence of change, where change was needed. Thus, interviewees expressed their frustration at problems with CRMs (excessive turnover, inadequate know-how) and/or HMRC's business understanding that had been identified for many years<sup>496</sup> and persisted or deteriorated. On this note, while HMRC's initiative to launch a consultation for addressing the BRR's shortcomings is a step in the right direction<sup>497</sup>, the fact that it was launched years after these flaws were evident<sup>498</sup>, indicates that the administration's ability to adapt to dynamic circumstances was inadequate.

Another authority that has decided to reform its co-operative compliance is the Irish Revenue, which introduced in 2017 a new version of its programme, originally started in 2005, after a review showed that both parties were unclear as to relationship's procedure and the benefits involved<sup>499</sup>.

Reforms are expensive, and this introduces a problem where administrative resources are limited. However, provided the changes are efficient and evidence-based, it is to be expected that some or all of the costs are mitigated with revenue from enhanced voluntary compliance and/or that their cost is offset against the revenue losses which could arise from deteriorating compliance.

## **9.2. Addressing legitimacy issues and limiting political intervention is necessary to prevent public opinion and political interference's harmful effects on co-operative compliance.**

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<sup>496</sup> Refer to chapter six.

<sup>497</sup> HMRC, *Large Business Compliance -Enhancing our Risk Assessment Approach: Summary of Responses*

<sup>498</sup> Refer to Freedman, Vella and Ng, *HMRC's Relationship with Business*

<sup>499</sup> Duffy and Stapleton. Ireland's Cooperative Compliance Framework.

The current social environment can be said to be characterized by criticism towards large corporations because of their tax contribution<sup>500</sup>. Additionally, co-operative compliance's horizontality is easily mistaken by the public for a waiver of administrative authority, and the provision of legal certainty following cooperative dialogues tends to be confused with privilege or regulatory capture. Moreover, the availability of dedicated administrative officials and the possibility of discussing tax positions proactively or in real time, options normally unavailable for most taxpayers, may lead observers to single out co-operative compliance as creating a two-tier system of administration that contradicts equality before the law.

Excluding SME's from co-operative compliance can be controversial. As explained in chapter four, there are sound technical arguments justifying differential treatment, including the trade-off between the administrative cost of maintaining dedicated officials and assessing taxpayers' risk and amenability and SME's revenue-generating potential and the fact that SME's often lack the in-house resources and/or governance structures for the tax control frameworks necessary to operate under co-operative compliance. Regardless of technical correctness, the perception of unfair or inequitable treatment felt by non-participants is highly problematic because it damages co-operative compliance's public legitimacy. Thus, the implementation of this type of regulation should be accompanied by an effort to communicate that the selection of participants is not arbitrary and that the collaboration of large taxpayers can facilitate allocating

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<sup>500</sup> See Freedman J, 'Restoring Trust in the 'Fairness' of Corporate Taxation: Increased Transparency and the Need for Institutional Reform' in Goslinga S; van der Hel-van Dijk LM, P; Van Steenberghe, A (ed) *Tax and Trust: Institutions, Interactions, and Instruments* (Eleven Publishing 2018)

resources towards other segments like SMEs. Additionally, collaborative alternatives for this segment, such as the Netherlands' reliance on tax practitioners as assurance intermediaries, should be explored.

Concerns about co-operative compliance's potential for regulatory capture are understandable, since this type of regulation can create more opportunities for this phenomenon than traditional audit-based enforcement<sup>501</sup>. However, this type of regulation might be attacked as illegitimate or unfair, even where the programme's selectivity is not inequitable, outcomes are technically-sound, and the treatment afforded to participants is responsive and within parameters for administrative discretion. If co-operative compliance is seen as illegitimate by the society at large, corporate taxpayers which, as evidenced in both samples' responses, are highly sensitive to reputational risk, may refuse to participate (if participation is elective), or participate begrudgingly, in a non-committal fashion.

Additionally, the participants' confidentiality may be jeopardized when their specific tax positions are brought into question as part of the debate. While disclosure of the nature of taxpayers and their tax positions might increase the model's accountability and improve its legitimacy, it could disincentivise interparty dialogue and/or encourage selective disclosure, therefore damaging trust. Moreover, as evidenced in UK responses, excessive scrutiny and political interference can have a pernicious influence on the administration: Officials in charge of monitoring large corporations may cease to provide legal certainty and/or start to act arbitrarily to avoid becoming publicly criticised for participating

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<sup>501</sup> See section 4.4.1.

in co-operative programmes or adopting a specific interpretation, particularly where the outcome was one which would not necessarily satisfy the public, even if this is simply the consequence of applying the law. This generates an erosion of trust and changes in the taxpayers' assessment of the administration's exercise of power that weaken voluntary compliance.

Limiting political interference on the administration entails the difficulty that, while generally trust-eroding in relation to participating taxpayers and efficiency-damaging, political intervention can occasionally play an oversight function in controlling the administration's exercise of its discretionary powers and can, when supportive of the administration, increase its public legitimacy.

Gribnau and Végh describe this balancing act:

It is therefore important to rule out (daily) political interference in tax administration, especially in the handling of individual cases. However, while a higher degree of autonomy may help to improve the performance of the tax authority and its political neutrality, it may also undermine the tax authority's credibility in the absence of adequate rules on 'checks and balances'<sup>502</sup>

The idea of political control presumes that the administration needs external oversight and that politicians can effectively render such oversight, and these assumptions do not always stand. Thus, in contexts like the UK's, where corruption is low, the administration is relatively well-resourced, and there is a strong rule of law, the room for arbitrary behaviour is reduced (see 4.4.3). Additionally, because politicians and political organs are rarely highly specialised in tax law, and the codes followed in politics are not the same as those of law – political logic might look at electoral preferences and media impact rather than at fairness or compliance, political intervention is likely to have a

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<sup>502</sup> Végh and Gribnau, 'Tax Administration Good Governance' (2018). Page 4.

damaging effect. This concern about the lack of technical discussions in the political stage was highlighted by P25UK, according to whom 'The level of debate at the PAC has been very poor'. Similarly, P3UK felt that the PAC's concern was not compliance, but rather 'not being seen to cooperate with business'.

The administration is not beyond reproach. As shown in the UK Uncut case<sup>503</sup>, the administration may depart from protocol when dealing with significant tax positions, and the proximity and horizontality with participating taxpayers may lead it to consider extra-legal factors like the breakdown of the relationship and the administration's reputation when deciding how to treat a specific case. This justifies scrutiny. The author shares Freedman's opinion that preserving the administration's independence is not against accountability<sup>504</sup>. Indeed, the administration should be held accountable when it breaches the law since, as stated by Boer and Gribnau, co-operative compliance 'must not be seen as a way to pay less taxes than due according to the law'<sup>505</sup>. However, the process to review and/or challenge the administration's conduct under co-operative compliance exchanges should be eminently legal and technical, not political.

Tax regulation should be subject to political debate in relation to its objectives and its results, but this debate should centre on whether the approach is the best policy alternative or on proposals on how to improve it, not on

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<sup>503</sup> UK Uncut Legal Action Ltd v HMRC [2013] EWHC 1283 (Admin)

<sup>504</sup> Freedman. 'Restoring Trust in the 'Fairness' of Corporate Taxation: Increased Transparency and the Need for Institutional Reform' page 136.

<sup>505</sup> Boer and Gribnau. 'Legal Aspects of Behaviourally Informed Strategies to Enhance Tax Compliance'. Page 232.

approving or disapproving the outcome of specific taxpayer-administration dialogues. While determining if the administration conducted itself responsibly and fairly is a valid exercise and is essential to reinforce this approach's public legitimacy, it should only take place when there are reasonable grounds to suspect misconduct by one or both parties, and should be resolved by technical experts who examine the facts under applicable laws, not by the court of public opinion or by electoral logic.

Accordingly, jurisdictions implementing co-operative compliance should rely on a combination of strategies to increase the external stakeholders' understanding of how this regulation really operates and what its objectives are, and on mechanisms to prevent political interference in relation to the discussions, agreements, and disputes involving specific taxpayers. Specifically:

- a.) **Demystifying co-operative compliance:** In order to prevent difficulties with legitimacy, the administration needs to invest in communicating to the public and other stakeholders that co-operative compliance's ultimate objective is to increase compliance; that i.) It does involve the application of punitive measures where non-compliance or non-collaboration is present; ii.) That participants cannot operate in the programme without full disclosure; iii.) That the exercise of administrative discretion must be reasoned, evidence-based, and cannot be contrary to the legal system, and iv.) That while the regulator responds to each taxpayer differently, the treatment afforded corresponds to the differences in the regulatees' behaviour and characteristics, which have been assessed under pre-set, publicly-available parameters which condition access and participation to

proving satisfactory levels of risk, the ability to self-regulate, and alignment with co-operative compliance's principles. The objective is to dispel the notion that co-operative compliance is inherently unfair or inequitable.

Informing stakeholders about co-operative compliance is important not only for gaining external support, but also that of the administration, since some of the strongest resistance might come from members of the administration who feel that adopting this type of regulation means they will lose power, particularly where the prevailing practice has been vertical enforcement under a command and control style. As explained by Enachescu et.al in their account of the Austrian experience with a co-operative compliance pilot,

the acceptance or resistance regarding the paradigm change...may originate from uncertainty and misperceptions of its goals and strategies and from speculations, particularly by poorly informed members [of the administration]<sup>506</sup>

In jurisdictions like Colombia, where the administration has become accustomed to a regulatory approach based on vertical enforcement, the administration must endeavour to retrain its staff to prevent their adherence to coercive methods from becoming an internal obstacle. While this problem does not appear to have affected HMRC, other administrations in developed economies have faced internal resistance. Thus, De Widt reports that Horizontal Monitoring faced criticism from tax

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<sup>506</sup> Enachescu and others, 'Horizontal Monitoring in Austria: subjective representations by tax officials and company employees'. Page 1.

inspectors who felt that reduced audits would diminish the administration's awareness<sup>507</sup>.

