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DUTCH HORIZONTAL MONITORING: The Handicap of a Head Start

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List of abbreviations

HM	Horizontal Monitoring
HMRC	Her Majesty's Revenue and Customs (UK tax authority)
IRS	Internal Revenue Service
MNE	Multinational enterprise
NOB	The Dutch Association of Tax Advisers (<i>Nederlandse Orde van Belastingadviseurs</i>)
NPM	New Public Management
NTCA	Netherlands Tax and Customs Administration
OECD	Organisation for Economic Co-operation and Development
Sox	Sarbanes-Oxley Act
TCF	Tax Control Framework
VNO-NCW	Dutch Employers Organization
WRR	Dutch Scientific Council for Government Policy (<i>Wetenschappelijke Raad voor het Regeringsbeleid</i>)

Abstract

This report outlines the Dutch model of Horizontal Monitoring (HM), which is widely regarded as one of the first examples of a cooperative compliance program. It describes how, since 2005, the Netherlands Tax and Customs Administration (NTCA) developed a monitoring regime that has significantly altered the relationship between the Dutch tax authority and corporate taxpayers. The report demonstrates that under HM the attitude of both corporates and tax administrators has shifted from an adversarial 'them and us' relationship, to one stronger characterised by cooperation. Despite the widely identified benefits of HM, including increased ability of corporates to acquire fiscal certainty, the monitoring regime faces major challenges. It has proven particularly difficult to quantify the model's impact on revenue collection and the tax authority's administrative resources. The report concludes that if HM is to subsist, it is vital to increase formalisation and transparency of the risk monitoring techniques as applied by the tax authority, and develop more advanced metrics than have been available hitherto.

Keywords: cooperative compliance, Dutch horizontal monitoring, tax administration.

1. Introduction

In recent years, tax administrations have put increasing emphasis on developing more cooperative relationships with corporate taxpayers. Referred to by the OECD (2013) as ‘cooperative compliance’, new forms of interaction between tax administrations and corporate taxpayers have been introduced in several countries. As a ‘soft law instrument’ (Gribnau 2015, 186), cooperative compliance is aimed at increasing voluntary compliance, and as such it is expected to result in an easier and more efficient application of tax law, generating advantages for both the tax administration and corporate taxpayers. As one of the pioneering countries, a cooperative compliance based regime has been operating in the Netherlands since 2005. According to the Netherlands Tax and Customs Authority (NTCA 2013, 22), the system, known as horizontal monitoring (hereafter: HM), focuses upon increasing ‘trust, transparency and mutual understanding’ between the tax administration and corporate taxpayers.

The development of cooperative compliance regimes can be seen as part of a broader international trend starting in the 1980s, when many OECD countries started to emphasise efficiency and responsiveness in the delivery of public services. This trend, referred to by Hood (1991) as New Public Management (NPM), was pronounced in Anglo-Saxon countries, such as Australia, New Zealand, and the UK. Due to its strong focus on Anglo-Saxon management trends, the Netherlands was influenced by NPM type reforms from a relatively early stage (Yesilkagit and De Vries 2004). Examples of reforms implemented in the Dutch public sector constitute agentification, public-private partnerships, and creating more client-oriented services (Pollitt and Bouckaert 2004). Many of the reforms have also affected the tax administration, such as large businesses no longer referred to as taxpayers, but customers. Similar to other countries (see OECD 2013), the Dutch tax administration has faced significant budgetary pressures, necessitating a more efficient use of administrative resources. Both trends provided strong impetus to review the auditing practice and service provision by tax administrations.

Although cooperative compliance has spread to many countries, including Denmark, Ireland, and the US, tax administrations use significantly different arrangements. In Dutch HM, corporate taxpayers agree covenants with the NTCA, which are formal compliance agreements between the tax authority and individual corporate taxpayers. In the agreements, companies commit to developing a high level of internal fiscal control, and self-assessment, while the tax authority is obliged to offer a more supportive approach, such as giving speedier replies to enquiries. More than a decade after its implementation it is possible to draw some conclusions about the experiences of actors in the Dutch tax system

with HM. HM demonstrates major strengths but also several weaknesses. As this report demonstrates, it has proven particularly difficult to quantify the model's impact, which challenges the progression of HM, and, according to some observers, constitutes an existential threat to the regulatory model (Stevens et al. 2013; Van der Hel-van Dijk and Poolen 2013). HM impacts on all three sets of actors, referred to herein as the 'tax triangle', comprising tax administrators, internal corporate tax specialists and external advisors.

This report is structured as follows. Following a brief discussion in section two of the methods and material that have been used to conduct the research, the third section discusses the factors leading to the implementation of HM. The different ways of working in HM are discussed in section four, including the role of main stakeholders. Some of the main features of HM, including its legal aspects and impact upon the relationships between different groups of tax professionals, are analysed in section five. The report ends with discussion and conclusions.

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2. Method and material

This report draws upon a range of primary and secondary sources. The main primary source is a series of face-to-face interviews amongst 25 tax actors: 6 representing the corporate tax side, 9 from the tax administration, and 7 from the tax advisory profession. Corporate interviewees included senior corporate tax professionals working in listed enterprises. Interviewees representing the tax administration included NTCA client managers responsible for maintaining contacts with companies, policymakers and researchers at the NTCA's head office, and civil servants from the Dutch Ministry of Finance. Interviewed tax advisers were based in Big-4 firms and a mid-tier tax advisory practice. All interviewees held extensive experience working with HM, and were able to reflect upon the evolution of the regulatory regime since its introduction in 2005. In addition, three Dutch tax academics were interviewed, who have long practitioner careers in the area of corporate tax.

Interviews were in-depth and semi-structured, providing some flexibility and spontaneity and allowing the interviewees 'a degree of freedom to explain their thoughts' (Horton et al. 2004, 340). The interviews were transcribed to improve reflection upon the data and the conclusions drawn from the transcripts. NVivo qualitative analysis software was used to assist data management and data analysis. Analysis of the interviews was combined with archival sources which enabled a rich and triangulated understanding of the study phenomenon. Documentary sources included resources from the tax administrations and associations of tax advisers.

3. Background

The relationship between tax administrations and taxpayers has traditionally been characterised by power asymmetry. Cooperative compliance, instead, focuses on realising a more cooperative relationship in which compliance should be enhanced by other than strict control-and-punishment mechanisms. Four factors are relevant as to why the need was felt in the Dutch tax system to make relationships more cooperative. First, in the early 2000s, influential voices criticized the increasing regulatory pressures felt across Dutch society, and the increasing supervision burden this put on regulators. An influential report from the Dutch Scientific Council for Government Policy (WRR 2002), published in 2002 emphasised the greater need for self-regulation to reduce pressures on both regulators and those being regulated. To realize this, implementing organizations would need the necessary additional scope, which, according to the report, could be realized by ‘a less rigid application of the principle of equality that focuses on a differentiated approach as determined by the degree to which the citizen assumes his or her responsibility’ (WRR 2002, 111). Changes in the Government’s general approach to supervision were set out in documents published in 2001 and 2005, in which the Dutch Government articulated a preference to adjust the relationship between government and society. More than in the past, so one of the document states, the government is ‘neither willing nor able to bear all risks’ and, continues by stating that ‘[T]he control of risks and prevention of errors is a joint duty of both government and society.’¹

A second reason for the introduction of HM relates to incidents in the Dutch and international business community that happened in the early 2000s. Major international stock market scandals with companies including Enron, WorldCom, but also the Dutch retailer Ahold, increased attention for corporate governance and tightened regulations on the internal control systems of businesses. In the US, this led to the introduction of the Sarbanes-Oxley Act (SOx) in 2002, while the Netherlands introduced the Corporate Governance Code in 2004. Both the SOx and the Corporate Governance Code requires company’s management to issue a statement in their annual report about the effectiveness of their internal control systems. The regulatory changes introduced in Dutch corporate governance offered the NTCA an opportunity: a specific category of (large) businesses were compelled to improve their internal control systems, systems that the NTCA could take advantage of in its modification of its supervisory methods (Stevens et al. 2002, 1).

A third incentive for the introduction of HM was criticism from the Dutch business community of the NTCA’s supervisory process. In discussions held by the Dutch Ministry of

¹ *Minder last, meer effect zes principes van goed toezicht*, annex to Parliamentary Documents II 2005/06, 27 831, no. 15, p. 9.

