

## Restoring Trust in the ‘Fairness’ of Corporate Taxation: Increased Transparency and the Need for Institutional Reform

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### Abstract

This chapter examines the relationship between trust and transparency in the context of corporate taxation. It draws on the work of philosopher Professor Onora O’Neil to show that transparency will not always increase trust and might even undermine it. Sometimes this loss of trust will be deserved and might help to bring about change that is needed, but at other times transparency can lead to misunderstanding and inability to absorb or utilize the information that is being made available, with a consequential unjustified and unfortunate loss of trust. In such cases, increased transparency can actually lower tax morale and the willingness of taxpayers to pay their taxes voluntarily, with little or no corresponding benefit. The pressure for increased transparency to the public in the tax world arises largely from lack of trust not only in large multinational companies (MNCs) but also in governments, institutions generally and tax authorities in particular. It has become clear in recent years that bilateral tax treaties are inadequate to ensure that tax is collected in a way that the public (and many experts) perceive to be ‘fair’ and this has further undermined trust in the taxation of MNCs. This chapter argues that this widespread lack of trust in our tax system needs to be addressed through improved institutions and fundamental reform. There may be many views of what a ‘fair’ corporate tax would look like, and there should be public debate on this, but ultimately it is essential for trust to be restored in governments and tax authorities to design, impose and administer taxes on businesses in a way that the public perceive to be procedurally and administratively fair, whatever system is ultimately chosen for this purpose. It is institutional reform rather than increasingly detailed

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\* This chapter represents the views of the author only and not those of any other person or institution. The author thanks the Dutch Tax Administration for inviting her to the conference that forms the basis of this book, the participants at that conference and the anonymous referees.

information in the public domain that is needed to achieve this. This is not anti-democratic – there should be debate and input – but democracies also need well-functioning, trustworthy and trusted institutions to serve them.

## 6.1 Introduction

The brief for this chapter was to write about fairness, trust and corporate taxation. It will be noted that there are quotation marks around the word ‘fairness’ in the final title. Fairness is a subjective word and, as such, not normally very useful when writing about tax. When talking about such a complex subject it is better to use more precise concepts. But in the context of trust, which is the topic of this book, perceived fairness is important. It is necessary, however, to recognize that fairness is just that – a perception – and so may be shaped and, indeed manipulated. It has been adopted by governments and non-governmental organizations alike to mean ‘tax as I/we think it should be charged’ and is now used by the media, politicians and other commentators to convey a sense of dissatisfaction with the current system.

Part I of this chapter introduces the concept of trust in the context of current corporation tax debates. Part II investigates the relationship between trust and transparency. The remainder of the chapter uses current UK debates as a case study to shed further light on the issues. Part III examines some aspects of the history of trust in a tax context. Part IV moves on to discuss the trust involved in the cooperative compliance approach for large companies and the impact of that on other forms of trust. The chapter concludes by considering the way forward to improve public trust in the administration of corporation tax by revenue authorities.

## 6.2 Part I: Corporate Tax and Lost Trust

There is a widely held view that there is a general loss of trust in governments in the world at the moment (OECD, 2017). More specifically, there is little doubt that the public, politicians and the media have lost trust in the current system of corporate taxation as a method of collecting revenue, especially when this involves large multinational corporations (MNCs). This loss of trust in tax institutions needs to be addressed; the resulting poor tax morale translates into loss of tax revenue (Torgler, 2007, pp. 152-188; Steinmo, 2018). Trust, as discussed here, is not a matter of blind faith but of justified reliance and so must be based on competence and good systems and institutions (Nooteboom, 2018).

The fact that the Organisation of Economic Co-operation and Development (OECD) has been engaged in a major project, the Base Erosion and Profit Shifting

Action Plan (BEPS),<sup>1</sup> to improve the workings of business taxation at an international level, results from the breadth of concern that many large and successful corporate groups are paying very little tax anywhere in the world and that this is undermining tax collection both from those firms and more generally. When presenting the final package of BEPS measures in 2015, OECD Secretary-General Angel Gurría stated that BEPS affects all countries, not only economically, but also as a matter of trust.<sup>2</sup> While the BEPS package has made some important changes, many commentators believe that more fundamental reform is needed and problems remain (*e.g.* Devereux & Vella, 2014; Avi-Yonah & Xu, 2017). There might be some who consider that we do not need a corporate profits tax at all, because tax can be collected more effectively in other ways (sales taxes for example) but often they too would agree that the activities of some MNCs are not leading to sufficient revenue collection, leading to suggestions for levies on digital services, for example.

This situation will not change simply by appealing to 'morality' or the better nature of shareholders and managers of MNCs. To the extent that the international tax system permits structures that reduce liability to tax, some companies will use these structures. It might be possible to name and shame them into engaging in fewer highly artificial arrangements or pushing up their effective tax rate a little and reputational pressure may cause some reduction in highly artificial tax reduction schemes, but there will always be some companies that do not respond to this. Even those arguing that much tax compliance is voluntary must recognize that there needs to be an inescapable legal obligation to ensure that all taxpayers pay their taxes (Gribnau, 2017). The only way to achieve significant change is to have substantive legal and structural reforms. Whether or not current changes, being introduced by the OECD, the European Union (EU) and individual jurisdictions, will be sufficient to capture all the taxation that it is perceived is being lost to the system at the moment is not the focus of this chapter. This chapter will focus on how trust can be rebuilt in national tax authorities to apply the applicable rules, with the indirect effect of improving the way MNCs are taxed at an international level.