The training offered to the administration's employees must extend to operational levels in addition to senior staff. As argued by Burton and Dabner in relation to the Australian and New Zealand experience with co-operative compliance, it is possible that a gap presents itself between staff at the operational level and more senior staff, with the former adopting less-collaborative approaches and the latter embracing the paradigm shift towards cooperation more wholeheartedly<sup>508</sup>. Unless all staff is familiarised with co-operative compliance, there is a risk that, while initiatives are well received by the upper echelons that are accustomed to dealing with policy and macro-regulatory decisions and who will engage in high level talks with corporate senior management, the staff that has to interact with the taxpayer on a daily basis and solve operational questions is not equally familiar with the model and sees it as impractical or contrary to their adversarial experience.

By educating parties and external stakeholders about the reality of co-operative compliance and the boundaries that it will have under each jurisdiction's legal system, the negative psychological effects that can arise as a consequence of uncertainty in the context of regulatory changes, and which damage voluntary compliance, can be prevented. Enachescu et.al describe these effects:

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<sup>507</sup> De Widt, *Dutch Horizontal Monitoring : The Handicap of a Head Start*. Page 21.

<sup>508</sup> Burton, J; Dabner, M. 'Lessons for Tax Administrators in Adopting the OECD's "Enhanced Relationship" Model - Australia's and New Zealand's Experiences'

Low commitment and resistance are often observed among those who feel inadequately informed about goals and change strategies...resistance and distrust can quickly gain traction in a climate of uncertainty, in which actors fear the unknown consequences of change<sup>509</sup>

**b.) Establishing boundaries between the political process and administrative practices in specific cases:** Depending on the legal system and its constitutional arrangements, insulating co-operative compliance from political interference could be done either by establishing legal boundaries, like rules excluding specific taxpayer cases from parliamentary hearings, rules strengthening taxpayer and/or administrative prerogatives not to be summoned or asked to provide certain types of information concerning their engagement, or by political convention. For example, in Colombia there are robust rules at the constitutional (art.15 Colombian Constitution) and legal level (Art.583 of the National Tax Statute) which forbid the tax administration from releasing information contained in taxpayers' tax returns to anyone other than a judge or a control authority (e.g. ombudsman). However, it could be necessary to introduce specific changes in the Constitution and in the organic law that regulates parliamentary proceedings (Law 5/1992) so that the ample authority granted to parliamentary commissions to summon any person or entity to produce testimony under oath and to question government ministers and administrative directors (like the head of DIAN) could not be used to breach the confidentiality of specific taxpayers in their dialogues with the administration or to attempt to review

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<sup>509</sup> Enachescu and others, 'Horizontal Monitoring in Austria: subjective representations by tax officials and company employees'. Page 4.

the outcome of administrative proceedings in a way which should be left to the judiciary and, possibly, to technical organisms like ombudsmen.

Limiting political interference is not about preventing debates around co-operative compliance's merits in abstract, or about the features characterising a specific programme; this debate is both desirable and necessary. The point is to prevent political debates from becoming a platform for non-technical attacks on the administration and/or taxpayers regarding specific co-operative compliance exchanges, what P27UK described as the PAC 'dragging up' and 'beating up' HMRC. In this regard, the author shares Freedman's concern with the role of the PAC and answers her invitation to question the 'need for a dedicated and expert tax institution to scrutinise and act as the bridge'<sup>510</sup> between the administration and the legislative by saying that the role of scrutinizing and, where necessary, questioning co-operative compliance's outcomes and/or the procedure followed, should be reserved to the judiciary and/or to the monitoring/auditing of technically-focused bodies. These bodies would be capable of deciding based on the law rather than on electoral preferences or other extra-legal considerations which characterize political debate.

**9.3. Co-operative compliance should rely on tiers, where administrative action is differentiated depending on taxpayers' risk, tax controls, governance and assurance, and regulatory amenability**

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<sup>510</sup> Freedman J, 'Creating new UK institutions for tax governance and policy making: progress or confusion?' (2013) British Tax Review 373. Page 380.

Co-operative compliance is closely linked to conditionality (the ability to influence regulatee behaviour by making the availability of certain benefits conditional on satisfying pre-set requisites or objectives), responsiveness, and self-regulation. Accordingly, full participation should be reserved to those taxpayers who have demonstrated that they are aware of their tax risks, have robust internal processes in place to manage risk and enhance compliance, are committed to compliance, and also evidence a tax behaviour, morale, and organizational characteristics that indicate compatibility with this type of regulation, what is referred to in 9.5 as “amenability”. Limiting participation and access to differential treatment to satisfying objective, verifiable, criteria is important to improve the model’s public legitimacy and strengthen its fairness by showing that, even though the treatment afforded to participants might be different than that of non-participants, said treatment is technically justified and equal to that of other taxpayers who display equivalent characteristics.

Allowing all taxpayers to participate in a full co-operative relationship, regardless of their profile, would deprive the regulator of the opportunity to influence taxpayers into improving their self-regulation, reducing their tax risk, building a compliance-minded culture, and shifting from an adversarial to a collaborative stance towards the administration. In contrast, where access is selective, and the criteria for selection are made aware to the taxpayers, regulatees can be prompted into adopting the necessary changes to fulfil these criteria in return for full co-operative exchanges.

While non-compliant taxpayers can benefit from intensive administrative interventions to improve their compliance, these interventions should have a different dynamic than those under co-operative compliance: When non-

compliance is intentional or due to gross negligence, administrative interventions should use coercive enforcement, a “penalty shock” to punish, maintain deterrence and strengthen other taxpayers’ resolve to comply, followed by a plan to instil a tax culture change in that taxpayer’s organization that prevents future non-compliance. This punitive approach can strengthen co-operative compliance’s validity by showing taxpayers that the administration is powerful, something which, as was evident in both samples’ responses, is often questioned by taxpayers who perceive that other taxpayers’ non-compliance is not punished.

Although satisfying the programme’s conditions might force the taxpayer to spend resources to improve their internal governance and tax controls, and corporations may not want to participate for reasons other than non-compliance (e.g. fear of confidentiality breaches), corporations have signalling compliance and/or a cooperative attitude to the administration as an incentive to participate and achieve a favourable assessment<sup>511</sup>. Additionally, improving controls and governance could reduce compliance costs and disputes, thus representing an investment for the taxpayer.

Having the opportunity to assess the taxpayers’ risk profile and their fit with co-operative regulation provides the administration with access to valuable information about the corporation’s governance, its approach to taxation, and the types of positions or areas where the company foresees a higher risk of non-compliance. Even where the taxpayers’ assessments indicate that they should not be admitted into co-operative compliance, the information obtained by the

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<sup>511</sup> Boll and Brehm, 'Corporate experiences with Cooperative Compliance in Denmark'. Page 14.

administration can be used both for taxpayer-specific, and for general administrative purposes. Thus, besides using the information to target its investigations and interventions, the administration can assist taxpayers on improving their self-regulation and adapt to co-operative compliance, something that would be particularly useful in contexts like Colombia's, where organisations may not be adapted to risk-based tax cooperation and/or may require capacity building in terms of self-regulation.

The proposal is to set up a tiered system where each tier would offer incremental benefits in line with improvements in the taxpayers' risk and amenability assessments and provide for a different focus and degree of intervention by the administration. Recalcitrant taxpayers should face intensive administrative intervention focused on penalising and subsequently initiating a culture change in the taxpayer's organisation. Once the taxpayer can prove that they are amenable to co-operative compliance (including having the intention to comply), they can move to a low-tier of co-operative compliance, where the administration is still heavily intervening, but doing so under a non-coercive approach and focusing on capacity-building. If taxpayers show an adequate capacity and amenability, they can move on to a proper co-operative exchange, where the administration supports self-regulation and provides legal certainty in return for full disclosure and collaboration in implementing agreed positions. Finally, taxpayers who have proven to work well under the co-operative exchange for more than one tax period can transition to an upper tier, with minimal administrative intervention, focused on metaregulation and maintaining the taxpayer's internal controls and compliance culture. This phase would be

similar to the US' Compliance Assurance Programme's (CAP) Compliance Maintenance phase<sup>512</sup>.The following diagrams illustrate:

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<sup>512</sup> Refer to the Internal Revenue Service's Internal Revenue Manual, Part 4, available in [https://www.irs.gov/irm/part4/irm\\_04-051-008#idm139704865402608](https://www.irs.gov/irm/part4/irm_04-051-008#idm139704865402608)