Finance and the NTCA in 2004 with representatives from large businesses, the Dutch Employers Organization (VNO-NCW), and the Dutch Association of Tax Advisers (NOB), participants stated that the NTCA was 'guilty' of adopting a 'them and us' mentality (Stevens et al. 2002, 28). An illustration of the difficult interactions is that the period of the 1990s saw an increasing number of tax disputes between the tax administration and corporates. The rather antagonistic relationships were absorbing a growing amount of resources from both the side of the Dutch tax administration and the side of corporate taxpayers. Demonstrating sensitivity for the criticisms from the business community, the Secretary of State for Finance stated during the introduction of HM in Parliament in April 2005 that he wanted to end the 'them and us' attitude governing the relationship between taxpayers and the NTCA (Stevens et al. 2012, 28).

A fourth factor relevant to explain the introduction of HM relates to negative media publicity for the NTCA in the aftermath of the 'De Vinkenslag' incident. The 'De Vinkenslag' was a mobile home park in the city of Maastricht, and significant consternation occurred when it became public that the NTCA had reached agreement with the park's residents on the manner in which their profits were to be assessed. The agreements were considered to be contrary to the law, and, encouraged by the media attention to the incident, more stringent regulations were implemented in the NTCA that reduced discretion of tax administrators. The so-called 'Vinkenslagproof' regulations were first announced in a letter of the Secretary of State for Finance to the Dutch House of Representatives in June 2004. In this letter, the Secretary of State for Finance announced several measures to review the approach to domestic tax shelters, amongst which an exploration into a differentiated approach to supervision according to the risk profile of taxpayers. The letter, which introduced the term 'horizontal monitoring', stated:

(...) The Tax and Customs Administration shall explore several forms of horizontal monitoring in the coming years. The introduction of these less stringent forms of compliance risk management for taxpayers who fulfil all their obligations will create a balance between these forms and the implementation of more stringent forms of compliance risk management for persons perpetrating fraud.²

Hence, in addition to a planned reduction in the supervision burden for compliant taxpayers, the NTCA foresaw the introduction of HM to be juxtaposed by an intensification of monitoring on taxpayers showing a high risk of noncompliance.

² Parliamentary Documents II 2003/04, 29 643, No. 2, p. 3 and p. 6-7. 3 June 2004.

The above-mentioned factors incentivised the Dutch tax administration to experiment with a different type of monitoring. HM started in 2005 with a pilot including twenty large, mostly listed companies. Most of the companies were Dutch, and, despite initial reservations, the NTCA had to make relatively little effort to convince the companies to participate in the pilot.³ Corporate interest in the pilot largely resulted from: (1) the benefits of HM as perceived by the companies, (2) commitment by high-level officials in the NTCA and the Dutch Ministry of Finance to make the pilot a success – e.g. reflected by visits of high-level officials to companies potentially interested in the pilot –, (3) already existing close relationships between the NTCA and large Dutch companies.

It was agreed that the NTCA and companies participating in the pilot would work on the basis of ‘mutual understanding, trust and transparency’, with the objective to conclude a covenant between the NTCA and every participating company. In a letter sent to Parliament in April 2005, the Secretary of State for Finance described HM as aimed at ‘adjusting the NTCA’s supervision to a company’s level of fiscal control’.⁴ The first pilot was extended in 2006 to another twenty companies, and, following a positive evaluation in 2007, the program was rolled out to the rest of the NTCA’s Very Large Businesses segment. The pilots were evaluated through a survey amongst corporates and members of the NTCA’s processing teams assigned to these businesses, and focused on whether they experienced HM as an improvement compared to traditional monitoring. No attempt was made for a more comprehensive and objective evaluation, such as specification of the expected benefits and measurement in practice (Stevens et al. 2012).

In 2008, HM was further extended to the Medium-Sized Businesses Division, and, through the use of intermediary organizations such as tax advisory firms, to small enterprises. Given the significantly different shape of HM for the smallest business segment, and many medium-sized businesses, the investigations in this report focus on the experiences of large businesses in the Netherlands. These businesses are part of the NTCA’s Large Businesses Division, which was founded in 2013, following the merger of the NTCA’s Very Large Businesses Division with the largest businesses from the Medium-Sized Businesses Division. Currently, around 9,600 companies are part of the NTCA’s Large Businesses Division (De Widt and Oats 2017).

³ E.g. interviews NLO1 (The Hague, 2 March 2016), and NLO7 (Amsterdam, 25 May 2016).

⁴ Parliamentary Documents II 2004/05, 29 800, No. 2.

4. Ways of working

HM aims to create a more equal relationship between the tax authority and taxpayers, which is expected to better accommodate the interests of both sides. The term ‘horizontal monitoring’ refers to both the working relationship between the NTCA and the taxpayer and the manner in which the supervision is given shape (Stevens et al. 2012, 23). Some commentators believe that ‘horizontal monitoring’ is an odd combination of terms as monitoring always presupposes a hierarchical relationship (Stevens et al. 2012, 27). The Netherlands Court of Audit avoids the combination of terms and refers to ‘horizontal accountability’ (Netherlands Court of Audit 2011, 10). A main feature of Dutch HM is that it is a voluntary program to which corporates can apply, with admission being the discretion of the NTCA. HM has not replaced traditional supervision, but has continued to exist for companies unwilling, or deemed unqualified to join HM. The NTCA applies an ‘individual customized treatment’ to all businesses part of its Large Businesses Division, which in practice means that every business has its own dedicated tax administrator as first point of contact. The approach is also applied to companies in HM with the difference that the tax administration concludes a covenant with businesses part of HM. In line with the NTCA’s published documentation (cf. NTCA 2013, see also Vennix 2011), covenants are standard texts that outline the future working relationship and have the following features:

- The covenant applies to the entire business group, or at least those business units which are engaged in the core activities and over which the Dutch management exercises a controlling influence. This should prevent cherry picking – i.e. one part of the entity participates, the rest does not.
- The tax administration and business articulate the wish to build an effective and efficient working relationship, based upon ‘mutual trust, understanding and transparency’.
- Rights and duties of taxpayers remain unchanged, with the outcome of the taxation of taxpayers participating in HM neither more nor less favourable than the outcome of the taxation pursuant to other forms of supervision.
- The corporate puts effort in developing a system of internal and external control, known as Tax Control Framework (TCF). The TCF is aimed at filing acceptable tax returns and should be adapted to the characteristics of the business. The tax administration, in its turn, customizes its supervision based upon the quality of the company’s TCF.
- The company ensures it settles its tax debts in time, while the tax administration ensures it pays any tax refunds in time.

- Real-time working is promoted by both sides. The company actively provides the NTCA an insight into all facts and circumstances relevant for its fiscal position, as well as the standpoints and the company's perception of the resultant legal consequences. The NTCA, in turn, undertakes to provide rapid certainty in the event of requests to adopt a standpoint. Real-time working should enable fast processing of tax returns, which, in turn, will increase legal certainty for taxpayers, and optimise use of administrative capacity in both the tax administration and corporate tax divisions.
- HM is not limited to corporation tax, but includes all taxes for which a business might be liable.
- Companies remain free to execute transactions that received negative judgement from the tax administration during the preliminary consultations. The company, however, must explicitly label these transactions in its tax returns, and the tax administration is then likely to apply corrections on those returns. The company is subsequently able to litigate against these corrections, with similar objection and appeal procedures available to covenant companies as for non-covenant companies. Albeit the similarity in legal options available to companies in and outside HM constituted a discussion point during the introductory phase, it has since then become a core principle of HM (also known as 'agree to disagree').
- The covenants are concluded for an unlimited period of time. In case one of the parties wishes to terminate the compliance agreement, it must provide a written statement to the other party of its reasons for doing so. Within the tax administration, the account management team must always consult with the NTCA's management and professional specialists before taking any decisions that may lead to the termination of HM relationships.
- Periodic evaluations of the compliance agreements are undertaken. In theory, these are conducted once a year with very large businesses and once every two years for other large businesses.

Participation in HM is open for all businesses, although only businesses classified as part of the Large Business Division conclude a covenant with the NTCA. The next section discusses the accession process to HM.