In addition to the substantive changes being worked upon across the world, it is clear that procedural change and, in particular, increased disclosure and transparency, are required by many governments as well as commentators and the public

The perceived successes of BEPS package to date include the introduction of country-by-country reporting and automatic exchange of that information as

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1. OECD Base Erosion and Profit Shifting Action Plan [www.oecd.org/tax/beps](http://www.oecd.org/tax/beps).  
2. OECD press release 2015, cited in Avi-Yonah & Xu (2017).

between revenue authorities.<sup>3</sup> But these new procedures are not enough for some, who call for, in particular, public disclosure and not just the transfer of information to the tax authorities. There are various reasons for this, not least to give the campaigning organizations (and academics) further material, but it also stems from a lack of trust in the tax authorities themselves and a view that the public needs a mechanism to enable it to check up on these authorities. Recent state aid decisions at EU level (still under appeal) reflect the view of the European Commission that some tax authorities of Member States are giving unwarranted tax rulings, raising the issue of distrust of national jurisdictions by a supra-national jurisdiction.<sup>4</sup> In the UK we have had at least one case in which the court, while clearing HMRC of doing 'sweetheart deals', suggested that procedures needed tightening.<sup>5</sup> These developments have influenced the introduction of requirements for tax rulings to be shared under Action 5 of the OECD BEPS project<sup>6</sup> and as part of the EU's response to BEPS.<sup>7</sup>

In this way the current lack of trust not only in other taxpayers but also in tax authorities results in more and more calls for greater transparency. This chapter argues that arguments for transparency must proceed with care and be focussed, so that the material disclosed is useful and disclosures are made in a way that will be valuable. This also requires institutional change, since trust will only be built if appropriate institutions are created and sustained to manage the information disclosed and, if necessary, pursue any tax due under the law. Those institutions must themselves be trusted. If such care is not taken, transparency may even decrease trust.

In this age of austerity in many countries, tax is at the top of the political agenda. Change is occurring partly as a response to that political and popular pressure and partly as a result of administrative pressures and new technological developments. New technology makes physical presence less important as a connecting factor for tax jurisdiction as profits and assets can be moved around the globe with no physical footprint. Taxation of the digital economy poses special problems (European Commission, 2018; OECD, 2018). Technology has also had a part to play in ramping up the political agenda as it becomes easier to access and disseminate material and leak vast amounts of material as happened with the Panama Papers (ICIJ, 2017a).

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3. See [www.oecd.org/tax/automatic-exchange/about-automatic-exchange/country-by-country-reporting.htm](http://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/country-by-country-reporting.htm); European Commission 12.4.2016 COM(2016) 198 final 2016/0107 (COD) Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches.
  4. For example, Luxembourg (Fiat) and the Netherlands (Starbucks) 21 October 2015 IP-15-5880 and Ireland (Apple) 30 August 2016 IP/16/2923.
  5. *R (on the application of UK Uncut Legal Action Ltd) v HMRC* [2013]EWHC 1283.
  6. OECD (2018) 'BEPS Action 5 peer review and monitoring'.
  7. Council Directive 2018/822/EU amending Directive 2011/19/EU as regards automatic exchange of information on reportable cross-border arrangements.

The pace of change in the tax world has left many in the tax community gasping for breath. But despite all the conferences and meetings and commissions and committees, and despite all the information that has been leaked and that which is now coming forward from new disclosure requirements, it is not clear that the current public, media and political debate on taxation is sufficiently well informed to be reliable and useful. Reported public opinion on taxation matters is still too often based on misunderstandings; confusing turnover or sales with profit, for example, or failing to understand the use by corporate taxpayers of deliberately granted incentives and reliefs. The many issues coming to light range from instances of fraud and evasion on the one hand to the use of low tax jurisdictions as base for holding intellectual property on the other. These are all issues for consideration, but some require law change while others need improved enforcement and, very often, more resources for the revenue authorities. Viewing them as composite problem will often obscure the fact that these different matters raise a range of issues and require a range of answers (Forstater, 2018). Asking the public about the consequences of these leaks inevitably leads to over-simplistic responses since people can only be asked broad questions and they have to give binary answers. The polls themselves are far from trustworthy (O'Neill, 2002, p. 9).

For these reasons, the current public debates can undermine trust rather than building it. This may be valid. Trust must be earned and trust is only valuable if placed in trustworthy agents (O'Neill, 2018). For this purpose, evidence is required of honesty, competency and reliability (O'Neill, 2018; Nooteboom, 2018). Governments and tax authorities have not always won public trust by showing competence and perfect motivation. But sometimes the problem is that despite the actual trustworthiness of the institutions, it is hard to show sufficient evidence of reliability and competence to displace the repetition of misleading allegations and the misunderstanding of tax regimes. Conflicting narratives of complex transactions and situations from variously motivated participants in the debate can create a situation in which it is hard for the public to see where trust should be placed. Whose account is more trustworthy – that of taxpayers, campaigning organizations, academics, employed government officials or elected governments? It is not clear that the publication of more detailed information will help members of the public to ascertain that.

To sum up this introduction, trust is taken here to be the justified belief in the reliability, honesty and ability or capacity of someone or some group, institution, organization or government. For a tax system to work well, trust is needed between many different groups.