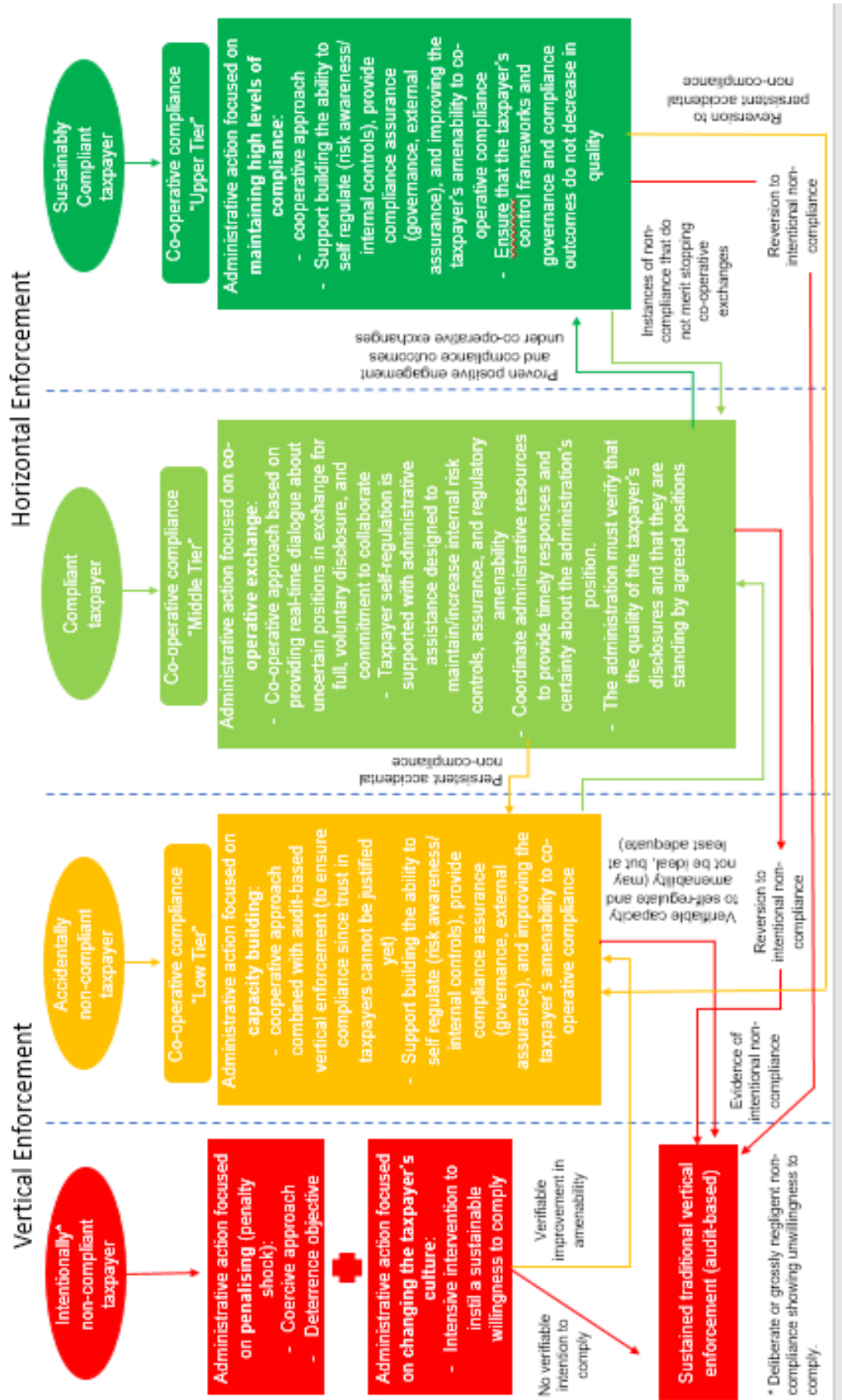


Figure 58 Operation of a proposed tiered co-operative compliance system

Co-operative compliance tiers	Coercive Vertical Enforcement	Low Tier	Medium Tier	Upper Tier
Characteristics				
Intensity of Intervention	Very high	High	Medium	Low
Frontline style of regulation	Coercive vertical enforcement	Collaborative vertical enforcement	Horizontal enforcement, supported self-regulation	Horizontal enforcement, meta-regulation
Specific objective(s)	<ol style="list-style-type: none"> <li>1. Taxpayer and systemic deterrence</li> <li>2. Tax culture overhaul</li> <li>3. Detection of non-compliance and prompting taxpayers to comply (Ordinary investigations and audits)</li> </ol>	<ol style="list-style-type: none"> <li>1. Capacity building regarding internal control framework and tax governance</li> <li>2. Strengthening compliance-mindedness and regulatory amenability</li> <li>3. Detection of non-compliance and prompting taxpayers to comply (Ordinary investigations and audits)</li> </ol>	<ol style="list-style-type: none"> <li>1. Facilitating the co-operative compliance exchange (disclosure for certainty)</li> <li>2. Verify the quality of taxpayer disclosures and compliance outcomes</li> <li>3. Maintain and increase taxpayer risk awareness and control, governance, and amenability.</li> </ol>	<ol style="list-style-type: none"> <li>1. Maintaining a healthy co-operative compliance exchange</li> <li>2. Using metaregulation to ensure that the taxpayer's control frameworks, governance, assurance, and amenability do not deteriorate.</li> <li>3. Verifying the quality of taxpayer compliance outcomes and disclosures.</li> </ol>
Expected taxpayer profile	Low amenability (including unwillingness to comply) High risk (may include low risk awareness, poor control frameworks, weak governance and/or assurance)	Medium/High amenability High risk, inadequate ability to self-regulate (low risk awareness, poor control frameworks, weak governance and/or assurance)	High amenability Medium/Low Risk (adequate ability to self-regulate, there might be room for improvement in controls, risk appetite, and/or assurance)	High amenability Low Risk High ability to self-regulate

*Figure 59 Comparison of the features of the different proposed co-operative compliance tiers*

The tier structure is not unidirectional, so if the administration detects that the quality of a taxpayer's internal/external tax control frameworks, their tax governance, their disclosures and/or the implementation of agreed-upon positions deteriorate, the taxpayer can be demoted to a lower tier or, in reiterated or very serious instances of non-compliance coupled with no intention to cooperate or comply, to the coercive intervention designed for non-cooperative taxpayers. This process of periodical evaluation could be like the one

recommended by the Netherlands Tax Administration in *Horizontal Monitoring*<sup>513</sup>.

Different mechanisms of accessing co-operative compliance's benefits have been used, among others, in Denmark<sup>514</sup>, where access is by invitation only, and in Ireland, where the reformed co-operative compliance framework is fully elective<sup>515</sup>. In fact, the UK is now one of the few jurisdictions where participation is not elective. As for the use of tiers, the United States' CAP and the Netherlands' Horizontal Monitoring provide examples of this approach.

A tiered access system can increase co-operative compliance's validity by nudging taxpayers towards the profile desired by the administration in terms of risk and governance, as well as encouraging a shift to a collaborative mindset. This last factor is particularly important in jurisdictions like Colombia, where the tiered system would allow for a gradual transition where the administration can adapt its culture and resource allocation while assisting taxpayers in moving from an adversarial vertical enforcement to horizontal collaboration. Additionally, the parameters for moving between tiers operate as guidelines for taxpayers, something which contributes to deal with the expectations mismatch issue highlighted in section 9.1. Moreover, these guidelines mean that the administration's discretion is bounded, thus limiting the opportunities for corruption or arbitrariness. This would ease some of the concerns voiced by

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<sup>513</sup> Netherlands Tax and Customs Administration, *Horizontal Monitoring Within: The medium to very large businesses segment*. Page 63.

<sup>514</sup> Boll and Brehm, 'Corporate experiences with Cooperative Compliance in Denmark'.

<sup>515</sup> Duffy and Stapleton, 'Ireland: Ireland's cooperative compliance framework'. Page 1.

Colombian interviewees, which would otherwise reduce co-operative compliance's validity.

Finally, a tiered system allows taxpayers to connect co-operative compliance with specific changes in their relationship with the administration and in their compliance needs. This means that one of the issues identified as problematic in UK interviews - and in the literature from other jurisdictions' experiences with co-operative compliance<sup>516</sup>, the difficulty to link participation in the programme with specific benefits and to associate administrative assessments with specific consequences, can be addressed.

#### **9.4. Co-operative compliance programmes should rely on taxpayer-dedicated administrative officials as points of contact**

One of the aspects signalled as part of an ideal taxpayer-administration relationship by both samples' interviewees is having an administration that possesses in-depth knowledge about the taxpayers' business, their organisation, and can interpret applicable tax rules within the taxpayers' specific operational context. Similarly, interviewees in both samples highlighted their preference for a relationship that is direct, based on real-time dialogue, and with a reduced number of intermediaries.

Achieving these objectives is difficult where the administration's staff is assigned multiple tasks and officials must change their focus from one taxpayer

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<sup>516</sup> De Widt and Oats, 'Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison' and Boll and Brehm, 'Corporate experiences with Cooperative Compliance in Denmark'.

to the other frequently, or where the administration's supervision of a taxpayer is shared by multiple divisions within the regulator.

In contrast, where administrative officials are tasked with handling one or a limited number of corporations, it can be expected that having more time to spend on continuous exchanges with a specific taxpayer will increase that official's knowledge of the taxpayer, of the industry in which they operate, and of their often-specialised applicable tax rules. Thus, the administration can gain the necessary understanding of the regulatee to be truly responsive, something which is fundamental for co-operative compliance, and which both UK and Colombian interviews demonstrate is a key concern for large corporate taxpayers.

Moreover, having a single official be the taxpayer's point of contact means that the corporation's tax director and the in-house tax staff can build a personal relationship with this official, something which favours the creation of an emotional bond that reduces the social distance between the parties, increases trust, and consequently, strengthens co-operative compliance. The psychological benefit of having a dedicated official should not be understated, because taxpayers who see that the administration has invested in assigning an official specifically to their supervision can feel that they are respected and that, through their dialogues with him/her, they have a voice, both factors that enhance procedural fairness<sup>517</sup>.

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<sup>517</sup> Hartner M and others, 'Procedural Fairness and Tax Compliance' (2008) 38 *Economic Analysis and Policy* 137.

Additionally, dedicated administrative officials can increase co-operative compliance's efficiency by providing taxpayers with a permanent point of contact, meaning they no longer spend resources and time acquainting different officials with their business model and their particular tax profile. Similarly, these officials can increase the administration's efficiency by taking ownership of the relationship and using their awareness of the taxpayer's characteristics to direct/coordinate other staff within the administration when addressing said taxpayer.

Coordination between dedicated administrative officials and other staff within the administration is a difficult aspect to manage, since the benefits described above must be balanced against the need to have specialists intervene when dealing with the complex tax questions typically posed by large corporate taxpayers. As described in chapter six, one of the main complaints from UK taxpayers in relation to CRMs is that they are perceived to be 'post-boxes', having to refer all complex queries to specialists, who then relay an answer back to them, without them having the power to intervene. When this is the case, co-operative compliance's efficiency can be damaged because of the loss of immediacy, but most importantly, taxpayers' trust is eroded if they feel that the personal connection with the dedicated official and their ownership of the relationship is replaced by an institutional procedure, where the specialists are not familiar with their specific circumstances and with how the relationship has evolved. Furthermore, unless specialists are routinely involved in co-operative compliance and these are familiar with and agree with this approach, their intervention might sabotage the relationship by introducing adversarial elements. Indeed, recent evidence suggests that staff from the administration

that does not participate in co-operative compliance can have ideas highly opposed to this type of regulation<sup>518</sup>. However, dedicated officials cannot be experts in all areas, and providing legal certainty regarding highly complex transactions or positions involving niche areas of the law requires the intervention of other units in the administration. Moreover, even if the dedicated officials have enough know-how to be able to answer all types of queries, resolving them without the intervention of anyone else in the administration could lead to inconsistent results in similar cases handled by different officials, something which would trigger problems with equality before the law and impede interpretative harmonisation for the administration. Finally, while efficiency-reducing, having other officials intervene can reduce the incidence of regulatory capture and corruption.