4.1 Access to the regulatory regime

Once a business indicates interest in HM, the NTCA starts a procedure in order to assess the suitability of a business to join the program. The standard entrance process to HM consists of three phases. The first phase is aimed at exploring the feasibility of HM for the

organisation. A meeting is organised between the NTCA and the company's senior management at which the tax administration explains HM to the company, including the steps the company would be expected to undertake in order to enter the program. The focus is not only on the company's tax department, or the individual corporate official in charge of tax, but also the attitude taken within the wider company towards compliance. This is reflected during the application phase to HM; the NTCA and the company's board meet to find out the 'tone at the top' towards fiscal compliance (NTCA 2013, 14). The first stage is concluded by drafting a client profile, which outlines the favourable and unfavourable elements of the current relationship between the NTCA and the company, including possible outstanding disputes

If the company indicates continued interest in HM, and there are no fundamental objections in the eyes of the NTCA, both parties embark upon the second stage of the process, which is a compliance scan conducted by the tax administration, in collaboration with the company. In contrast to the general exploration during the first stage, the compliance scan is aimed at reviewing the feasibility of HM for the company. As part of the scan, the NTCA interviews a number of the company's key officers to acquire more knowledge about the company's tax attitude, and its ability to achieve an adequate level of fiscal control. The number of officers to be interviewed depends on the nature and size of the company, and will normally be between two and five. The main question to be clarified during the review is whether the NTCA has 'gained the impression that the organisation is willing to gain tax control (in the longer term) and is transparent about tax issues' (NTCA 2013, 19). Topics to be discussed in relation to the tax function include the company's strategic objectives, its internal control environment, such as IT systems, and external monitoring and advice the company receives. A further outline of sub-processes and associated areas for attention is shown in table 1. Due to the broad approach, representatives of the company to be interviewed can be based across the organisation, such as executive board members (CEO/CFO), the controller, or IT specialists.

The NTCA will consider it feasible for the company to join HM unless there are indications to the contrary. When the compliance scan does not raise fundamental issues, and both the tax administration and the business are positive, the relationship is confirmed in a covenant. The covenants are concise – mostly one to two pages – and concentrate on the

Table 1: *Sub-processes and associated areas for attention in the NTCA's review process of a company's tax control structure parent companies*

Sub-process	Area for attention
Tax organization	Agreement between the tax objectives and organisational objectives Organisational and tax structure Duties, powers and responsibilities Staffing level and training Integration in the organisation
Tax planning	Recognition and implementation of tax opportunities
Tax risk management	Organisation of tax awareness within the organisation Identification of tax risks Response to tax risks (control)
Communication	Promotion of tax awareness within the organisation Preparation of reports
IT	Support provided by IT for the achievement of the tax objectives
Monitoring	The organisation's internal monitoring of the tax function
Tax accounting	Tax positions in the financial statements Tax provisions in the financial statements
Tax compliance	Timely filing of complete and correct tax returns Timely and complete settlement of tax debts

Source: NTCA 2013, 29.

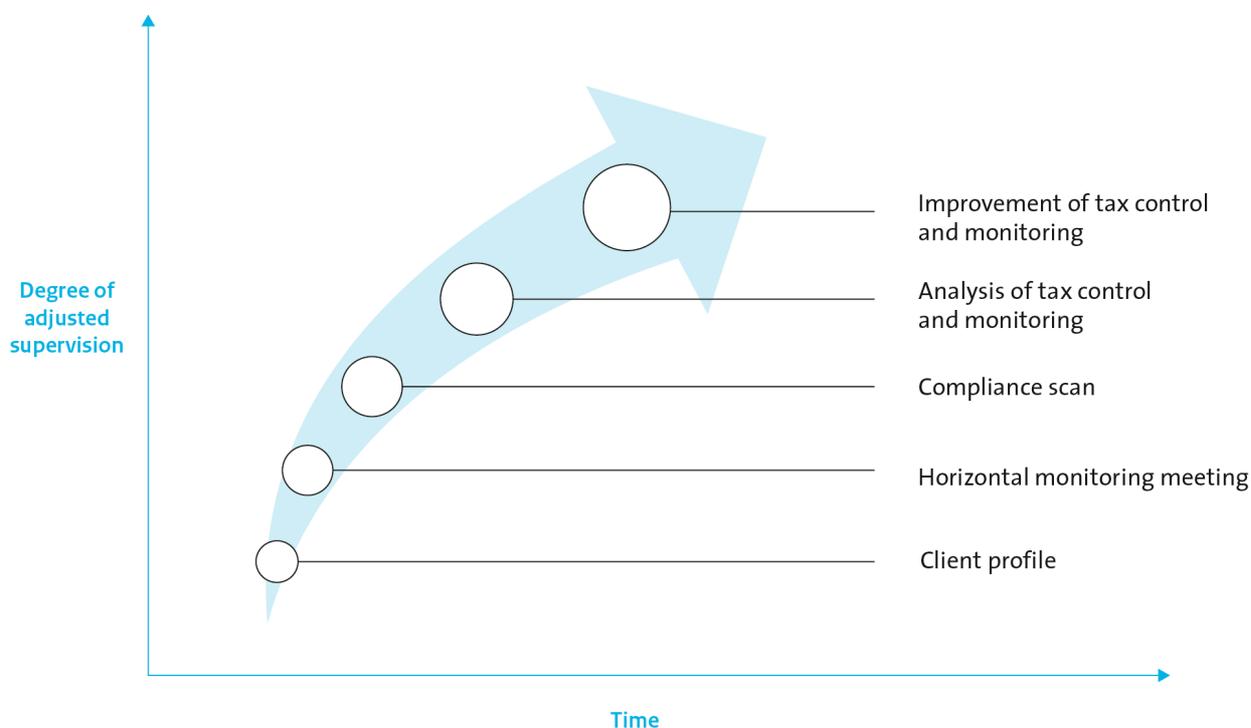
intentions of both parties to develop a cooperative relationship, without detailing the terms and standards referred to in the compliance agreement (see Appendix I for an illustration of a covenant).

Due to legal equality, procedural efficiency and neutrality requirements, variances from the standard text are not permissible (NTCA 2013, 24). Despite the NTCA's focus in HM on the process by which tax returns are produced by corporates, in formal legal terms HM has not brought any change as to how the NTCA determines corporate tax compliance. With the focus on the accuracy and timeliness of the company's tax returns, the same criteria are applied as were in use prior to the implementation of HM.

The entrance process to HM shows that even though a company's tax position is thoroughly examined as part of the compliance scan, the decision as to whether or not a company is allowed access to the program is mainly based upon how the NTCA perceives the company's level of fiscal control. Due to the reduction in supervision granted to companies who have concluded a covenant, covenant companies are expected to show a higher level of control

over their fiscal affairs, or willingness to improve control in this area, as compared to non-covenant companies.

Figure 1: *Steps involved in the horizontal monitoring process*



Source: NTCA 2013, 8.

With respect to companies of the second category, the NTCA assumes that once a company has signed the compliance agreement it will be dedicated to improving its internal (tax) control procedures and its ability to monitor those procedures. Hence, evaluation of the TCF is strongly based upon self-assessment and it is the company who, according to the NTCA guidelines, 'bears the responsibility for its TCF'. To evaluate a company's performance in developing its TCF, the NTCA expects companies to develop an action plan that should specify the work it plans to undertake in order to arrive from its actual to its required level of tax control. When a company claims that it is already at a level where no further improvement is necessary, it must demonstrate this by an analysis carried out by the company itself (NTCA 2013, 15). Figure 1 provides a graphical illustration of the different steps involved in the HM accession process, and how, with each step, the NTCA adjusts its level of supervision. To understand why the NTCA has chosen a model that puts strong emphasis on self-assessment we need to go back to the origins of HM.

4.2 Why is this approach chosen?

HM has developed in a rather incremental way, both during and after the pilot phase. Instead of using a blueprint, interviewees indicate that the NTCA gave shape and content to HM ‘on the job’. The approach is also reflected by the term ‘intuitive’ frequently being used during interviews conducted for this research with a number of key figures at the NTCA in that period (Stevens et al. 2012, 33). One of the interviewees, who had been critical to the implementation of HM, explains his approach during the program’s introductory period as follows:

Look, I've tried to work as an entrepreneur. I've often been asked questions such as ‘did you not have any scientific reports when you decided to introduce HM?’ But then my reply is ‘yes, but this is not a way I would have been able to work – not a single entrepreneur works like this.’ If your plan is backed up by proven, scientific evidence you are not working like an entrepreneur, as anyone could have been successful in such a situation.

Notwithstanding the strong engagement of several high-level Dutch civil servants with HM, the comparison some of them drew as ‘had they operated as businessman’ seems rather inaccurate given the relatively narrow objectives private businesses pursue – creating profits in order to survive – as opposed to the much more heterogenous objectives pursued by organisations operating in a political administrative environment. Most interviewees highlighted the absence of any clear indicators to evaluate the performance of HM; objectives remaining largely undefined in case of HM.