Taxpayers need to trust governments, politicians, revenue authorities, courts, international organizations and each other. Governments and revenue authorities must trust the taxpayers. National governments must trust each other and international organizations, such as the EU and the OECD, must trust the domestic gov-

ernments. The public need to decide whether to trust corporate taxpayers, the media, the government or the various lobbying groups that speak on tax matters.

It is clear that sustainable tax systems must rely on trust to a considerable degree. Systems dependent purely on coercion generally do not work in the long term. But trust is many layered; there will be interlocking networks of trust across different groups. And trust between small elites, for example, could result in distrust by other groups that are not part of this relationship and so make things worse (by creating the perception of conspiracies). Thus a relationship in which large business taxpayers win the trust of revenue authorities and are rewarded by a light touch relationship, as in cooperative compliance arrangements, can increase distrust in revenue authorities by small business taxpayers (Freedman, 2011). So, we need the right kind of trust, and checks on the wrong kind of trust.

Taxation remains fundamental to the relationship between the citizen and the state. The relationship has been complicated by globalization, the rise of MNCs and the involvement of international organizations, but at its heart the relationship must be with national governments and their revenue-collecting agencies, since only domestic governments can currently levy and collect taxation.

### 6.3 Part II: Trust and Transparency

We are currently on a trajectory that will increase transparency and regulation, but we risk failing to address this fundamental underlying issue of trust. If transparency is increased but justified trust is not, the aims behind transparency (better tax collection, increased 'fairness' or balance between groups and nations) will not be served. We are likely to lower tax morale and raise distrust in the general population without necessarily increasing tax collection overall or improving its balance.

Increasing the amount of data available can be valuable if it reveals otherwise undetected problems. This seems to be the case with some of the Panama Papers and the Paradise Papers, for example (ICIJ, 2017a, 2017b). Where there have been attempts to hide information for criminal and corrupt purposes, where there has been deception, then better data is obviously valuable. Now that Panama and other jurisdictions have signed up to the Common Reporting Standard<sup>8</sup> this may become less of a problem, although this will not solve all the data problems and not all jurisdictions have signed up to the Standard. No doubt the leaks and the pressure of campaigners have been helpful in achieving the change that has occurred and that pressure continues. And this is only the beginning: the publication of some data will lead to pressure for more. There are already demands for disclosures to be made public rather than being made only to the revenue authorities. With the European Parliament and even the UK Parliament expressing support in principle for the publication of Country by Country Reporting to the general public

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8. See OECD (2014).

(Sukhraj, 2016), many businesses view it as only a matter of time before they are required to report to the public and some may volunteer the information anyway. There are issues about the value of the information that will result and whether the costs will outweigh the benefits. Some suggest that it will increase disputes and double taxation (Stanley-Smith, 2016). Simply having more details does not resolve the dilemma of where the tax should be paid. This is not clear-cut under the current system and country-by-country reporting will do nothing to clarify this. Only structural change would alter that. One argument is that public country-by-country reporting would highlight the mismatch between public expectations and actual tax paid in each country, but this is already known, as are the causes. What needs to be debated is the solution, but we do not need any more information to know what the problems are.

Some go even further than demanding public country-by-country reporting and argue for public disclosure of all corporate tax accounts of individual public companies. This would produce a vast amount of material. Quite apart from any other concerns, and even assuming that the existence of the internet would make it possible to deal with the volume of material necessary in a sensible way, it is not clear who would have time to look at all this information and analyse it. Commercial confidentiality would be an issue. Even some tax justice campaigners agree with the arguments against corporation tax returns being on record (Murphy, 2017).

Supposing, however, that it were to be considered a good idea to make all this information public, what then? A senior official from Oxfam GB was quoted in *The Guardian* newspaper as saying,

It's not good enough for information about company owners in UK-linked tax havens to be available only to HMRC – it needs to be fully public to ensure that governments and people around the world can claim the money they are owed and hold tax dodgers to account. (Wintour, 2016)

He is arguing for public disclosure around beneficial ownership, because he does not trust governments to pursue this information and act upon it. In this world-view, governments are seen as being part of the elite group, which also includes the offenders, and as such are part of the problem. But 'people around the world' cannot claim the money they are owed. They can clamour, they can name and shame, but in the end this has to be done by governments. So, in the end we need to develop institutions that will lead a serious public debate and then increase public understanding and acceptance, to the point that trust exists. If the current clamour is not used to achieve this, but instead focusses only on naming and shaming particular companies, many of which are minimizing their tax but being careful to do so within the rules they currently operate, we shall have missed the most important point. Relying on whistle-blowers, media, NGOs and the public to administer taxation cannot be a sustainable or adequate answer to the problems.

This is not an argument against increased transparency, but it is a warning that it cannot by itself solve our problems.

There could be resulting public pressure on governments (correctly or incorrectly depending on how the data was processed and by whom) but ultimately there would be a need to trust governments and tax authorities to deal with the issues. If the public were to believe that the tax authorities were unwilling to deal with this data, or could not manage it and use it properly, there would be a crisis of confidence, nothing would have been resolved and tax morale would have worsened. So the aim needs to be to ensure that the governments are properly equipped to consider the issues arising and legislate as necessary and that the revenue authorities then have the resources to review the activities of large corporations and the legislative tools to deal with them. In a democratic parliamentary system the public have systems, albeit imperfect, designed to hold governments to account. In addition there needs to be a mechanism that makes the revenue authorities properly accountable to the public. This is not a question of criticizing the revenue authority but of monitoring it in a constructive way to build trust, both for the benefit of the public and those working in the revenue authority.