Thus, a balance involves leaving the authority on the content of the decision to the specialists while maintaining the dedicated administrative official as an integral part of the team dealing with all the taxpayer's queries. Even if the decision does not always come from them, taking part in the analysis means that their know-how about the taxpayer can assist specialists in their judgment, and that once a decision is reached, they can explain it to the taxpayer and try to coordinate its implementation, thus preserving cooperation. This is summarised well by P20UK who praised their CRM for being pragmatic in intermediating: '[he/she] may not be the expert but knows how to talk to the experts. We have been lucky'

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<sup>518</sup> Enachescu and others, 'Horizontal Monitoring in Austria: subjective representations by tax officials and company employees'.

That several of the UK's interviewees complained about issues with their assigned CRMs, including excessive CRM rotation, shortcomings in business understanding, and, most importantly, CRMs lacking the authority to provide timely legal certainty, should not be taken as an indictment of this type of officials. Indeed, consistent with previous UK research<sup>519</sup>, most of these interviewees highlighted the CRMs' positive contribution to the relationship and stated that they valued their approachability and their desire to make the exchange more efficient, supportive, and fluid. What these critiques show is that, regardless of the lack of audits and reduced disputes, co-operative compliance entails difficulties in administrative allocation of resources and that CRMs are affected by the bigger issues this type of regulation faces regarding the timely provision of legal certainty.

However, the difficulties associated with dedicated officials should not be dismissed: Relying on a specific individual to intermediate between the corporation and the administration risks personalising the relationship in a way that increases the model's vulnerability to regulatory capture, and which also makes it highly dependent on the quality of the personal connection between the official and the corporation. In Boll and Brehm's words:

[in collaborative relationships] the personal competencies seem to get more weight as tax compliance is to be accomplished through relational and dialogue-based collaborative arrangements.<sup>520</sup>

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<sup>519</sup> See Freedman, Loomer and Vella, 'Corporate tax risk and tax avoidance: new approaches' and FreedmanVella and Ng. *HMRC's Relationship with Business*

<sup>520</sup> Boll and Brehm, 'Corporate experiences with Cooperative Compliance in Denmark'. Page 46.

A high personalisation of the relationship can be a risk, both for the engagement's sustainability following personnel changes, and for regulatory capture. Interparty proximity can create opportunities for outright corruption and, even where no collusion is present, a loss of perspective for the official, who may lose the ability to assess the taxpayer objectively. Thus, there is a challenge in giving taxpayers permanent access to a specialised and approachable official, while preserving this figure's independence and the relationship's institutional strength.

In the UK, corruption was not pointed out by interviewees as a pressing concern. In contrast, in Colombia, where interviewees often referred to administrative corruption, introducing dedicated officials would face the challenge of an increased possibility of corruption and regulatory capture. However, regulatory capture can be present in both types of contexts because it occurs not only following overt attempts by the taxpayer to corrupt the tax officer (or vice-versa), but also more subtly, with constant interaction between the parties leading to a situation where a tax officer begins to adopt the taxpayer's interpretations of the law and their way to approach tax without questioning them. This is more likely to take place whenever there is a considerable asymmetry in the resources available to the taxpayer and the administration and where the dedicated officer is not experienced. Thus, UK interviewee responses like those of P25UK, according to which experienced tax directors would 'run rings around' inexperienced CRMs, are concerning.

A separate difficulty is administrative resourcing, since dedicated officers must be experienced and well trained in skills like risk assessment, capacity-building, and negotiation in addition to having the know-how to deal with large

corporate tax issues. Training and retaining this type of officials is a difficulty not only in emerging markets and low development nations, but also in advanced economies where the public sector is constantly being reduced to cut down on government expenditure. Indeed, multiple UK interviewees like P36UK and P18UK stated that they felt HMRC had resourcing difficulties. As explained in previous sections, co-operative compliance should not be mistaken for a cost-savings mechanism; while there are savings in potential reductions of disputes and in better-targeted audits and responsive interactions with participants who need less direct supervision, training and maintaining taxpayer-dedicated officials is expensive, and under a tiered system taxpayers in lower tiers require intensive interventions to improve their ability to self-regulate and their amenability. Thus, co-operative compliance should not be viewed as an austere alternative for tax regulation, but rather as a mechanism to improve the allocation of existing resources.

When thinking of emerging markets or developing nations, co-operative compliance can be introduced gradually to mitigate the impact on the administration's resources. Other alternatives include assigning two or three corporations to each officer and relying on intra-sector expertise to allow officers to work with different taxpayers operating in the same industries. In relation to regulatory capture, officials would need to undergo internal auditing (ideally ex post-facto so as not to incur in the difficulties with providing legal certainty that were described by UK interviewees as a consequence of HMRC's increased bureaucracy) and be rotated after three or four years of working with one company. If the officials are rotated only within the same industry sector, or at least fairly similar sectors, this would allow for their know-how not to be lost.

### **9.5. Access to co-operative compliance should be conditional on assessments regarding the taxpayer's risk and their compatibility with this model's ethos**

As revealed in UK interviews, taxpayer perceptions about the way in which the administration profiles them for determining its response to them can be an important source of discontent and/or scepticism towards the administration and are particularly important for co-operative compliance's validity, given this regulatory model's responsiveness. Thus, the administration's ability to tailor its responses using objective, reasonable parameters that enable an efficient allocation of resources but which are also considered fair by the taxpayers and other stakeholders is arguably one of the core factors in determining the level of trust taxpayers have for the administration, and how powerful they deem it to be.

Whilst dissatisfaction with the outcome but not with the parameters for the administration's regulatee assessment might lead taxpayers to alter their behaviour to match what the regulator intended and therefore obtain a better administrative response, disagreements with the assessment itself might drive taxpayers to cease collaboration, therefore incentivizing non-compliance<sup>521</sup>.

#### **a.) Risk Assessment**

Relying on compliance-risk as the primary element to calibrate administrative responses allows the administration to anticipate instances of non-compliance and attempt to prevent their occurrence by increasing its interventions where necessary or, alternatively, by supporting taxpayer self-regulation, where internal control and governance are robust. As explained in section 9.3, this

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<sup>521</sup> Freedman, *Responsive Regulation, Risk, and Rules: Applying the Theory to Tax Practice*. Page. 640.

means that the administration does not have to perform in-depth investigations on the generality of taxpayers and can allocate its resources more efficiently through metaregulation<sup>522</sup>, leaving resource-intensive traditional enforcement for high risk and/or low amenability taxpayers. Additionally, as argued by Oats and DeWidt<sup>523</sup>, focusing on risk enables the regulator to capitalize on other corporate governance regulatory systems focused on risk management such as the UK's SAO rules, or the US' Sarbanes-Oxley regulations.

Provided that the programme's benefits are clearly outlined to taxpayers and match their expectations, by setting up taxpayer risk as a key component of its responsiveness assessments, the administration can benefit from taxpayers' efforts to improve their tax control frameworks<sup>524</sup> and amenability to accede to a higher tier of co-operative compliance.

Based on the results of this thesis' interviews, risk and uncertainty are a major concern for corporations and corporate tax directors both in the UK and in Colombia, minimizing risk is often seen as a primary professional objective by tax directors, and there are transnational trends that point to an increased risk awareness and aversion by large corporations. Thus, by relying on a corporation's approach to tax risk to calibrate its interventions, the administration can boost taxpayer cooperation by harnessing the parties' mutual interest in reducing risk.

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<sup>522</sup> Braithwaite, 'Meta Risk Management and Responsive Regulation for Tax System Integrity'.

<sup>523</sup> De Widt, 'Risk Assessment in a Co-operative Compliance Context: A Dutch-UK Comparison'.

<sup>524</sup> Enachescu and others, 'Horizontal Monitoring in Austria: subjective representations by tax officials and company employees'.

While administrations implementing co-operative compliance should make use of non-compliance risk assessments as a primary responsiveness criterion, assessing risk will inevitably be complicated, since the parties are likely to disagree on what constitutes a risky tax position, corporations differ on their procedures to assess risk (e.g. Colombian corporations were shown to prefer flexible, less-structured risk analysis procedures than those in the UK), and, as evidenced in UK responses, the regulatees might object to the benchmarks used to qualify or quantify a taxpayer's riskiness and/or the way in which these are applied to them. Indeed, as shown in this thesis' analyses of the UK's BRR, the association between many of the benchmarks used to score a taxpayer's risk, such as a corporation's size, and actual compliance may prove not to be consistently reliable. Thus, the recommendation is to rely more heavily on indicators based on past and present tax behaviour, on the taxpayer's individual actions or omissions in terms of tax governance and setting up robust tax control frameworks, and the taxpayer's willingness to disclose, discuss with the administration, and implement recommendations (amenability). While structural factors like size, business complexity, and industrial sector can signal a greater opportunity for non-compliance, they can - and often are- offset by the greater resources spent in risk management and IT systems, the greater depth of in-house tax staff, availability of tax advisors, and the higher sensitivity to reputational damage that these regulatees exhibit.

Finally, it must be emphasized that a taxpayer's risk level does not only respond to its behaviour and its control frameworks and governance, but also to its risk appetite. This is particularly important since interviews revealed that in both countries it was the reputational consequences and not compliance itself

that worried corporate taxpayers the most, meaning that corporate taxpayers could be engaging in superficial or cosmetic compliance<sup>525</sup> and still adopt non-compliant positions deemed to have a low risk of being discovered. Moreover, the association between co-operative compliance's reduced potential validity in Colombia and the presence of risk-taking incentives in tax director remuneration and evaluation and risk-inducing personal and social norms, indicates that if co-operative compliance was to be implemented there, the taxpayers' risk assessments would have to be especially thorough in order to prevent the programme from being exploited by high-risk taxpayers.