A similar conclusion was reached by the Committee Horizontal Monitoring Tax and Customs Administration, also referred to as the Stevens Committee, named after its chair. Despite the rapid expansion of HM since its introduction in 2005, it was only in 2012 that with the Stevens Committee an evaluation of HM was conducted that went beyond the original pilot reviews. The Committee’s investigation concluded that ‘the concept of horizontal monitoring is the appropriate approach to be adopted, in particular for the group of (very) large businesses’ (NTCA 2013, 5). However, the Committee identified a lack of empirical information as a major impediment for conducting an evaluation of the new tax arrangements. According to the investigation committee, the Dutch tax authority had devoted ‘insufficient energy and effort to a management approach on the basis of adequate (management) information’ and had omitted to formulate explicit ‘performance indicators’, which had led to the new working methods being introduced ‘on the basis of intuition’ rather than rational considerations (NTCA 2013). Partly to address this critique, the research section of the NTCA conducted a survey amongst 350 randomly selected large Dutch

corporates, both in and outside HM. The results, which were published in 2017, gave support to the idea that a good working relationship results in more transparency and improved (components of) a corporate's fiscal management (Belastingdienst 2017).

From the start, 'trust' has been one of the core building blocks underlying HM relationships, something that is reflected by interviewees frequently referring to the model as a 'gentleman's agreement'. NTCA officials interviewed emphasise that the tax authority does 'not trust blindly'. The NTCA defines trust as the 'positive expectation of the behaviour of the other' (Belastingdienst 2008, 8). The NTCA states that all companies that demonstrate an ability and willingness to comply with fiscal rules are given the opportunity to conclude a covenant with the tax authority. To enable the tax authority to decide whether a company will voluntarily put effort in ensuring it is a compliant taxpayer, the Tax Control Framework (TCF) was developed. Although the TCF was not part of the initial pilots that were organised to introduce HM, as the new supervision model expanded the NTCA quickly felt the need to have an objective framework in place to decide on a company's admission to the model, and monitor its performance over time. Demonstrating a high level compliance does not mean that a company will always be compliant, but does mean that any mistakes that are due to systematic failures will be absent, or dealt with instantaneously. As lack of trust by the NTCA in a company's willingness and ability to be compliant may lead to the company being excluded from HM, it is of critical importance that the NTCA is able to list objective reasons for its decision, as to avoid acting against the equality of taxpayers, an important principle in Dutch constitutional law (Happé 2000).

The NTCA trusts companies of which it holds a positive 'client profile'. In practice, this means that the business is: (1) fiscally transparent, (2) in fiscal control, and (3) has a tax strategy in place that satisfies the tax authority (NTCA 2013, 11). The substance of these concepts remained rather general in the NTCA's first edition of its main publication on HM, entitled *Guidelines on Supervision of Large Businesses [Leidraad Toezicht Grote Ondernemingen]*. Partly in response to external critique, an updated version of the guidelines published in 2013 provides significantly more content to the concepts, particularly to the NTCA's understanding of 'fiscal control'.

According to the NTCA, fiscal transparency refers to the obligation of taxpayers to be open about their tax activities and behaviour, and share any fiscally relevant positions with the NTCA before acting upon them. As part of the transparency requirement, the company will share its tax strategy with the NTCA. The NTCA perceives tax planning an integral part of a company's tax strategy, but the general understanding is that space for tax planning by covenant companies is relatively small, as their tax planning does not only need to conform

to the letter but also the spirit of the law. Although the covenant does not directly prohibit the use of aggressive tax planning, the NTCA wants to avoid concluding a covenant with a company that engages in aggressive tax planning, since such tax behaviour is perceived as undermining the trust relationship the NTCA aims to build with covenant companies. The NTCA may equally decide to terminate a covenant with a company that starts to display a more aggressive tax planning approach after it has joined HM. However, in a letter to Parliament in 2010 the Secretary of State for Finance emphasised that in case a covenant company implements, or considers implementing, a fiscal strategy that is primarily aimed at reducing the company's tax contribution this would not necessarily be reason to dissolve the covenant, as long as the covenant company is transparent about its change in strategy:

If a taxpayer is fully transparent and shares fiscally relevant information in advance with the tax inspector, the termination of a covenant is not at stake. This also applies to cases where the taxpayer and the inspector do not agree with the tax consequences of a specific factual situation. In such a situation, the dispute may ultimately be submitted to the court. In case a taxpayer uses fiscally aggressive structures and is not (fully) transparent therein, the covenant will be eliminated. Moreover, it does not fit into a covenant relationship when a taxpayer is constantly engaged in sophisticated tax avoidance activities.⁵

Hence, tax planning in accordance with the spirit of the law is allowed, but covenant companies should refrain from aggressive tax planning under threat of their covenant being dissolved. While a single aggressive tax structure would not directly lead to cancellation of the covenant, multiple and continuous use of those structures would lead to the covenant's termination (Huiskers-Stoop 2016; Meussen 2015).

Compared to its initial guidelines, the NTCA has offered more clarification as to what it evaluates when it analyses a company's TCF. Despite this, the NTCA has left the decision about the operationalisation of the TCF largely to individual companies (De Widt and Oats 2017). In its policy, the NTCA only refers to the general rule formulated in the Dutch General Law on National Taxes that requires companies to keep books and records of their financial position.⁶ This is an open standard that only states that the administration must comply with the requirements of the business, as formulated by the company's dedicated administrator, which can be anyone within the organisation. As Dutch legislation does not define the term 'administration', the norm provides limited direction for companies. Due to this, the norm should be primarily perceived as reflecting the intension to organise a

⁵ Letter of the Secretary of State for Finance, 1 July 2010, nr. DGB2010/2996U, p. 3.

⁶ General Law on State Taxes (Algemene Wet inzake Rijksbelastingen, AWR) art.52.

company's administration in such a way that the tax administration receives adequate and timely information on the company's level of fiscal control (Van Elk, Poelmann and Veldhuizen 2013). This information is subsequently one of the information sources used by the NTCA to decide upon its supervision level.

There are multiple reasons as to why the NTCA has decided not to provide a blueprint for the TCF. The main reason stated is that every company has its own dynamics and needs in terms of fiscal control, hence every TCF will be unique as it needs to be adjusted to a company's specific profile. The decision of the NTCA is understandable given the diversity in companies' tax risk profiles; a listed company with global activities can be assumed to be in need of a different tax function compared to a company that is part of the NTCA's smallest segment of large companies and only operates domestically (De Widt and Oats 2017, 490). In addition, interviewees in the NTCA indicate that if the tax authority were to impose the structure of the TCF upon businesses, and problems then arise, the tax authority might be held accountable.

From this overview of the history of HM, it can be observed that the claimed benefits of HM from the perspective of the tax administration gradually changed over time. Whereas in the introductory period, HM was strongly perceived to be a way to increase the efficiency of the tax system, both for the tax administration and corporate taxpayers, over time increasing the number of companies participating in HM became an objective in itself. This occurred when, following trends in the international literature and foreign tax administrations, the term compliance became increasingly commonplace in the Dutch tax administration. As part of this trend, indicators that had been used up to that point to analyse the NTCA's performance in relation to corporate taxpayers, such as the number of corporate tax audits conducted, were widely seen as inadequate to assess compliance behaviour of corporate taxpayers. Following the positive evaluation of HM in 2007, the number of covenants agreed on seemed to be able to fill the need for a relevant compliance indicator (cf. OECD 2014). With the number of covenant companies perceived as an important compliance indicator, and those figures subsequently being included in the NTCA's annual reports, the NTCA's management started to formulate targets for the number of companies it aimed to conclude a covenant with. Senior level interviewees in the Dutch Ministry of Finance indicate that politicians subsequently used the figures as performance measures for the NTCA, which built up pressure in the Dutch tax administration to expand the model.⁷ Following the pilots with 40 companies in 2005 and 2006, the number of concluded covenants increased rapidly,

⁷ Interviews in the Dutch Ministry of Finance in May 2016 (NL13 and NL15).

bringing the total number for the large business sector to 1,944 covenants in 2015 (Belastingdienst 2016, 37).