Before addressing the issue of how we might tackle the perceived trust deficit, however, we should consider whether and to what extent it really exists and how it has arisen. Baroness O'Neill has addressed whether we are currently undergoing a crisis in trust and has questioned the evidence for this and called it a "cliché of our times" (O'Neill, 2002, p. 9). She points out that much of the 'evidence' of loss of trust derives from newspaper articles around opinion polls that highlight particularly dramatic statistics. In a tax context, this usually follows some 'scandal' highlighted by journalists and campaigners. If, in the aftermath of a spate of press reports about tax schemes and businesses paying little or no tax, pollsters ask taxpayers if they think companies pay their 'fair share' of tax, or if the government has been effective at encouraging businesses to pay their 'fair share' of taxes, it is not surprising that 68% of people will say that it has not been effective.<sup>9</sup>

Such a response is about perceptions and trust and not about the particularities of the issue. Those asked do not have the information to judge where things stood before, nor how much the government has done, nor have they been given a definition of 'fair share' or asked for one. They cannot give a qualified answer and so they have to opt for a simple, binary response. As O'Neill points out, the kind of yes and no answers that such polls demand lead to answers that do not reflect the full complexity of the issues, so we need to be careful about assuming a crisis of trust over taxation. With politicians at the bottom of the trust spectrum, according to these polls (21% trust them) and journalists only fractionally above this at 25%,

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9. For example, Global Witness "4 in 5 UK voters think PM has moral duty to ensure offshore transparency, poll shows ahead of London anti-corruption Summit", 8 May, 2016. <http://us7.campaign-archive1.com/?u=11a019056071df3aaac3ef300&id=451600d584&e=bddf869ca>.

while civil servants stand at 59%,<sup>10</sup> the crisis of trust seems to be widespread and not confined to tax (or maybe it does not exist at all). Do we even trust the polls that give us this information?

Whether we have concrete evidence of lack of trust of multinationals and governments in relation to tax amongst the public or not, the corporate tax debate in recent years has assumed it exists and bases calls for action, including increased transparency, on this premise. For example, the documentation of the European Parliament on rulings notes that corporate tax avoidance risks feeding democratic mistrust and affecting overall tax compliance.<sup>11</sup> In its report on tackling tax fraud published in 2016, the UK Parliament's Public Accounts Committee (PAC) (PAC, 2015) expressed a lack of trust in HMRC because it did not feel it had the information it needed to assess what HMRC had done about fraud, despite having received a report from the UK National Audit Office (NAO, 2015). It was therefore forced to rely on what was available to it and commented that "The perception that HMRC does not tackle tax fraud by the wealthy needs to be addressed" (PAC, 2015, 5).

If HMRC cannot convey that they are doing a good job, they will not be trusted, even if in fact they are doing the best that could possibly be expected in the circumstances. The point here is not to comment on whether HMRC are actually doing enough: like the PAC, the author does not have the information to judge. Rather the issue is that the transparency provided by the Panama Papers and similar leaks has potentially negative consequences for tax morale and administration unless it can be translated into trusted and trustworthy actions. The information has to be processed and acted upon by a trusted agency. Much that was in the Panama Papers has been released to the public now, but who amongst us will sit down, read, absorb and understand it all? It is far more important that HMRC and other national revenue services have the resources to do that. A large team of journalists has looked at the material already and, interestingly enough, they are holding back some of the information since they consider it would be irresponsible to publish it. Thus they are self-selected as 'responsible journalists', trusted by the whistleblower, but they do not have tax gathering powers and, how does the public know whether to trust *them*?

Thus the increased transparency we need is from the tax collection agencies, not only to convince other taxpayers and the public that they are deserving of trust but also so that the agencies can defend their actions and protect their own staff from

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10. Ipsos MORI. (2016, January 22). Politicians Are Still Trusted Less Than Estate Agents, Journalists and Bankers - Ipsos MORI Veracity Index 2015: Trust in Professions. Available from [https://www.ipsos-mori.com/researchpublications/researcharchive/3685/Politicians-are-still-trusted-less-than-estate-agents-journalists-and-bankers.aspx#gallery\[m\]/1/](https://www.ipsos-mori.com/researchpublications/researcharchive/3685/Politicians-are-still-trusted-less-than-estate-agents-journalists-and-bankers.aspx#gallery[m]/1/).

11. P8\_TA-PROV(2015)0408 Tax rulings and other measures similar in nature or effect European Parliament resolution of 25 November 2015 on tax rulings and other measures similar in nature or effect (2015/2066(INI)).

criticism. Information by itself is not helpful until it can be properly interpreted. As Baroness O'Neill has commented,

Perhaps it is not [...] surprising that public distrust has grown in the very years in which openness and transparency have been so avidly pursued. Transparency certainly destroys secrecy: but it may not limit the deception and deliberate misinformation that undermine relations of trust.