#### **b.) Amenity assessments**

When co-operative compliance's responsiveness assessments focus solely on evaluating the taxpayer's likelihood of non-compliance, like HMRC's BRR, the regulatory approach fails to recognize that different taxpayers having similar compliance risk assessments might exhibit important differences regarding how responsive they are to co-operative compliance. These differences mean that collaborating with taxpayers with a higher compliance risk and a better fit to co-operative compliance could yield better outcomes than doing so with lower compliance risk, but lower regulatory-fit subjects. Different taxpayer characteristics can make corporate taxpayers less prone to operating well under co-operative compliance. Some examples include having an adversarial approach to the administration, a highly formalistic and strategic understanding of the law, incentivising tax directors to take tax risks, a record of fractious

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<sup>525</sup> For a similar notion of 'calculated minimal compliance' refer to Gribnau H, 'Voluntary Compliance beyond the Letter of the Law: Reciprocity and Fair Play' in Peeters B; Gribnau, H; Badisco, J (ed) *Building Trust in Taxation* (Intersentia 2017). Page 19.

interactions with the administration, operating under a tradition of secrecy, and having low levels of trust in the administration and/or negative opinions about its technical expertise and attitude.

Therefore, regulators implementing co-operative compliance should add to their risk assessment of taxpayers a second layer of analysis, focused on factors associated with a lower or higher likelihood of effective cooperation. Provided participation in co-operative compliance was selective and tiered (as explained in 9.3), this could be an effective way to condition taxpayers' behaviour and to restrict access to co-operative compliance to those taxpayers showing a greater degree of alignment with the model and a greater possibility of seeing the program yield benefits - what Black and Baldwin call 'amenability'<sup>526</sup>. As shown by the findings, it is likely that amenability analyses would have negative outcomes for many of the taxpayers in Colombia, where corporations were often shown to have weaker governance structures, a highly critical opinion of the administration, and a tradition of adversarial approaches to the administration.

While adding an analysis of each taxpayer's likelihood to operate well under co-operative compliance introduces an element of subjectivity and administrative discretion which can generate a feeling of procedural unfairness among taxpayers – subjectivity was one the UK respondents' main complaints- and possibly increase litigiousness from those who see themselves excluded or demoted to a lower tier, it can assist in allocating limited administrative resources. Additionally, it can diminish the risks of regulatory capture by

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<sup>526</sup> Black and Baldwin, 'Really Responsive Risk-Based Regulation'. Page 191.

excluding those more likely to have a strategic, self-interested behaviour from access to the most horizontal, trust-based tiers where metaregulation prevails. These benefits are particularly important in contexts like Colombia's, where weaker internal control frameworks and an adversarial mentality might complicate corporate adaptation to co-operative compliance, and where the administration would need to be particularly careful about being exploited. However, an amenability analysis can also be valuable in jurisdictions that have more experience with co-operative regulation because, as shown in several UK interviews, some seemingly-low-risk corporate taxpayers might be seeking to exploit the relationship by selectively disclosing and complying only superficially.

#### **9.6. The agreements about tax positions reached between participating taxpayers and the administration should be legally binding**

The interviews from both samples showed that, regardless of the context, corporate taxpayers and their tax directors place a high value on certainty and predictability. Considering co-operative compliance's promise of offering taxpayers legal certainty in exchange for transparent disclosure, the taxpayers' elevated interest in managing uncertainty is clearly one of the main factors supporting the argument that there is an ideological alignment between regulatee expectations and the premises of co-operative compliance that makes this type of regulation attractive, even in different socio-economic and legal contexts.

However, drawing a balance between an adequate provision of legal certainty - providing a timely answer to taxpayers, allowing the administration to analyse each case thoroughly, and the need to preserve the rule of law against

corruption or arbitrariness whilst maintaining responsiveness is one of the most complicated challenges faced by co-operative compliance.

Indeed, UK interviews and literature about other jurisdictions' experience with co-operative compliance reveal that one of the main factors taxpayers focus on in assessing whether their participation is beneficial to them is the administration's ability to provide them with timely answers to their queries about tax positions and whether they can rely on these responses subsequently.

Co-operative compliance's demand for taxpayers to provide full disclosure about their material tax positions and about the variables that will be assessed in profiling the taxpayer mean that the administration benefits from a reduction in the information asymmetry which is often present between sophisticated taxpayers, who control the financial information regarding their business, and the administration, who must rely on third party reports, self-reporting, or enforced information requests. This creates an imbalance in the parties' benefits associated to the timing of disclosure: whereas the administration benefits from the relationship as soon as the taxpayer discloses information -assuming the information is accurate, the disclosure does not immediately benefit the taxpayer, since they must wait for a risk/amenability assessment to accede the programme and/or enjoy the advantages afforded to low-risk taxpayers, and for the administration to produce a timely answer to their queries and provide legal certainty.

Thus, when the administration delays in providing responses, fails to provide them, or, when the response is later found to be unreliable - e.g. if the administration reneges on its word or a different authority overrules it-, it is to be

expected that participating taxpayers who have already fulfilled their end of the bargain feel that they have been manipulated. As evidenced in multiple UK responses which expressed dissatisfaction with HMRC's provision of legal certainty, this feeling strikes at the core of co-operative compliance as reciprocal and collaborative, and can damage perceptions of procedural fairness and trust, thereby limiting voluntary compliance.

However, there are multiple reasons for wanting to limit the binding nature of the acts whereby the administration states its interpretation of a tax position, particularly where an advance clearance is provided. These include the complexity of the positions adopted by sophisticated corporate taxpayers, the possibility that taxpayers provide inaccurate, false, or incomplete information, the material consequences of the administration's determinations in terms of revenue impact, and the need to preserve systemic coherence and equality under the law. Furthermore, the existence of a possibility for the administration to renege on its earlier statements could increase co-operative compliance's legitimacy among external stakeholders worried about mechanisms to control administrative error or intentional misuse of power.

Working without the administration's statements about a taxpayer's tax positions being legally binding might function in jurisdictions where there is a high level of trust in the administration and a highly established rule of law that would allow for the taxpayers to feel comfortable about the administration standing by its word. For example, this seems to be the case in Denmark<sup>527</sup>. However, the experience described by UK interviewees shows that even in

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<sup>527</sup> Boll and Brehm, 'Corporate experiences with Cooperative Compliance in Denmark'.

contexts where trust in the administration is high, taxpayers still fear that the agreements they have reached with the administration will not be relied upon if the administration is not legally bound to follow them, or if their binding nature can be easily overruled by other authorities. Considering the materiality (revenue impact) of the tax positions often discussed by large corporations, their technical complexity, and that each taxpayer's circumstances are likely to be unique, it can be expected that the conclusions reached by the administration will often be difficult to accept by external stakeholders such as the public, NGOs, and politicians. As mentioned by multiple UK interviewees, this often leads to political interference in a way that influences administrative behaviour but not because the administration is held accountable after a technical review, but rather because it is pressured by populism and sensationalism.

In a context like Colombia's, low trust in the administration and a high perception of corruption work in opposite directions: informal agreements<sup>528</sup> (non-legally binding) would most likely be rejected by taxpayers for being too uncertain (most taxpayers would not trust the administration to abide by its commitments without the *obligatio iuris*) but, at the same time, making agreements legally binding and bullet-proofing them against reversal would appear to be too risky in terms of losing the ability to control the administration in the face of regulatory capture and outcomes contrary to the rule of law.

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<sup>528</sup> In this context, an 'agreement' refers to the mutual understanding reached by the parties about how a specific tax position will be interpreted by the administration, not to a document where the taxpayer and the administration commit to collaborating under co-operative compliance (as would be the case in systems like that of the Netherlands which rely on the so-called 'covenant'). In the case of countries like the UK, where participation is mandatory, there is no negotiated document stipulating the conditions for the parties' collaboration.

The solution does not appear to be in limiting the possibility to reach agreements. As shown in the UK interviews and in the literature discussed in chapter four, discretion-restricting policies, which include the UK's Litigation and Settlement Strategy and Denmark's Case Handling Guideline<sup>529</sup>, have had a considerably negative effect on co-operative compliance's dynamics because the taxpayer-dedicated administrative officials find themselves lacking the authority to commit the administration to a given interpretation of the law or having to wait prolonged periods of time to receive clearances from other officials. While well-intended in terms of addressing regulatory capture and improving accountability and public legitimacy, these policies carry an implicit message that one or both parties cannot be trusted, something which conflicts with co-operative compliance's premises.

An interesting side question here is the role of supranational authorities, because even if the domestic legal system manages to create sensible rules to oversee the administration's exercise of power within the context of co-operative compliance, supranational organs could seek to challenge the taxpayer-administration agreements, particularly regarding international tax positions. As argued by Szudoczky and Majdanska<sup>530</sup>, this is a clear concern for EU countries, where agreements could come under attack under the guise of State Aid rules, if they are found to confer a competition-distorting selective advantage to the taxpayer. Whilst this might not be a key issue in jurisdictions like Colombia, where the intervention of a supranational authority would be less likely - although

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<sup>529</sup>Ibid. Page 75.

<sup>530</sup> Szudoczky and Majdanska, 'Designing Co-operative Compliance Programmes: Lessons from the EU State Aid Rules for Tax Administrations'

not impossible, considering the role of the Andean Tribunal, the requirement to exchange information concerning taxpayer-specific rulings which could give rise to base erosion and/or profit shifting concerns under Action 5 of the OECD's BEPS minimum standards means that, regardless of the intervention of supranational authorities, there is still a possibility that decisions made within the context of co-operative compliance dialogues are disclosed outside the jurisdiction where they were produced and that they could lead administrations elsewhere to take actions for or against the taxpayer that were unforeseen by both parties in the relationship. This could deter participants from disclosing these types of issues and/or the administration from providing certainty in relation to them.

Considering the above, the author believes that the administration's views regarding specific tax positions which are communicated to the taxpayer during co-operative compliance need to be legally binding on the administration. This is necessary to protect the legitimate expectations that taxpayers understandably acquire following their disclosure and co-operative dialogue. This would endow them with the legal certainty and predictability shown in interview responses from Colombia and the UK to be highly important for corporations and tax directors and is which essential to maintain taxpayer trust in the administration and in the relationship, and therefore bolster voluntary compliance. This protection against arbitrary changes in the administration's positions is particularly important in contexts where there is low trust in the administration, but it is also important in jurisdictions where, despite having a more established rule of law, there is a higher likelihood of the administration

being pressured into changing its behaviour because of external interference and extra-legal considerations.