4.3 How are stakeholders engaged?

There are different levels of engagement with HM amongst Dutch tax actors, which do not only depend upon the type of stakeholder, but also varies over time. The large corporates, especially those of Dutch origin, have generally shown strong interest in HM. The initiative to develop HM originated from within the NTCA, but large corporates were actively involved in the model's development stage, especially those participating in the first pilots. The corporates generally perceive the model positively, and some corporate tax professionals have become active (international) promoters of the model. The Dutch employers' association (VNO-NCW) also approached the model positively, and played an important role in endorsing the model amongst its members, of whom some had some hesitations about the model's working in practice, such as the level of openness required towards the tax administration.⁸

Engagement within the Dutch tax administration during the model's initial stage was high, especially amongst the administration's political and administrative leadership. This engagement is deemed critical by interviewees to explain the model's rapid expansion. In particular, the Director General of Taxation in the Ministry of Finance and other high-level civil servants in the tax section of the Ministry of Finance were strongly committed to a successful launch of an alternative supervision model for corporate taxpayers. High-level civil servants visited corporate boards not only to get to know 'the tone at the top', as part of a company's application process to HM, but also to actively promote the model and take away any corporate concerns.

While the initiative to implement HM came from the administrative top in the Ministry of Finance and the NTCA, civil servants were strongly endorsed by their political superiors to experiment and then rollout the model amongst corporate taxpayers. In the Netherlands, it is traditionally the Junior Minister of Finance who carries the primary responsibility for tax matters. The Christian democrat Joop Wijn, and his successor and political associate Jan Kees de Jager, gave strong political backing to implement HM. Following several failed internal reorganisations, the NTCA has been in a tumultuous phase since 2016, and is widely criticised in Dutch politics. In addition, international tax avoidance and tax evasion investigations, such as those related to the Panama Papers, or the European Commission's

⁸ Interview NLO1 (The Hague, 2 March 2016).

tax order on the NTCA's Starbucks tax ruling have increased political and media scrutiny of the NTCA's performance in the corporate tax domain. In this context, the current Junior Minister of Finance has been less outspoken in his endorsement of HM, even though he has positively referred to the model at several occasions.⁹

Despite enthusiasm amongst the political and administrative top of the tax administration, HM received a critical response from many tax administrators, especially tax inspectors working in corporate tax. Interviewees and other available sources indicate that the inspectors feared that HM would reduce the NTCA's awareness of the tax position of companies because of the strong reduction in audits, and, would therefore pose risks to the collection of taxes amongst corporate taxpayers. The NTCA's management has put effort in generating positive engagement amongst tax officials with HM, through various activities including workshops and a special training program, for example focused on realising improved understanding amongst tax administrators of the internal operation of businesses. Although these activities had some success, especially amongst younger generations of tax officials, they did not resolve concerns amongst tax inspectors over the model's effects in practice. Ongoing challenges in the implementation of HM, in combination with limited empirical information of the model's impact in practice, have only heightened concerns.¹⁰

4.4 Frictions in HM

The actors that were interviewed for this report generally hold positive views about the contribution of HM to the evolution of relationships in the Dutch tax triangle, even though the majority indicated that this was too narrow a benchmark to evaluate the model's overall performance. Despite the overall positive experience, several frictions were identified, especially in relation to the model's emphasis on reconfiguring regulatory relationships on the basis of trust.

First, tax advisers appear to be most critical of HM. With its emphasis on direct interaction between the NTCA and corporate tax payers, tax advisers have generally observed the model as a threat to their intermediary role. In addition, unwillingness by the NTCA to provide guidelines on how companies can improve their TCF has reduced commercial opportunities for the advisory profession. Second, tax administrators have shown difficulties in establishing their relationship with corporates based on trust. Although dedicated training

⁹ E.g. Junior Minister of Finance, Eric Wiebis, referred to HM as 'a strength of our tax system' (*Trouw* 2017).

¹⁰ Concerns were articulated by a number of interviewed tax administrators, and, generally in stronger terms, have also been reported in Dutch media – mostly relying upon quotes from either retired tax inspectors, or anonymised sources based in the NTCA (cf. Awater and Kuijpers 2017).

programs have helped in realizing a mind-set shift amongst large parts of the NTCA's workforce, some tax administrators continue to rely on traditional, hierarchical styles of interaction. In some cases, this can be explained by fundamental disagreement amongst tax administrators with the regulatory shift propagated by HM from an emphasis on control to trust, something that seems more prevalent amongst older than younger generations of tax administrators (Awater and Kuijpers 2017).

Third, the trust approach that is required from businesses when participating in HM has not been attractive to all companies. Many large Dutch companies already had a relatively open relationship with the NTCA, and for them the move to HM was not a major step. However, other companies, such as foreign multinational enterprises (MNE's) originating from fiscal cultures with more adversarial relationships between the tax authority and taxpayers tend to stay out of HM more frequently. Interviewees from all sides of the Dutch corporate tax triangle indicate that, based upon their own experience, US MNEs operating in the Netherlands tend to join HM less often as they 'are not eager to develop a close relationship with the tax authority'. A fourth element undermining trust and confidence is that companies do not know about the potential consequences of leaving HM, and whether this would potentially generate distrust amongst tax administrators and hence higher scrutiny by the NTCA.

Next to challenges in reconfiguring the regulatory relationship on the basis of trust, difficulties have arisen with the implementation of HM due to the higher than expected administrative demands caused by the model. Although in-depth evaluations are absent, anecdotal evidence indicates that, hitherto, HM has been unable to generate clear administrative efficiencies for the Dutch tax administration. Partly, this has been a result of the NTCA's success in concluding the covenants and the subsequent rapid increase in the number of covenant companies. The rapid expansion put high demand on the NTCA's resources, especially as it allowed companies to join HM because they showed willingness to improve their level of fiscal control but were not yet in a position of control. To bring these companies to a higher level of fiscal control the companies need above average support from the NTCA, which NTCA officers struggle to provide, partly due to budget cuts and staff reductions. An illustration are the annual working plans, which are supposed to be concluded between covenant companies and the NTCA on an annual base, and should contain a working plan as to how to improve the company's TCF. However, the role of the working plans in practice is rather different – several officers in the NTCA indicate that the tax authority struggles to provide the resources to draft these plans with the companies. Hence, interviewees frequently referred to HM as 'a relatively expensive model of

supervision¹¹, and shared the view that the administrative benefits of HM for the NTCA have not (yet) materialized.

4.5 How is the collaboration perceived?

With the emphasis on the relationship, combined with a lack of formalisation, the success of HM as a regulatory system is strongly determined by the extent to which the tax administration and company are willing and able to provide a relatively similar level of professional judgement when dealing with fiscal matters. It is especially important that covenant parties hold relatively similar interpretations of the obligations as formulated in the covenants, which are formulated in a rather general manner. An illustration of this is that the company aims to be transparent with the tax administration, and will share relevant information with the tax authority that may affect the company's fiscal position, but the covenants do not give any indication as to when information is considered relevant, such as a financial threshold level. A corporate tax adviser indicates that parties do not always hold similar judgements:

It sometimes happens that a particular risk is not shared with the tax authority, and that the tax authority then approaches the business, saying something like 'yes, you are in HM but now you have failed to report this risk', and that the company then responds by saying 'yes, but I thought this has such little implications, and if we need to start reporting this, then there will be no end'. Or, what may also happen is that the company assumes that the tax authority is aware of something, and then it turns out it is not.¹²

Some interviewed corporate tax officials and tax advisers preferred more guidelines and regulations from the NTCA, for example with respect to the TCF, or when information should be disclosed. While the push for more formalisation by tax advisers has mainly a commercial background, for corporates more formalisation is likely to minimize uncertainty about how the tax administration assesses a company's fiscal risk profile. It needs to be emphasised that only a minority of our interviewed corporate tax professionals articulated a preference for more formalisation of the HM arrangements.

Despite the frictions previously discussed, HM has increased mutual understanding between the tax administration and corporate taxpayers. Multiple interviewees explain the decline in

¹¹ E.g. interview with a high-level civil servant in the Dutch Ministry of Finance (NL15, The Hague, 27 May 2016) and interview with a tax partner at a Big-4 firm (NL20, Rotterdam, 21 June 2016).

¹² Interview with a tax partner at a Big-4 firm (NL20, Rotterdam, 21 June 2016).

the number of fiscal disputes between the NTCA and corporate taxpayers since the introduction of HM by referring to the increase in mutual understanding.¹³ Compared to the more antagonistic interactions of the 1990s and early 2000s, where fiscal disputes regularly occurred – often simply due to a lack of communication – increased real-time interactions under HM prevent many conflicts and enable controversies to be settled before one or both parties take the dispute to court.