She continues,

[...] Increasing transparency can produce a flood of unsorted information and misinformation that provides little but confusion unless it can be sorted and assessed. It may add to uncertainty rather than to trust. And unless the individuals and institutions who sort, process and assess information are themselves already trusted, there is little reason to think that transparency and openness are going to increase trust. (O'Neill, 2002, pp. 70-72)

Indeed, excessive information may create a distraction from the real issues and be used to create smokescreens. Reporting requirements may become a tick box exercise, which is costly for the compliant and can be used by the non-compliant to divert attention from real issues. Moreover, O'Neill explains how transparency can increase the incentives for dishonesty in some circumstances, as one could imagine would be the case if individual tax returns were published. Someone not wanting his neighbours to know the full extent of his wealth might actually fail to declare it to the revenue authority rather than have it published. Similarly with a corporation – if corporation tax returns were to be made public, companies might be more reticent about what they disclosed to the revenue authorities as well as to the public. There may be even less chance of rooting out abuse than if the information was confidential (Blank, 2009). This could only partly be dealt with by stricter regulation, since there would be a great incentive to hide information.

This is not an argument against all forms of transparency but a comment on its limitations. We have to be careful about seeing transparency as universally good. In some recent tax debates transparency seems to have become an end in itself. But transparency is in some ways the antithesis of trust. As Power puts it, “constant vigilance is somehow autodestructive”. If there was no trust without transparency, “individuals would need personally to check the capital adequacy of their banks on a daily basis” (Power, 1997, 2). For this reason, this chapter argues that transparency must be limited to what is practical and shown to be valuable; otherwise it could become counterproductive. Transparency will only be useful if there is trust in the institutions designed to collect, filter and act upon the data collected. Transparency will never be a substitute for trusted institutions.

#### 6.4 Part III: Was There Ever Trust?

Before one can discuss restoring trust, it is necessary to consider whether trust ever existed. Trust in tax authorities varies considerably from country to country and from time to time and is at the root of a good tax system with high levels of compliance (Torgler, 2007). Changes in our society make trust much harder to achieve and maintain and recent events, leaks and publicity have undermined trust in business and revenue authorities. Once trust is lost it is hard to regain.

In the UK, trust has been at the foundation of the relationship between taxpayers and the tax authorities in the past, although this is clearly something that has not been constant. We have moved from a world where tax was always about the relationship between the citizen and the national government, and where taxpayers were a relatively small percentage of the population who moved in the same circles, to a world of corporations and high-net-worth individuals mobile across states and often with a very different relationship to the nation state from that in the past. Revenue authorities have vastly superior technology and methods of compiling data and spotting patterns and relationships, but society is still working out what the limits of the use of that new technology should be. The technology can be put to good use and bad and itself requires systems of scrutiny if it is not to undermine trust (Klous & Wielaard, 2018).

In the eighteenth century, trust was the foundation of the ability of the British state to create a strong tax system. In his book, *Trusting Leviathan*, dealing with British taxes between 1799 and 1914, the historian Martin Daunton shows how the ability to collect taxation efficiently and without public unrest is connected not only with the economy and the form of the state but also with the institutional procedures in place and the social norms created. Daunton tells us that

Although taxation was a higher proportion of the national income in Britain than in France in the eighteenth century, and was two to three times higher in per capita terms, resistance to taxes was higher in France than in Britain. Unlike in France, there were no glaring exemptions to taxation in Britain and taxpayers were incorporated into the fiscal regime through local machinery for assessment and collection and participation in the negotiating of duties in parliament... In France, the fiscal system created greater tensions, with fewer opportunities for bargaining and resolution of conflicts (Daunton, 2001, p. 7).

The UK system broke down during and after the wars with Napoleonic France at the turn of the nineteenth century, so much so that by 1816 the UK government failed to renew the income tax. But by the second half of the nineteenth century, trust had been re-established. Partly this was by keeping down state expenditure as a proportion of Gross National Product (GNP), but it was also the result of the detailed annual control over expenditure operated through Parliament. So tax collection was seen as a 'bargain' into which the electorate (albeit a very elite one)

could have input. Although the somewhat cumbersome UK annual budget process has come under much criticism from many tax commentators,<sup>12</sup> it is interesting to note its role in the past in creating a sense of ownership and engagement in policies.

Daunton shows that the UK system was also strengthened by the fact that the central state delegated the assessment and collection of income tax to members of the taxpaying public. These were the law commissioners chosen by the local business and professional community. Daunton's conclusion is that the British sought out cooperative solutions, whereas the French relied upon coercion (Daunton, 2001, p. 6-11). It seems that there is nothing that is new about the idea of 'cooperative compliance' in the UK. Unfortunately, under current pressures, the UK is now in the process of making the cooperative compliance system more coercive again and may be losing sight of the importance of trust (Freedman & Vella, 2016).

Although some of the differences between the UK and France were of a wider political and economic nature, it is interesting to note how important the nature of institutions was to the building up of a system that people trusted as fair. People could feel part of the system and the assessment and collection process felt individual and involved contact with people with local knowledge. After this system was dismantled, General Commissioners of Income Taxation were considered able to know the norms in their local population and this was an important basis for trust that taxpayers generally were paying their share. This system lasted until 2009, when the system was reorganized and tax tribunals staffed by professionals took over.

Even towards the end of the twentieth century there was a sense that advisors and many taxpayers could work closely with their local tax inspectors. But the link between people and individual revenue officials is being lost as tax returns become electronic and local tax offices are dismantled and replaced by call centres. It is inevitable that technology will change the way in which organizations work and it would be foolish to try to resist this, but technology now needs to be harnessed to establish that sense of direct connection as business has done, by using online chats, for example.