Different jurisdictions will have mechanisms to protect legitimate expectations under their general public law. This is the case both in the UK and in Colombia, where protection has come about primarily through the role of the judiciary<sup>531</sup>. While taxpayers participating in co-operative compliance could rely on these generic protections to ensure that the administration commits to the positions stated during co-operative exchanges, the author believes that additional specific protection should be granted in statute. Relying on the judiciary to protect legitimate expectations means taxpayers will face litigation costs, time delays, and an additional level of uncertainty attributable to the procedural and substantive restrictions developed by case law. This is particularly concerning for co-operative compliance because the timely provision of legal certainty is crucial for this model and having to wait for a judgment and pay for its costs would go against its premises of real-time working and compliance efficiency. Furthermore, the judiciary is likely to struggle to fit the administration's actions under co-operative compliance within the conceptual frameworks that have been developed with more traditional regulatory approaches in mind. For example, the level of trust inherent in co-operative compliance means that ordinary tests for reliance might not be appropriate and

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<sup>531</sup> For an analysis of UK case law regarding legitimate expectations in tax matters refer to Freedman J and Vella J, 'HMRC's Management of the UK Tax System: the boundaries of legitimate Discretion' in Evans C, Freedman J and Krever R (ed) *Delicate Balance: Revenue Authority Discretions and the Rule of Law* (International Bureau of Fiscal Documentation 2011). In Colombia, the protection of legitimate expectations has been construed by the Constitutional Court to be a constitutional principle that originates from the need to protect regulatees' good faith. See Colombian Constitutional Court. Case C-131/04, February 19, 2004.

the fact the taxpayers' expectations often refer to the administration's position in relation to ambiguous tax rules and future tax outcomes could cause difficulties if the judiciary felt the administration was acting *ultra vires*.

Having an explicit statutory mandate according to which the administration's positions communicated to the taxpayer under co-operative compliance will be considered legally binding *prima facie* prevents taxpayers from having to convince the judiciary that the administration's conduct gave rise to expectations which were legitimate and that they relied on them. This reinforced certainty should give participants the confidence to cooperate, particularly in contexts where the judiciary is not seen as trustworthy, like Colombia, or where the case law surrounding legitimate expectations and the standards for judicial review impose an onerous burden of proof on claimants, like the UK<sup>532</sup>. Additionally, knowing that instances of fraud or incomplete disclosure might defeat the presumption of legality could induce taxpayers to disclose fully and truthfully.

Granting taxpayers reinforced legitimate expectation protection does not mean forcing the application of administrative decisions that contradict the law. As explained throughout this section, if the administration breaches the law, the presumption of legality of its agreements/stated positions would be defeated, as would be the case if the taxpayer had committed fraud or had failed to disclose all material information. While making the administration's decisions legally binding might introduce a hard-law approach to co-operative compliance which

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<sup>532</sup> For example, in relation to establishing that the administration's choice to renege on its positions would amount to an abuse of power under judicial review standards. See Freedman and Vella, 'HMRC's Management of the UK Tax System: the boundaries of legitimate Discretion' (2010).

seemingly conflicts with the idea that co-operative compliance transcends the strictly legal<sup>533</sup>, and might therefore be seen as detracting from the regulatory model's innovativeness, the fact is that, as shown in the UK findings and in some of the literature quoted in chapter five, taxpayers are finding that the current, purely trust-based, mechanisms are not giving them the degree of legal certainty they expect from the relationship. This is true even where the administration is seen as highly trustworthy, since broader trends in taxation such as a drive towards limiting what is perceived as abusive tax behaviour and the accompanying socio-political pressures towards "fair taxation" lead to policy changes and/or external pressure which effectively reduce the ability of the administration to commit to a given tax position and/or increase the likelihood of agreements with the administration being challenged by a third party.

Requiring the administration to be legally bound by the conclusions it reached during the co-operative dialogue and communicated to the taxpayer can be seen as the counterweight to the idea of requiring taxpayers to 'justify' being trusted by showing robust tax control frameworks. Thus, the administration has its trustworthiness 'justified' by the fact that it will be legally estopped from changing its stated position arbitrarily.

The fact that the administration's disclosed positions are made legally binding does not mean that they are immune from scrutiny and/or challenge since, as stated previously, the administration's decisions could be audited internally and, depending on each country's administrative law, could be subject to judicial review or alternative dispute resolution mechanisms. This last

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<sup>533</sup> Soler Roch MT, 'Tax Administration versus Taxpayer - A New Deal?' (2012) 4 World Tax Journal. Page 292.

alternative has been proposed, among others, by Cicin Sain, who highlights the possibility of using mediation to solve disputes without jeopardising the trust-based nature of the relationship<sup>534</sup>.

Administrative decisions should have the presumption of legality, and ought to stand unless there was proof of taxpayer fraud or material omission, or the administration was proven to have acted *contra legem* in exercising the discretion to interpret and apply tax rules which are often ambiguous and which, in matters like transfer pricing, tax abuse, or permanent establishment profit attribution, are fairly subjective. In the case of technically wrong decisions, aggrieved taxpayers would be expected to challenge administrative acts in administrative appeal and/or judicial review, where available. Third party challenges are a complex issue because, depending on each jurisdiction's administrative law, there are three issues which would need to be addressed and for which there are multiple alternative solutions: 1. What is the test for granting standing to third parties?, 2. What is the standard for judicial review (can the judiciary review the merits of the decision or just the administration's rationality, reasonableness, or procedural criteria)?, and 3. What are the effects of the challenge in terms of remedies?

Regardless of the answers adopted in each jurisdiction, what is essential is that the rights of good faith taxpayers covered by the decision are protected and that any re-examination of the administration's decisions is legal and technical, not political or mediatic. Moreover, similarly to other instances where

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<sup>534</sup> Cicin-Sain, 'A New Approach of The Croatian Tax Administration towards Taxpayers Based on Cooperation instead of Repression: A True Change in Attitude'. Page 862.

the tax administration relies on taxpayer disclosures to reach its decisions<sup>535</sup>, the legally-binding nature of the decisions produced during co-operative compliance could be made conditional to the taxpayer materially satisfying their obligation to act transparently, so that the administration could be exempted from its obligation to stand by its position under the exceptional circumstance where the taxpayer was proven not to have provided a full and truthful disclosure, or to have supplied fraudulent information. This last characteristic should ease concerns of taxpayers gaming the co-operative compliance engagement, especially in environments where there is a resource asymmetry between the large corporate taxpayers and the administration, or where there is suspicion of selective disclosure.

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<sup>535</sup> For example, taxpayer offshore asset disclosure initiatives, tax amnesties, or advance transactional clearances and pricing agreements.

## **CHAPTER 10**

### **CONCLUSIONS**

#### **10.1. What the thesis has found**

This thesis has shown that the degree of alignment between the different factors that influence large corporate taxpayers' tax morale and tax behaviour and the premises of co-operative compliance is dissimilar in Colombia and in the UK. While these taxpayers' display similarities like an increased aversion to reputational risk and personal norms at the tax director level which show ideological alignment with co-operative compliance, there are multiple differences that suggest that the conditions currently present in Colombia are contrary to the introduction of co-operative compliance, whereas those in the UK tend to favour this model.

The findings presented in Part II reveal a considerable mismatch between co-operative compliance's core elements, the taxpayers' characteristics and those of their environment in Colombia. Chief among these are critically-negative perceptions of the administration, affecting both its trustworthiness and the perception of its power, corporate tax governance issues that weaken internal tax control frameworks, tax-risk prone and non-compliance minded social norms, and contextual factors like a high perception of corruption that damage trust and question the convenience of horizontal regulation.

Although tax director personal norms are mostly favourable to co-operative compliance, they often showed a non-reciprocal view of trust, a lower importance granted to tax risk management than in the UK, and the existence of a significant minority that prioritised tax savings over compliance and/or risk reduction. Likewise, although Colombian corporations assign an increased

importance to tax risk and public perception in tax decision-making, have stronger and more compliance-oriented in-house tax teams, and more opportunities to control tax risks in the business-decision-making process, they maintain tax director remuneration and evaluation practices which encourage tax risk-taking and display uninvolved boards and structures for evaluating in-house tax departments which increase the potential for conflicts of interest.

Finally, Colombian perceptions about the administration and its relationship with taxpayers were shown to be substantially negative in most dimensions, including trust and various indicators of power. Although the taxpayer-administration relationship was perceived to be positive by most interviewees, this is not favourable for co-operative compliance because it reduces incentives for changing approaches, and because responses indicate that the relationship is positive because of an increased distance between regulators and regulatees or because of preferential treatment that is concerning in terms of regulatory capture and responsiveness.

In contrast, UK corporate taxpayers were found to have a greater alignment with co-operative compliance. Corporations are adopting tax risk-averse practices and their tax teams have better opportunities to control tax risk than in the past. Furthermore, UK tax directors exhibit personal norms favouring compliance and risk aversion which coincide with co-operative compliance's ethos. Additionally, UK interviewees displayed favourable perceptions of the administration's trustworthiness and of the taxpayer-administration relationship associated with generally-positive experiences of co-operative compliance.