While the emphasis on more egalitarian interactions has made relationships between the NTCA and businesses less antagonistic, over time the NTCA has started to reemphasise its hierarchical position towards taxpayers. This was partly to rectify perceptions that had developed within the tax administration during the period in which there was a strong focus on extending the number of covenant companies. In 2007, the model was also extended to small and medium-sized enterprises, which gave impetus to the impression amongst many tax administrators that HM was ‘seemingly becoming the NTCA’s only monitoring model in use for corporate taxpayers’. In practice, the pressure to expand the model led to tax administrators misrepresenting the authority aspect that would continue to exist between the tax administration and covenant companies. One tax administrator reflects upon this period as follows:

The covenants have been concluded far too quickly because tax administrators felt responsible for concluding them. They said, for example [to a company]: ‘If you conclude a covenant with us, then you will never be subjected to supervision again’. This has been a misinterpretation of the intention of HM.

Real-time working, as a central feature of HM, is highly valued by corporate tax professionals as it enables them to acquire greater certainty about the company’s fiscal status. Although there are no empirical studies available as to how HM has impacted upon the tax function of corporates, interviewed corporate tax officials indicate that being part of HM has enabled them to substantially reduce the company’s fiscal workload.¹⁴ In the words of one corporate tax director of a large listed Dutch company, this resulted in a reduction of around half of the staff of the company’s tax department.¹⁵ What has particularly reduced the corporate tax workload is that due to the more frequent interactions between tax administrators and corporate tax professionals, tax liabilities have been concluded much faster. This spelled a discontinuation of the trend common prior to the introduction of HM where both the NTCA

¹³ Multiple interviewees; e.g. interview with a tax administrator in March 2016 (NLO6, Rotterdam, 4 March 2016) and interview with a tax partner at a Big-4 firm (NL20, Rotterdam, 21 June 2016).

¹⁴ The corporate tax function exists in most large corporates and refers to the dedicated team of in-house professional tax specialists who manage the corporate tax affairs and obligations (Oats and Mulligan 2016).

¹⁵ Interview with a corporate tax director of a Dutch listed company (NLO7, Amsterdam, May 2016).

and corporate tax professionals spent many administrative resources on clarifying and discussing not yet concluded tax years.

Corporate tax officials have recently taken a more critical stance regarding the gains they perceive to acquire from HM. This is particularly due to a perceived reduction in speed by the tax administration in providing clearance on corporate tax enquiries. One of the reasons for the reduction in speed is that client managers in the NTCA, but also the tax officials on which the client managers rely, have become more careful in formulating answers to enquiries put forward by corporate tax officials and their advisers. Another reason is that enquiries, or other fiscal issues on which NTCA client managers are uncertain about, must be forwarded to working groups of tax inspectors that operate at the national level, who discuss the matter and provide binding advice on how to deal with it. Although the working groups have a long history in the Dutch tax administration they have become more prominent recently due to the greater emphasis put by the NTCA on policy consistency, which has led to the groups being consulted more frequently by tax administrators. According to several interviewees, the working groups, who mostly decide on a consensus basis, often take ‘too much time to arrive at a joint position’.¹⁶ NTCA client managers, and especially those who interact with companies that have concluded a HM covenant and hence have been promised fast interaction, do feel responsible for speeding up the decision-making process by the working groups, but have limited possibilities for doing so, besides ‘trying to chase them up’.¹⁷ To explain the NTCA’s changing interaction style with corporates over the lifetime of HM, interviewees from all sides of the corporate tax triangle refer to political and societal factors affecting the Dutch tax system. One corporate tax official comments about this:

What I have been seeing lately [-] is a retreating availability and accessibility of the tax administration to quickly get to business and to get a quick reply to questions. And this is particularly due to Brussels, which means that they [the NTCA, DW] put increasing emphasis on policy unity, as it is aptly called, but of course this has a negative impact on what happens in our company, because we always assumed that we were able to make those quick decisions.¹⁸

The perceived reduced effectiveness of HM in being able to support corporate interests, especially by increasing fiscal certainty through speedy interactions, attenuates the HM relationship. Another factor diminishing HM from a corporate perspective is that in contrast

¹⁶ E.g. interview with a corporate tax official (NL10, The Hague, 25 May 2016) and interview with a tax partner at a Big-4 firm (NLO4, 4 March 2016).

¹⁷ Interview with a tax administrator (NLO6, Rotterdam, 4 March 2016).

¹⁸ Interview with a corporate tax official of a Dutch listed company (NL10, The Hague, 25 May 2016).

to the assumptions underlying the regulatory model, the NTCA has been unable in practice to intensify scrutiny of taxpayers who have not joined HM and have a high-risk of showing fiscal noncompliant behaviour. This mismatch between the original intentions of HM and the model's implementation can largely be explained by administrative capacity issues on the side of the NTCA. It has, however, generated some frustrations amongst covenant companies, who partly decided to make the significant investments in their tax function to prevent the intensified scrutiny they assumed they would be subjected to once they would have opted not to join HM. Finding out that high-risk companies have continued to be subjected to traditional supervision is seen by these companies as the NTCA being insufficiently reciprocal in its commitments, or, as put by one interviewee: 'the NTCA has failed hitherto to go after the bad guys'.¹⁹

Results of a survey conducted by the NTCA also indicate differences in perception between NTCA officials and corporates regarding the effects of HM on the tax strategy of businesses. While the NTCA client managers indicated a positive impact between HM and companies' fiscal strategy, survey results amongst corporate participants did not provide support for any impact of HM on companies' fiscal strategy (Belastingdienst 2017).

Some interviewees also relativize the impact of HM on collaboration between actors in the Dutch tax triangle. According to these interviewees, large corporates already had relatively easy access to the NTCA and the Dutch Finance Ministry, and HM has formalised some of these interactions, especially through the use of covenants, but not fundamentally altered the nature of those collaborative dynamics already occurring.²⁰

¹⁹ Interview with a corporate tax director of a Dutch listed company (NL07, Amsterdam, 25 May 2016).

²⁰ E.g. interview with a corporate tax official (NL09, The Hague, 25 May 2016) and interview with a tax partner at a Big-4 firm (NL, Eindhoven, 4 March 2016).

5. Legal considerations

The legal aspects of HM have generated some debate in the Netherlands. The main legal feature of HM is the covenant and interviewees indicate that the legal status of this document creates uncertainty amongst some corporate taxpayers, especially foreign companies unfamiliar with the typical Dutch tradition of concluding covenants between public and private sector actors (Stout 1994).²¹ A further reason for the unclear status of the covenants is that both the tax administration and corporate taxpayers have resigned from using the covenant in the small number of judicial disputes that have occurred within HM arrangements.

Interviewees showed mixed views about the legal position of the compliance agreements, with some arguing that the status of a covenant is equal to a private contractual agreement, and hence additional obligations are put on both the tax administration and corporate taxpayers in case of a HM relationship.²² Others, however, emphasise that the introduction of HM has not brought any formal change in how compliance is assessed for corporates who participate in HM and those who do not. With no legal disputes having yet arisen to clarify the judicial status of the covenants, the obligations as formulated in the covenants are observed by most interviewees as merely setting out intentions of commitment for both parties without having any direct legal implications in case of nonfulfillment.

Apart from some tax advisers, the NTCA and corporate taxpayers are hesitant to provide HM with a stronger legal base. A prevalent concern is that formalisation would eliminate important gains of HM, such as its flexibility and speed. After all, the most important gain of the model is the real-time and flexible interactions it facilitates between corporate tax officials and NTCA client managers, which has enabled corporates to reduce their fiscal risk, and the tax administration to faster process submitted tax returns. It is this flexibility that is likely to be impaired in case of further formalisation. For example, formalisation will likely reduce discretionary space of NTCA client managers.

Although the low level of legality provides HM with flexibility, the absence of significant formal structures results in limited transparency, which has made HM vulnerable to external critique. Vennix (2011) refers to the model as a ‘legal no man’s land’, and particularly criticises the complete absence of any formal regulations for situations where a company

²¹ Stout (1994) describes a covenant as ‘an agreement between two or more parties, at least one of which is a public actor, involving an exchange between the government and the target group concerned’.

²² Interview with a tax academic in May 2016 (NL16, Leiden, 27 May 2016).

that is eager to join HM is denied access, or the covenant of a company within the programme is being terminated by the NTCA against the company's will.