## 6.5 Part IV: Building Relationships to Restore Trust

The basis of a trust relationship is knowing that the other person is reliable and for this, one needs evidence. The personal relationship that existed between taxpayers and their tax inspectors in the UK in the past was a valuable one, which allowed that trust to be built up. Social science experiments suggest that the level of social interaction impacts on the level of trust shown (Hoffmann, McCabe & Smith, 1996).

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12. Most recently, Rutter et al., 2017.

Thus this is an issue of wider significance than simply the relationship with one inspector – it affects tax morale more generally.

It is no surprise that calls for transparency and fairness in relation to large businesses are reaching a crescendo in the UK at a time when personal contact with HMRC is being lost for other smaller businesses and individuals, as HMRC moves towards the use of more centralized functions such as call centres and more computer-based interfaces for taxpayers.

The sense of unfairness is compounded by the feeling that one group (large business) has a relationship of trust denied to others. This is the so-called cooperative compliance approach that, in the UK, adopts a light touch for large corporations that are considered low risk and agree to real-time disclosures and other forms of cooperation with HMRC (Freedman, 2011). There has been a concerted effort to build trust – that between HMRC and Large Businesses, in which individuals (customer relationship managers (CRMs)) have played a major role. The author's research with colleagues found that 79% of large businesses responding said that having a good CRM affected their ability to communicate with HMRC to a large extent (Freedman, Ng & Vella, 2013). But the success of this policy has also led to a diminution of trust from the public. The big business relationship with HMRC is seen as too close. Interestingly, CRMs have now been renamed 'Customer Compliance Managers' – a relabeling apparently designed to make the relationship look less 'cosy' (Moore, 2016).

Part of the problem is that this attempt to rebuild the trust between the tax official and the large business taxpayer is being pursued at the same time as trust is being lost where it would be more natural – with small businesses and individuals. And there is more to come on this front. Although we are seeing a small increase in customer services staff at HMRC over the next two or so years, the ultimate aim is to cut numbers substantially as digital tax collection is introduced.<sup>13</sup> The substantial backlash against the UK's Making Tax Digital plans, which have now been put partially on hold,<sup>14</sup> suggests that this is not going to be easy and taxpayers, required to deal with HMRC entirely through computers, may have less and less trust in HMRC. There is already a feeling that large businesses get a better deal than others (TSC, 2018). It can be understood why not every taxpayer can have the attention paid to a large business, but some human interaction would seem to be a

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13. Edward Troup, then HMRC Executive Chair, in a letter dated 6 April 2016 to Meg Hillier, Chair of the Committee of Public Accounts, stated, "Focusing on the central role of tax in our work, combined with customer service excellence and truly transformational change, will enable us to create a tax, customs and payments authority fit for the future – smaller, more highly-skilled and offering modern, digital services." Available from <https://www.parliament.uk/documents/commons-committees/public-accounts/Correspondence/correspondence-chief-executive-chair-hmrc-leadership-structure-060416.pdf> [Accessed 12 May, 2016].

14. Government statement of position: <https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital>; Correspondence with House of Commons Treasury Select Committee [www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2015/making-tax-digital-correspondence-16-17/](http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2015/making-tax-digital-correspondence-16-17/).

good investment and advisable to maintain trust and thus taxpayer morale. Digitalization should not be seen as an excuse to cut staff yet further in the customer services arena.

Thus the encouragement to engage in cooperative compliance in the UK and many other countries is in direct tension with the current mood of distrust towards large businesses. The very existence of this level of trust between the revenue authority and large business groups may threaten the ability to build trust with other groups of taxpayers. In the UK we have seen suggestions made that HMRC is not pursuing businesses like Google as forcefully as it could do, though there has been no concrete evidence produced and this is strenuously denied by the authorities. But the PAC commented in 2016 that lack of transparency and the rules of confidentiality relied upon by HMRC not to reveal details of settlements meant that

The public is highly sceptical about whether large businesses pay the corporation tax they should in the UK, and HMRC must address this if it is to protect the integrity of the tax system. (PAC, 2016)

In other words, the perception of close relationships with business is undermining trust and leading to calls for more public transparency (Houlder, 2016). As the author of this chapter has argued elsewhere, the solution lies not in more transparency about the details of settlements, which are likely to be understood only by those with considerable data and understanding of the tax system, but in better scrutiny of the revenue authorities, which should lead to greater trust in their actions (Freedman, 2016).

As a result of this reaction to the perceived closeness of the relationship between business and the tax authorities, however, we may see a shift away from cooperative compliance, not only in the UK but elsewhere where the tension is felt between post-BEPS reforms and the cooperative compliance approach (Bronzewska, 2016, 543). As part of the same reaction, penalties are being introduced for non-complaint corporations (in the UK at least), some of which are accompanied by possibilities for naming and shaming corporate taxpayers (Freedman & Vella, 2016). Whether the stick will prove effective where the carrot of cooperation has failed only time will tell, but the pressure for more transparency may actually hinder the progress made to increase real-time disclosures to revenue authorities. This would be so especially if information provided in this way had to be released to the public. Indeed evidence from Sweden shows that in a country with very high levels of public transparency, cooperative compliance has failed (Larsen, 2016, p. 22). Larsen notes:

The nail in the coffin for [cooperative compliance] came when one person challenged it, demanding information about participating corporations, referring to the principle of public

access to official records, *offentlighetsprincipen*. He argued that this type of collaboration was more like counselling than having a specific relation to specific tax cases (which are excluded from public access). SKV denied this request and the case went to the Administrative Court of Appeal who ruled SKV to be correct (February 2013). The case was then taken to the Supreme Administrative Court, *Högsta förvaltningsdomstolen*, which ruled that SKV had to provide information about participating corporations. The information that can be publicly disclosed did not stop there; it was also ruled that details about issues handled were not part of the secrecy if these did not refer to specific tax cases.