Nevertheless, findings also show that UK context-specific factors like a passive involvement by corporate boards on tax matters, the subordination of the tax function to the finance function and HMRC's failure to match taxpayers' expectations regarding business understanding, responsiveness, and the provision of legal certainty that are negative for co-operative compliance. Moreover, an elevated mediatisation and politization of corporate taxation in the UK is associated with a widespread perception that HMRC has adopted a less supportive and more arbitrary attitude to appease the public and/or politicians. Altogether, this has begun to erode regulatees' trust in the regulator and in co-operative compliance itself. The following heatmap summarises:

HEATMAP OF COMPARATIVE FINDINGS REGARDING CO-OPERATIVE COMPLIANCE'S VALIDITY										
LEVEL OF VARIABLE	VARIABLE					UK SAMPLE			COLOMBIAN SAMPLE	
Assessment of findings in relation to co-operative compliance's validity	Strongly Positive	Slightly Positive	Mixed	Slightly Negative	Strongly Negative					
Personal Norms (Micro/Individual)	Tax Director ideals concerning the taxpayer-administration relationship					Strongly Positive			Slightly Positive	
	Tax Director views about the tax administration's ideal objectives					Strongly Positive			Slightly Positive	
	Tax Director professional objectives					Strongly Positive			Slightly Positive	
Social Norms (Macro/Country-Wide)	Perceptions about the tax behaviour of large corporations					Slightly Positive			Mixed	
	Perceptions about the main tax objectives of large corporations					Slightly Positive			Strongly Negative	
	Perceptions about the tax behaviour of tax directors and external tax advisors					Slightly Positive			Mixed	
Organisational Culture and Practices (Meso/Corporate)	Importance attributed to tax risk and associated behavioural changes					Strongly Positive			Slightly Positive	
	Importance of public perception in tax decision-making processes					Strongly Positive			Slightly Positive	
	Tax Director remuneration and evaluation practices					Strongly Positive			Strongly Negative	
	In-house tax teams' functional resource allocation					Slightly Positive			Slightly Positive	
	Interaction between in-house tax and non-tax teams					Strongly Positive			Strongly Positive	
	Timing of tax considerations in the business decision-making process					Strongly Positive			Strongly Positive	
	Practices for evaluating and supervising in-house tax teams					Mixed			Strongly Negative	
Perceptions about the administration and of the taxpayer-administration relationship (Macro/Meso)	Perceptions about the taxpayer-administration relationship (interviewees' own company)					Strongly Positive			Mixed	
	Trust in the tax administration					Mixed			Strongly Negative	
	Perceptions about the administration's main objectives					Strongly Negative			Strongly Negative	
	Perceptions about the adequacy of the administration's interventions on the interviewees' companies' tax affairs					Strongly Positive			Strongly Negative	
	Perceptions about the administration's staff's attitude and know-how					Mixed			Strongly Negative	
	Perceptions about the administration's business understanding					Mixed			Strongly Negative	
Perceptions about the administration's power					Mixed			Strongly Negative		

Figure 60 Heatmap summarising the thesis' comparative findings

Having found that corporate tax directors in different contexts share a degree of alignment with co-operative compliance's philosophy and that there are transnational organisational trends according to which large corporate taxpayers are becoming increasingly tax-risk-averse and more focused on compliance, there is support for the idea that co-operative compliance can be a valid regulatory model in various jurisdictions.

Additionally, in Colombia and jurisdictions with similarly high levels of non-compliance, co-operative compliance constitutes an attractive model to

attempt to replace vertical regulatory approaches and improve taxpayer voluntary compliance, particularly since several of the UK's co-operative compliance-conducive findings were associated by interviewees with improvements brought about by co-operative compliance or to practices typical of it.

However, the magnitude of the differences between the samples, particularly in relation to trust and tax risk awareness and aversion, lead to the conclusion that co-operative compliance is unlikely to succeed in Colombia or similar jurisdictions without previously implementing multiple policy initiatives to assist in corporate and administrative cultural transformations aimed at strengthening risk awareness and control and improving regulatee amenability to co-operative compliance, to protect the engagement from external interference and regulatory capture, and to reduce the likelihood of facing operational difficulties with administrative resources and information asymmetry.

Furthermore, the problems evidenced in the UK regarding taxpayers losing trust in co-operative compliance and in HMRC highlight that, even in settings with relatively well-resourced administrations, where co-operative compliance has been longstanding, and the taxpayer-administration relationship is broadly positive, the model's validity can face challenges in terms of its sustainability and its ability to adequately satisfy taxpayers' expectations. Accordingly, it would be unrealistic to expect co-operative compliance to solve all the problems with taxpayer perceptions of the administration and of the relationship as well as improving taxpayer risk awareness and self-regulation, and voluntary compliance.

## **10.2. This thesis' policy proposals**

Considering the findings summarised in 10.1, the challenge in Colombia is establishing the right conditions for implementing co-operative compliance and allowing it to assist in improving voluntary compliance, without expecting it to solve all the system's problems overnight. In comparison, the UK's difficulty lies in addressing the issues that are deteriorating taxpayers' experience with co-operative compliance in order to guarantee its long-term sustainability and prevent a regression in voluntary compliance.

Accordingly, this thesis proposed a series of policy best practices designed to improve the model's sustainability, and to allow for a more favourable environment and a progressive regulatory transition in jurisdictions where the model would represent a break from traditional command and control approaches. These proposals centre on dealing with the issues most evident in the findings: lack of/erosion of interparty trust, difficulties with the administration's ability to provide legal certainty, inadequate responsiveness, and insufficient administrative business understanding and efficiency.

### **10.2.1. Co-operative compliance must be designed to match the expectations of regulatees and the regulator**

One of the main conclusions, both from the UK's experience and from what other authors have found in jurisdictions where co-operative compliance has been implemented, is that whenever any of the parties feels that the costs vs. benefits equation they had anticipated before starting co-operative compliance does not match reality, there is an erosion of trust that impedes the relationship from functioning effectively and sustainably. Thus, it is crucial for co-operative

compliance programmes to be designed in a way that aligns the parties' expectations with what can be realistically offered under the circumstances present in the specific jurisdiction. This is particularly important in emerging market settings like Colombia's, where co-operative compliance would represent a step into the unknown for both parties.

For the author, achieving the desired level of alignment could be facilitated by an approach covering three stages of the policy's cycle: design, introduction, and operation. The proposal for the design stage is to perform empirical research on taxpayer tax morale and behaviour and combine it with extensive consultations with potential regulatees, practitioners, and the administration. By doing so, the programme will have a greater understanding of the parties' expectations and their patterns of behaviour that allows for a tailored policy package. Additionally, programmes should be introduced gradually, being preceded by pilots that provide an opportunity to test whether the designed policy will match parties' expectations in a real-life setting. Similarly, programmes should start with a reduced number of participants and be extended progressively, subject to positive evaluations, resource availability, and proof that the quality of the relationship is not deteriorating as the programme grows. This is fundamental in contexts like Colombia's, where administrative resources are limited and there are concerns about how regulatees and the administration would react to a vastly different regulatory experience. Nevertheless, it is also important in developed contexts, where maintaining a base of dedicated administrative officials and highly personalised engagements is a resourcing challenge in an age of public austerity.

While limiting access to the programme might exacerbate public legitimacy issues associated with a perception of inequality, particularly if co-operative compliance is seen as an upgrade from the regulatory model offered to non-participants, introducing the programme gradually allows for the parties to fine-tune the model before implementing it more widely or, alternatively, to limit the negative consequences in case the initial experience fails. Legitimacy concerns can be addressed by informing external stakeholders that co-operative compliance is based on responsiveness, not on privilege, and that its exercise must be responsible, and by effectively ensuring that participants share governance, risk and/or behavioural characteristics that objectively differentiate them from the rest of the taxpayer population and, therefore, justify dissimilar treatment.

Lastly, since the thesis' findings show that co-operative compliance can be significantly impacted by changes in its operating environment and/or in relation to the parties' circumstances, the regulator must be open to receiving feedback constantly and performing or having others (e.g. the academia) perform periodic evaluations of the initiative in order to update the programme as needed. This prevents regulation from becoming static and addresses path dependency and tunnel-vision.

#### **10.2.2. While accountable, co-operative compliance must be protected from damaging external interference**

Another best practice consists of insulating co-operative compliance from the damaging effect that political interference and the, often misguided, public opinion can have on the administration and, consequently, on the taxpayer-administration relationship. Due to its responsiveness and its collaborative and

horizontal approach, co-operative compliance can be easily mistaken for a renunciation of administrative power or an instance of regulatory capture to the benefit of powerful taxpayers. As evidenced in UK findings, this type of regulation can often face attacks from external stakeholders which believe that only vertical, coercive, enforcement is valid, or that co-operative compliance enshrines an unjustifiable two-tier system that favours participants over the rest of the tax population. This can result in alterations to co-operative compliance's procedures and/or the administration's treatment of participating taxpayers which reduce interparty trust and/or limit the ability and willingness of the administration to provide legal certainty. Nevertheless, the possibility of selective disclosure, cosmetic compliance, and the manipulation of the administration's weaknesses make it desirable to subject co-operative compliance to a degree of scrutiny, particularly in emerging markets or developing countries where corruption is high and/or where there is considerable asymmetry between the parties' resources.

Thus, a balance must be struck between accountability and public legitimacy, the model's efficiency, respect for the rule of law, and interparty trust. This can be facilitated by a.) Increasing the external stakeholders' understanding of co-operative compliance, and b.) establishing boundaries between the political processes of executive control and policymaking, and the administration's conduct in specific cases. Stakeholders should always be informed of five crucial aspects of co-operative compliance: 1. That its main objective is to increase compliance, 2. That vertical enforcement is part of the approach and co-operative compliance relies on coercive measures for deterrence and punishing non-compliance, 3. That the relationship's reciprocity demands full disclosure

from taxpayers and their commitment to implement agreements reached with the administration, 4. That the administration's exercise of discretion must be reasoned, responsible, factually-supported, and subject to the limits laid out in the law, and 5. That the administration's responses are not arbitrary, but tailored to each taxpayer's behaviour and characteristics, evaluated under objective, publicised parameters.

As for delineating boundaries between political processes and administrative practices, the objective is to protect legal certainty and allow the parties to operate without undue disruptions by preventing abstract political debate and policy evaluation, which is desirable, from turning into a space for non-technical attacks on the administration for the outcome of specific cases. Where necessary, scrutiny and challenge should be conducted by technically-oriented organisms and/or the judiciary, using legal parameters, rather than political ones<sup>536</sup>. While this can be achieved using different mechanisms, depending on the applicable legal system, robust solutions would likely require both specific legal provisions and political agreements.