Today, the informal nature of HM is largely considered a weakness due to the transition that has taken place in Dutch media and society over the past decade. The tax behaviour of large companies receives increasingly critical and prominent coverage in Dutch public debates, a trend seen in other countries. In this climate, referring to HM as a 'gentleman's agreement' may still hold the positive, professional connotation for actors involved, but to outsiders it seems a cover up term for what is perceived to be an exchange of illegitimate favours. Hence, one high level civil servant in the Dutch Ministry of Finance interviewed for this report doubted whether in the current Dutch societal climate, 'HM would have been given a chance, had its implementation been considered today'.²³

Notwithstanding general concerns that increased legalisation reduces the attractiveness of HM, there are several reasons as to why formalisation may be beneficial to both the tax administration and corporate taxpayers. First, HM does pose risks to the requirement of generality and equal application of rules. This does not so much result from the fact that the NTCA treats different categories of taxpayers differently. For example, a small family business presents different complexities than a listed company with global activities. These different fiscal profiles, in combination with the different fiscal contributions of these businesses, offer the NTCA a reasonable motive to apply its discretionary space and justify its service level accordingly. However, HM introduces an additional inequality in service provision to taxpayers: two businesses can have similar features, except that one company has concluded a covenant with the NTCA and the other is subjected to traditional monitoring. The covenant company is promised a higher service level than the non-covenant company. Clearly, this type of categorisation amongst taxpayers with seemingly similar inherent features raises more fundamental questions regarding the proper use of discretionary space by tax administrators. Although a higher level of fiscal control might justify a higher service level being provided to covenant companies, it is critical in such a situation that the NTCA is able to provide a clear benchmark against which the level of fiscal control of companies can be determined.

The inequality in service level promised by the NTCA is an inherent aspect of HM, and seems unavoidable to appeal to companies to participate in a voluntary model that demands them to be more open to the tax authority than they would otherwise have been (Sigler and Murphy 1988). As a pull factor, a higher service level can provide positive incentives for

²³ Interview with a high-level civil servant in the Dutch Ministry of Finance (NL15, The Hague, 27 May 2016).

corporates to improve their level of fiscal control, something that positively distinguishes Dutch cooperative compliance from models used elsewhere. In the UK and Australia, for example, cooperative compliance is largely a one-way relationship since participation is solely decided by the tax authority with heavy weight put on inherent risk features that are difficult to influence by the corporate through positive behavioural changes. However, as HM goes beyond the tax authority simply intending to improve its customer service for all business taxpayers, but instead articulates this commitment in one-to-one agreements with individual businesses it would be relevant to better specify the content of those mutual obligations.

Another legal issue raised with HM does not relate to the stronger service provision provided to covenant companies, but instead emphasises the disadvantages covenant companies may experience. Covenant companies are obliged to put forward to the tax administration any of the tax enquiries they may have. These can be both principle questions, dealing with fundamental tax questions of a general nature, and factual questions that relate to specific tax situations. The tax administration on its turn must answer the enquiries in a timely manner. While companies who are not part of HM can ask the tax administration both principle and factual questions, the tax administration is only obliged to answer the general questions, while answering the factual question is at the administration's discretion.

Due to their duty to put forward to the tax administration all queries they are uncertain about, covenant companies will be informed of the tax administration's view at an early stage. In case of disagreement, covenant companies have no direct option to contest the administration's view – their only option is to wait for the tax administration's final assessment of the company's tax filings, after which the company may decide to litigate against the tax administration's decision through the cumbersome trajectory of objection and appeal. Hence, several observers have proposed to enlarge the legal options of covenant companies by giving the answers of the tax administration to principle and factual questions the status of a decision that can be appealed against (*'voor bezwaar vatbare beschikking'*). This would enable covenant companies to directly contest the tax administration's position, rather than after tax returns have been filed, and as such fasten the ability of covenant companies to acquire legal certainty over their tax position (e.g. Huiskers-Stoop 2016).

Although the tax administration has been hesitant, critique from legal scholars in particular regarding the lack of legal options available to corporates in case of disagreement with the tax administration's position has resulted in changes being implemented, as well as currently considered. Since 2016, lower courts in the Netherlands may ask prejudicial questions to the Dutch Supreme Court, which is expected to speed up clarity in case of

principle questions (*rechtsvraag*). In addition, a recent report by the Tax Chamber of the Dutch Supreme Court proposes that the tax administration will issue all future answers to principle questions in the form of ordinances, which would open up the ability for taxpayers to appeal against those answers at the Dutch Supreme Court ('cassation').²⁴ The Tax Chamber's proposal does not only derive from concerns about the legal position of corporate taxpayers, but is also a result of growing unease in the Dutch legal profession about the consequences of the decline in legal disputes between the NTCA and corporate taxpayers since the introduction of HM. The reduction in cases at the lower courts has made that far fewer cases have ended up at the Dutch Supreme Court, which has impeded the Supreme Court's constitutional duty to contribute to the development of corporate tax law. The newly created opportunity for corporate taxpayers to appeal against the NTCA's answers to principle questions, without the necessity of an official dispute having arisen, should revive the Supreme Court's role in the area of corporate tax.

²⁴ *Commissie Hoge Raad: 100 jaar belastingrechtspraak, De Belastingkamer van de Hoge Raad. Verleden, heden en toekomst – een verkenning*, Geschriften van de Vereniging voor Belastingwetenschap, no. 255, 2015.

6. Discussion and policy implications

On the whole, HM seems to have positively strengthened relationships between tax administrators and businesses in the Dutch tax system. It is due to HM that interactions between both sides have increased, which has enhanced understanding amongst tax administrators of the position of corporate taxpayers, the motivations that underlie their behaviour and, where feasible, to adjust the NTCA's service provision based upon corporates' particular needs. Increased attention in the training of NTCA client managers for the internal operation of businesses, and tax administrators being incentivised to interact in an open and less hierarchical manner, also increased professional understanding between both sides. Increased interactions have also enhanced corporate understanding of the internal operation and challenges faced by the tax administration – e.g. reflected in comments made by corporate interviewees about the work pressures faced by 'their' NTCA client managers caused by the frequent reorganisations and staff reductions within the NTCA. Again, this contrasts with the pre-2005 period where lack of communication between the tax administration and corporate taxpayers meant that corporate taxpayers had limited awareness of the position of the NTCA, contributing to an atmosphere where a late reply to a taxpayer's enquiry would be explained by unwillingness from the tax inspector.

The increase in mutual professional understanding also followed from an explicit aim of the NTCA to increase knowledge amongst tax administrators about the way businesses operate beyond the fiscal dimension, and the administrative needs this generates amongst corporate taxpayers. Businesses, on their part, put effort in making it credible to the tax administration that they hold genuine intentions of building their relationship with the tax administration based on the fundamental principles of HM: mutual trust, understanding and transparency. Hence, under HM the attitude of both corporates and tax administrators has shifted from an adversarial 'them and us' relationship, to one stronger characterised by cooperation.

The analysis in this paper demonstrates that current societal developments change the dynamics of Dutch HM. First, the NTCA puts increased emphasis on policy unity, especially due to increased scrutiny by Brussels of tax rulings agreed upon between national tax administrations and corporate taxpayers. The emphasis on policy unity reduces discretionary space for tax administrators and has led to more cautious interaction by tax administrators with business taxpayers. This has slowed down interaction between both parties, reducing the pace of interaction as one of the core advantages of HM for business taxpayers. Second, negative media reporting about the fiscal behaviour of large corporates has increased cautiousness amongst corporates of being associated with fiscal arrangements that could give rise to accusations of receiving illegitimate favours from tax administrations

(‘sweetheart deals’). In both cases, the effect is that tax administrators and corporate tax professionals in HM relationships have become more rigid or set in their attitudes, reducing the chance to arrive at a shared professional judgement based on facts and shared values.

Several policy implications emerge from the Dutch experience. First, the Dutch system illustrates the importance of careful planning when introducing a cooperative compliance framework. The lack of experience internationally with cooperative compliance systems at the time of the introduction of HM means that the NTCA currently seems to be facing a phenomenon that has been referred to by the Dutch historian Jan Romein (1937) as the ‘law of the handicap of a head start’ – i.e. an initial head start in a given area results in a handicap in the long term, as progress in a particular area creates circumstances in which stimuli are lacking to strive for further progress. These lock in dynamics also seem to operate in Dutch HM, as tax actors have become used to a certain way of working, with any change to these processes likely to undermine the interests of at least one of the tax actors involved.

It can be expected that an adequate implementation of cooperative compliance requires more rather than less administrative capacity from the tax administration and participating company, at least during the initial period. To reduce administrative costs, it is crucial that both the tax administration and businesses develop systems enabling them to deal effectively and efficiently with the high degree of interactions that take place within cooperative compliance arrangements. This high level of interaction will especially occur during the initial stage of cooperative compliance, when a relatively large number of businesses are likely to be in need of more feedback to improve their level of fiscal control. The Dutch case demonstrates that admitting (too) many companies to a cooperative compliance system, which still possess a limited level of fiscal control, is likely to overstretch the administrative capacity of the tax administration.