Larsen notes other reasons too for the failure of cooperative compliance in Sweden, but anecdotal evidence given to the author of this chapter also suggests that the threat of publication of information was a very strong deterrent against companies participating.

In the UK, the perception that HMRC is doing 'deals' with large firms has not been displaced, despite a report from the NAO, which largely declared itself satisfied that HMRC was following its published Litigation and Settlements Strategy (HMRC, 2011; NAO, 2012). But there was some evidence of non-ideal behaviour from HMRC officials highlighted in a case, which came to the courts, bought by a pressure group, UK Uncut.<sup>15</sup> This has intensified concerns that the trust established between one group and HMRC may have become an elite kind of trust, without checks.

It may well be that this perception is unfair. It would be inefficient to take every case to court, so some capacity to settle cases seems desirable. And law is not always definite: there may be a range of legitimate possible outcomes. Where there are issues of valuation in transfer pricing, for example, the law we have at present does not render a precise answer, and discussion within a range may be needed. In addition, under the HMRC Litigation and Settlements Strategy (LSS) the outcome of a tax dispute, when achieved by agreement between HMRC and the customer, must be consistent with the law (HMRC, 2011). Whilst it might be preferable to have more precise rules, it is unlikely that any system of taxation could achieve absolute certainty. In any event, the law that HMRC has to apply at the moment requires it to consider valuations, judgement, and discretion. BEPS does not remove that necessity.

What is most worrying about the large companies 'deals' debate that re-merged in 2016 over Google (Freedman, 2016), is that the procedures set up in 2012 to create trust in HMRC's dealings with such matters – new forms of governance including the appointment of the 'Assurance Commissioner', whose very name relates to trust – apparently made no difference to the lack of trust shown by Parliamentary Committees, the public and the media. This does not mean that the procedures were not robust – but it does mean that they have not been well explained and that

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15. *UK Uncut Legal Action Ltd. v HMRC* [2013] EWHC 1283 (Admin).

they do not go far enough to satisfy the public, so that they do not achieve their objectives.

In the case of Google, no concrete evidence was produced to show that the tax paid in the UK was not based on the facts and the law at the relevant time, yet it was difficult for HMRC to satisfy its critics. This was because it could not reveal details of the case. It is arguable that HMRC could nevertheless have done more. When it did produce a general explanation, this was much criticized too – perhaps a case of too little too late – but also from the wrong people – not a minister, because of the argument that HMRC, a non-ministerial department is independent of the minister. This is despite the fact that HMRC has a ministerial sponsor. The department has been described as ministerial in all but name by Jill Rutter of the Institute for Government. Is it really helpful to reduce accountability on the pretext of preserving independence? There are other ways, surely to protect confidentiality (Rutter, 2013).

In 2013 this author commented that the appointment of the Tax Assurance Commissioner might not address all the underlying needs (Freedman, 2013). Given that the Assurance Commissioner was an employee of HMRC, the post did not seem sufficiently independent and transparent to quiet the concerns that led to its establishment. This proved to be correct. Once again we faced suggestions that more transparency is needed, companies need to publish their tax returns and that the PAC needs greater powers to examine the tax affairs of individual companies. The problem with all these suggestions is that, in the end, however much information is available, HMRC must apply the law to the facts and collect the tax due. This requires not only data but also analysis. Transparency may help commentators to raise questions, but it will not provide the answers. For this we need to delegate to an expert organization: HMRC. However, not only is there a need for robust procedures but the public has to be able to see that these exist. In their 2012 report, the NAO stated that

There should not be a need for external reviews of settlements, such as this one, to provide this assurance. The NAO will have a role in providing assurance that the Department's arrangements are operating efficiently and will continue to have access to the details of individual settlements. (NAO, 2012, para. 4)

This suggests a way forward. Currently the role of the NAO and the PAC is to review whether HMRC is operating efficiently. This is the correct role for the PAC: politicians should not be involved in the tax affairs of individual taxpayers as a matter of constitutional propriety. But an expert unit of the NAO could provide external scrutiny of a random sample of settlements on a regular, routine basis. This would be a small extension of the current role of the NAO and would be far preferable to special inquiries by non-experts emerging periodically as a response to particular events, because only a routine check will provide the reassurance nec-

essary. So far, no such system has been put in place, but it could do a great deal to help to build trust. Some would say that this would merely add another layer of bureaucracy. And 'who guards the guardians'? But an independent expert body that could scrutinize some settlements and tax paid by large businesses and influential individuals regularly and without waiting for a leak or scandal, and without involving politicians, would seem to offer a good route to improving understanding and confidence.

A procedural development of this kind cannot solve the very real problems facing the world about how to tax MNCs. This needs substantive reforms of the kind made by BEPS and going beyond BEPS. But whatever developments take place in international tax law as a result of the BEPS Action Plan and as a result of the push for increased transparency, ultimately the revenue authorities will need to decide how much tax is payable. An external scrutiny process would complement HMRC's own processes in order to reassure the public and politicians and also to protect HMRC officials from unfair allegations that they are not permitted to respond to fully themselves.