### **10.2.3. Co-operative compliance should operate under a tiered system**

Co-operative compliance's responsiveness and the possibility of influencing taxpayer behaviour through conditionality suggest that different levels of participation should be offered to taxpayers, depending on their satisfaction of the prerequisites/objectives set out by the regulator. Thus, only taxpayers with

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<sup>536</sup> For example, Freedman suggests that, for the UK, a viable solution is for an expert unit of the NAO to carry out routine external reviews of random samples of the settlements reached by HMRC. See Freedman. 'Restoring Trust in the 'Fairness' of Corporate Taxation: Increased Transparency and the Need for Institutional Reform'. Page 136.

proven tax risk awareness, robust tax control frameworks, a commitment to comply with applicable tax rules and regulations, and a tax culture that demonstrates compatibility with co-operative compliance should be granted the highest level of administrative benefits. These can include, for example, metaregulation, the accelerated provision of legal certainty, a higher frequency of interaction with dedicated officials, and/or access to specialist teams. By conditioning access to achieving and maintaining a desired profile, taxpayers can be nudged to improve their self-regulation, and the administration can make a more efficient use of its resources and gain data to reduce information asymmetries.

Moreover, tiers allow for gradual transitions into co-operative compliance, with vertical enforcement progressing onto directed cooperation and, eventually, metaregulation. This progressive system can facilitate tax culture changes in contexts like Colombia's, where co-operative compliance and/or tax risk aversion are still developing, and where the administration would also need to transform its philosophy and methods.

#### **10.2.4. Co-operative compliance should rely on taxpayer-dedicated administrative officials acting as points of contact**

Based on interviewee ideals about the taxpayer-administration relationship and on the UK sample's assessment of their co-operative compliance experience, it is evident that dedicated administrative officials are key for co-operative compliance's success. These actors increase the administration's knowledge of taxpayers, thus facilitating improvements in administrative business understanding and responsiveness. Moreover, having a specific person represent the administration reduces social distance, signals that the

administration is invested, and enables tax directors to find a peer with whom to develop a psychological/emotional bond, potentially enhancing trust and voluntary compliance. While maintaining dedicated administrative officials is costly because of the resources invested in training them and their exclusive dedication, they can offer a greater efficiency for taxpayers who can rely on them as points of contact, and for the administration, which can use their taxpayer know-how to better coordinate its responses and allocate resources to non-compliant taxpayers or to other segments like small businesses.

In terms of the interaction between dedicated administrative officials and specialist teams, the decision on substantive points of law should be left to specialists, but taxpayer-dedicated officials ought to remain an integral part by coordinating all the discussions involving their assigned taxpayers, communicating to the taxpayer any administrative decision, and assisting taxpayers to engage with the specialists and implement agreed positions.

Finally, concerns about regulatory capture can be addressed by establishing ex-post-facto internal auditing and rotating administrative officials between companies after three or four years, ideally maintaining them in the same industry to preserve their know-how.

#### **10.2.5. Access to co-operative compliance should depend on a dual taxpayer risk and amenability assessment**

As explained in 10.2.3., the author believes that co-operative compliance initiatives should operate using tiers in order to fully benefit from conditionality and responsiveness. While different programmes use a variety of parameters to profile taxpayers and calibrate administrative responses, the recommendation is that the criteria used are taxpayers' tax risk and their amenability to co-

operative compliance, understood as the degree to which their tax morale, behaviour, and their organisational characteristics, demonstrate compatibility with this type of regulation.

These parameters, related to the underlying regulatory objective of enhancing compliance, can be operationalised using objective indicators, and enable the administration to act responsively, using heavier intervention for high risk/low amenability taxpayers and lighter intervention for low risk/high amenability taxpayers. By focusing on risk, the administration can focus on working proactively, rather than reactively. Additionally, this allows the parties to work on the foundations built by other risk management systems used by large corporations. Moreover, centring on tax risk nudges taxpayers towards strengthening their tax control frameworks and re-evaluating their risk appetite, two elements that can enhance co-operative compliance.

Considering the challenges that assessing tax risk has presented in the UK and in other jurisdictions like the Netherlands, the administration should rely more heavily on behavioural risk factors than structural risk factors, which can be managed if the taxpayer is willing to control risk and acts consequently. The additional amenability analysis is designed to prevent low risk taxpayers who do not exhibit the potential to participate effectively in co-operative regulation from being given the same access and treatment as those with equally low risk but a greater regulatory alignment. This is important both in jurisdictions like the UK, where outward risk aversion might disguise non-cooperative strategic behaviour, and in jurisdictions like Colombia, where a tradition of vertical enforcement has left taxpayers with an engrained adversarial mindset contrary to co-operative compliance's collaborative nature.

### **10.2.6. The agreements about tax positions reached between participating taxpayers and the administration should be legally binding**

The final policy recommendation is to render the agreements about tax positions reached between the parties following co-operative compliance exchanges legally binding. For the author, this measure is needed to protect legal certainty and, consequently, preserve participating taxpayers' trust in the administration and in the reciprocal dynamic that characterises co-operative compliance. As evidenced in both samples' responses, corporate taxpayers are increasingly prioritising certainty and predictability as tax objectives, meaning that co-operative compliance's validity is inevitably linked to whether this model is perceived to provide timely legal certainty or not. Moreover, because providing legal certainty is seen as the administration's obligation in return for the taxpayers' voluntary disclosure, this aspect is crucial for the taxpayers' evaluation of the relationship under a cost-benefits calculation.

Taxpayers are likely to evaluate co-operative compliance negatively or see their positive opinion eroded whenever the administration takes too long to provide responses, fails to provide one, when the administration reneges on the position stated during the co-operative dialogue, or if the commitment is overturned by a third party.

Certainly, there is a possibility that taxpayers have been inaccurate or fraudulent in their disclosure, that the administration has erred in its positions, or that there has been a collusion between the parties to betray applicable laws. These issues, together with the need to maintain systemic integrity and policy coherence, justify external scrutiny on co-operative compliance's outcomes, but

this can be achieved through judicial review, and possibly with external auditing performed by technical bodies.

Thus, the administration's pronouncements should be afforded an express presumption of legality that protects taxpayer legitimate expectations, but which could be defeated if the administration was proven to have breached applicable law in exercising its discretion or if there is evidence of taxpayer fraud or selective disclosure. While this could shift the focus from mutual trust to traditional administrative legality, it settles regulatee concerns about the parties' equilibrium and strengthens the relationship against the effects of extra-legal intervention in high-trust jurisdictions like the UK and administrative arbitrariness in low-trust jurisdictions like Colombia. Additionally, the exceptional possibility to overturn agreements affected by taxpayer falsehood or material omissions can ease concerns about regulatory capture.

### **10.3. Looking forward**

A good starting point for reflecting about co-operative compliance's short-term panorama in the jurisdictions studied in this thesis is to realize that the same forces that have led co-operative compliance to shift toward a stricter risk-control-based approach, and which can reduce the model's efficiency and interparty trust by focusing on the possibility of regulatory capture and the idea that the agreements reached with taxpayers are inherently suspicious, have also contributed to sustain this type of regulation in jurisdictions where the model was experiencing fatigue (e.g. Ireland, Denmark), to introduce it in jurisdictions where the addition of tax control framework requirements helped overcome concerns about preferential treatment or equality before the law (e.g. Italy, Croatia,

Austria), and even pave the way for multilateral co-operative compliance relationships (the OECD-sponsored ICAP).

Thus, despite facing criticism, co-operative compliance is likely to continue to be supported by policymakers and administrations in countries like the UK, but under a model decreasingly reliant on trust, centred on risk management, and with more limits to administrative discretion. As suggested by this thesis' findings of an erosion in trust for the administration and the benefits of the relationship, this raises questions about the model's sustainability and whether taxpayers will continue to support these programmes, particularly when being treated as suspicious and facing an authority less capable of delivering legal certainty.

In countries like Colombia, co-operative compliance may be seen as a desirable model, under the idea that it provides an alternative capable of improving compliance while attempting to remedy chronic issues of low interparty trust and poor administrative responsiveness. However, as argued throughout this text, this fails to recognise that the variables present in these jurisdictions might reduce the model's validity. For example, while co-operative compliance can increase interparty trust by increasing dialogue and providing legal certainty, it requires an administration endowed with the resources to profile taxpayers and understand their situation accurately and a minimum pre-existing level of trust to enable the first exchanges to take place - the trust breeds trust conundrum. Similarly, potential regulatees must have a minimum degree of internal tax control and tax governance to make their disclosures credible and for the administration to be willing to discuss tax positions horizontally. Thus, while co-operative compliance can act as a catalyst for improvements in the

administration's procedural fairness, its understanding of taxpayers, compliance and collection efficiency, it can also fail to lift-off because it falls prey to circumstances present in emerging market contexts such as low trust in public authorities, corruption, engrained adversarial mentalities in administrative staff, or inadequate administrative resources. Additionally, even if the model functions well initially, this thesis' findings demonstrate that maintaining the parties' satisfaction and commitment to the model is a formidable challenge, even in jurisdictions with favourable contexts.

In terms of future research, the work presented here can be expanded upon by performing more in-depth studies comparing the tax culture of samples of large corporations operating under co-operative compliance against equivalent companies that are not participating the programme or possibly against the same corporations before they initiated their participation. This would provide useful data to analyse if, and how, participating in co-operative compliance impacts regulatees.

Other avenues for research include researching the role of auditors in relation to their client's tax control frameworks and performing additional empirical work focused on personnel from the tax administration and on tax practitioners in both countries. This would introduce different perspectives and enhance the understanding of co-operative compliance's validity therein. Additionally, further iterations of the research presented here would make the investigation longitudinal, revealing the impact of changing circumstances on the variables being studied. This would be particularly interesting for exploring the impact of changes in the UK's BRR following HMRC's consultation, seeing if the corporate trends towards greater risk aversion and increasing focus on

compliance continue to consolidate in both countries, analyse whether the erosion in trust identified in the UK decreases or intensifies, how the OECD's ICAP progresses, and whether Colombia or similar jurisdictions test co-operative compliance. Finally, while this thesis has allowed an in-depth comparison of an emerging market context with that of a developed economy, further research can include other jurisdictions with similar characteristics in order to assess the findings' external validity.

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