With HM facing a more challenging environment compared to its introductory period, the analysis of the regulatory relationships between the tax administration and businesses allows us to reflect upon the question how, in light of increased external scrutiny, the long-term sustainability of HM can be strengthened. Transparency about the differences in interest between the tax administration and businesses, and how the regulatory regime deals with these differences, is critical to make cooperative compliance systems more robust. With its emphasis on the relationship, and autonomy for corporates and NTCA client managers, HM has inherent aspects that do make the model vulnerable to outside critique, and require a robust and confident reply from the political and administrative leadership of the tax administration, businesses, and, where possible, third parties such as tax advisers. More openness about the model by the NTCA may help to circumvent some of the critique.

Currently, information disclosure about HM is highly limited, with not much more being reported than aggregate figures on the number of participating HM companies. The publication of an annual report, including a discussion as to why companies have joined HM, have left it, or have seen their covenant status being suspended, would be valuable in order to clarify procedures in place, and would enable feedback from both within and outside the Dutch corporate tax triangle. Greater transparency would also help to improve the model's working in practice. A possible concern is taxpayer confidentiality which could be resolved with reports which take their lead from the UK Tax Assurance Commissioner's office. The UK Tax Assurance Commissioner annually reports on the resolution of tax disputes between HMRC and corporate taxpayers, publishing discussions around selected, but anonymized, case studies (e.g. HMRC 2015, 19-22).

A higher level of formalisation is also a prominent option for change. First, a higher level of formalisation would be relevant for the actors involved. In case a company is subjected to low supervision in HM, because it has been able to acquire the trust from the tax authority, it would be relevant to specify the consequences of non-compliance. Clearly spelled out sanctions in case of non-compliance, such as higher penalties for covenant companies who violate the NTCA's trust, would increase the likelihood that the company concerned justifiably receives a high-level of trust. Covenant companies on their side might profit from the NTCA specifying the service levels it intends to provide, so companies can make a more well considered judgement as to whether they find the potential gains from HM sufficient for making the extra effort in the direction of the tax authority. Second, a higher level of specification of the commitments and working processes between both parties may help in reducing external concerns about HM.

This report highlights the importance of further research on the working practice of HM, and similar systems of cooperative compliance. Although the Stevens Committee conducted a largescale investigation in 2012, the endorsement the Committee gave of HM in its final conclusions was mainly based on the user experiences it had collected, especially through its conducted interviews, rather than a more independent analysis of the model's claimed effects, such as its impact on taxpayer compliance.

First, there is a need to better understand when businesses are 'ready' to participate in HM, and, in case they are not, how the tax administration can support businesses in increasing their level of fiscal control, in a manner that is effective and efficient both from a business and tax administration perspective. Second, more research is required on the administrative requirements for creating an effective and efficient cooperative compliance system. The Dutch case of HM illustrates a substantial gap between theory and practice. This raises the

question whether the administrative prerequisites of HM are realistic, especially considering the ongoing pressures on the resources of the NTCA, pressures which are not unlike the situation in many other tax administrations. Some cost and benefit analyses conducted of cooperative compliance programmes in other tax administrations, such as comparisons drawn in the US Internal Revenue Service (IRS) of the hourly revenue rates generated by tax inspectors from a traditional versus cooperative compliance audit, would also constitute relevant metrics for better understanding the performance of Dutch HM.

Obviously, there is no universal model of cooperative compliance and specific choices underlie the design of the Dutch system. Despite its specific features, Dutch HM demonstrates many similarities to cooperative compliance systems elsewhere, especially its emphasis on one-to-one relationships between the tax administration and corporate taxpayer. The Dutch case shows that this emphasis is both a strength and weakness of the model: it enables flexibility, solidarity and professional-based relationships, but it may also give rise to external distrust, demands high administrative capacity, and causes risk of regulatory capture. A promising way to circumvent some of these weaknesses is to improve aggregate data systems about corporate taxpayers, which may help tax administrations to validate their discretionary decision-making using big data. It would also enable tax administrators to provide more and better feedback to corporate tax professionals, focused both on features that increase and features that reduce a corporate's risk of non-compliance. Clearly, there is an important role for cross-disciplinary collaboration between scholars to analyse how recent technological innovations have and will affect cooperative compliance systems.

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8. Project information

FairTax is a cross-disciplinary four year H2020 EU project aiming to produce recommendations on how fair and sustainable taxation and social policy reforms can increase the economic stability of EU member states, promoting economic equality and security, enhancing coordination and harmonisation of tax, social inclusion, environmental, legitimacy, and compliance measures, support deepening of the European Monetary Union, and expanding the EU's own resource revenue bases. Under the coordination of Umeå University (Sweden), comparative and international policy fiscal experts from eleven universities in six EU countries and three non-EU countries (Brazil, Canada and Norway) contribute to FairTax research.

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Please respect that this report was produced by the named authors
within the FairTaxProject and has to be cited accordingly.

Appendix I

Illustration of a covenant agreement. English translation, as published by the NTCA.

ENGLISH TRANSLATION

Individual Compliance Agreement

Parties

This Agreement is concluded between:

- [COMPANY], established in [address], represented by[name] and the Netherlands Tax and Customs Administration (referred to as the Tax Administration), represented by
- [name, position, Tax Administration]

This agreement also applies to entities which are controlled by [COMPANY]. Parties have mutually agreed on the entities concerned. Together they will be referred to as [X].

Introduction

Parties want to achieve an effective and efficient mode of operation. They aim for permanent actual insight into relevant events and fast decisions in order to increase legal certainty. The basic principles and the desired form of cooperation are laid down in this agreement.

The original Agreement is in the Dutch language and the Dutch text shall prevail.

1. Basic principles

- Parties base their relationship on trust, understanding and transparency.
- Rights and obligations pursuant to legislation and regulations are and will remain applicable without limitation.
- This Agreement is applicable to levying of all [X]'s Dutch State Taxes¹ and collection.

¹ Where appropriate this may also include the application of the VAT Compensation Fund.

2. Agreements between [X] and the Tax Administration

[X]:

- provides a system of internal control, internal audit and external audit aimed at preparing and filing acceptable tax returns²;
- ensures timely payment of tax debts;
- submits its view, taken or to be taken, on relevant (fiscal) matters to the Tax Administration as soon as possible. This applies to matters on which a difference of opinion may arise with the Tax Administration, for instance on a different interpretation of facts or matters of law. [X] actively provides the Tax Administration insight into all relevant facts and circumstances, its view and its interpretation of the relevant legal consequences thereof;
- promotes real time processing. Tax returns and declarations will be filed as soon as possible after the end of the tax period. Any information requested by the Tax Administration will be provided as soon as possible, in full and unambiguously.

² An acceptable tax return conforms to legislation and regulations and contains no material misstatements;

The Tax Administration:

- adjusts the form and intensity of its supervision to the quality of internal control, internal audit and external audit;
- ensures timely payment of tax refunds;
- issues its interpretation of the legal consequences as soon as possible after receipt of a point of view taken or to be taken, as much as possible in consultation with [X];
- takes the relevant periods into account when giving its interpretation of the legal consequences;
- discusses (relevant) fiscal and other matters with [X]; in particular matters on which a difference of opinion may arise from the Tax Administration's point of view;
- will clarify and explain why specific information is requested from [X], and mutually agree on the response period with [X];
- promotes real time processing. Assessments will be imposed as soon as possible after filing of tax returns and in consultation with [X] as much as possible.

Parties have found solutions for or agreed on issues relating to fiscal and other relevant matters from the past presently known to [X] and/or the Tax Administration in accordance with legislation and regulations, or have agreed on procedural arrangements.

3. Duration, regular evaluation and termination

This agreement is made for an indefinite period of time. The agreement will be evaluated periodically by [X] and the Tax Administration. If one of the parties wishes to terminate this agreement, the other party will be informed in writing in advance of the reasons. Moreover, termination will not take place before oral consultation, if at least one of the parties would like such consultation. After such consultation, this Agreement may be terminated with immediate effect.

4. Commencement date

This Agreement commences when both parties have signed.

On behalf of [COMPANY]

On behalf of the Tax Administration

(Name)
(Position)
(Date)

(Name)
(Position)
(Date)