When the first Assurance Commissioner, Edward Troup, became First Permanent Secretary at HMRC, the Press Release announcing his appointment stated that the arrangements for assuring large tax settlements in HMRC would be reviewed.<sup>16</sup> This was a perfect opportunity for a rethink of the 2012 arrangements. But unfortunately it was not taken. Another internal appointment was made, of someone who is no doubt of the highest integrity and will manage the internal processes very well;<sup>17</sup> however, the question of trust has not been fully addressed. The House of Commons PAC and Treasury Committees, which could have questioned this, were preoccupied by that time with more pressing matters and nothing was made of this. But has trust been improved? Do we have the institutions that are robust enough to deal with the pressure when another issue about corporation tax emerges, whether justified or not?

HMRC continues to work to increase the trust of the public and politicians in HMRC and, as shown above, one result is that it is getting tougher with large businesses, reducing the number of settlements being reached and introducing new penalties and provisions (Goodall, 2018). The result could be the reduction of trust and transparency with the large business tax paying community and thus an undermining of the cooperative compliance model originally embraced in the UK. This author has been critical of some aspects of cooperative compliance but positive about others (Freedman, 2011). Perhaps it cannot survive well in the current

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16. Cabinet Office, The Rt Hon Michael Fallon MP, The Rt Hon George Osborne MP and HM Revenue & Customs Press release "New Executive Chair and Chief Executive Officer appointed to lead HM Revenue & Customs" 24 February 2016. <https://www.gov.uk/government/news/new-executive-chair-and-chief-executive-officer-appointed-to-lead-hm-revenue-customs>.

17. Jim Harra, <https://www.gov.uk/government/news/jim-harra-appointed-as-hmrcs-new-tax-assurance-commissioner>.

environment, but we need to ward against stripping the system of all its positive aspects and retaining the less good ones.

## 6.6 Part V: Conclusions – Improving Public Trust

This chapter has examined some general questions about the need for trust and the relationship between trust and transparency in a corporate tax context, using some examples from the UK.

Improved tax design on an international and domestic front would increase trust, but that is easier said than done. Greater transparency and wider consultation both require resources – and well-trained resources – otherwise there could be a downward spiral of lowering tax morale and less voluntary compliance from all sectors as suspicion rises. NGOs and the media are good at throwing up problems, and these require public discussion and wide consultation, but ultimately only governments and revenue authorities can take action. So, as history as well as current empirical work show, increasing trust requires well-funded, well-staffed and well-trained revenue authorities and institutions and adequate scrutiny of those institutions. New technology can be used to improve administration, but is not a substitute for personal relationships and proper scrutiny at times. The availability of technological solutions is not a good reason to drastically reduce the workforce of revenue authorities, but should be a way of improving administration for authorities and taxpayers alike.

Increased trust between revenue authorities and one group could increase distrust as between the revenue authority and another group, or the public, since it might seem that too close a relationship has been established. The chapter illustrates this with an example from the UK. Here the trust between HMRC and large companies was being increased by cooperative compliance and individual contact through CRMs. This has led to some resentment of large companies from smaller companies and individuals who cannot access similar individual advice, so much so that CRMs have been relabelled as Customer Compliance Managers. The benefits of personal contact need to be extended to smaller businesses and others to give validity to cooperative compliance for business. Moreover, there needs to be independent scrutiny of the operation of this system to reassure the public.

Given the above, in the UK there is a need to give assurance about settlements reached by HMRC with taxpayers by having a unit of the NAO or other similar body checking on this as a matter of routine. To the response, “Who will guard the guardians?,” as Baroness O’Neill points out, all guarantees are incomplete, but better than nothing (O’Neill 2002, p. 6) This tax settlements scrutiny body needs to be devised so that it is itself trusted.

Increased transparency may sometimes be helpful, but to question whether transparency is always useful is not to support deception or misinformation. Demanding information that will not be useful or that will turn into a tick box

exercise could be counterproductive. Important information may not be examined because resources are being wasted on information that will reveal nothing useful. Transparency initiatives need to be targeted carefully.

All those receiving information need to earn trust by using it responsibly and reporting accurately. This includes NGOs and the media. In particular, when discussing either the behaviour of taxpayers or of the revenue authority, care should be taken to distinguish between whether what is being done is within the current legal framework, so that the point being made is the need to change the law, which is a question for the government, or whether the concern is with the way current law is being administered, which may be a question for both the revenue authority and the government.

In sum, every tax system requires trust in order to operate effectively. It should not be assumed that increasing transparency will necessarily improve trust or even compliance. It will certainly not result in changes to tax law on its own. It cannot be expected that MNCs will start to pay more tax than is required by law because of disclosure requirements. Governments need to decide how to impose greater tax burdens if that is the desired outcome. Increased transparency might increase public pressure, but it might do so erroneously unless the data collected is useful and is well understood. Thus such public pressure could lead to rushed and poor tax reform, rather than well thought through and coherent action. The current flurry of proposals for taxing the 'digital economy' at both national and EU level might be thought a good example of this. The problem here is not lack of information, but lack of a good solution to the problem. Transparency has a role to play but must be managed carefully.

Trust in the tax system should not be blind trust but reasonably placed trust. But it is not for the media, NGOs and the public to become self-service tax officials. Good institutions are required to impose and apply tax on our behalf. Transparency and scrutiny are needed around these institutions. Transparency is not just about large flows of data to the public. Only well-understood and processed data will improve the way corporate taxation is managed and restore trust in the way large businesses are taxed.

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