

# Co-operative compliance

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**“An enhanced relationship offers benefits for revenue bodies as well as taxpayers ... taxpayers who behave transparently can expect greater certainty and an earlier resolution of tax issues with less extensive audits and lower compliance costs. An enhanced relationship between revenue bodies and tax intermediaries would also yield significant benefits.”**

Co-operative compliance: a framework from enhanced relationship to co-operative compliance (OECD 2013)

## 1. What is co-operative compliance

Co-operative compliance is an extension of a risk-based approach to tax compliance. It can be described as a voluntarily enhanced relationship between a revenue body and business taxpayers based upon mutual increased transparency, cooperation and collaboration. It is intended to change the nature of the dialogue between revenue bodies and taxpayers where taxpayers pro-actively notify revenue bodies of any issues with a possible or significant tax risk and to disclose all facts and circumstances regarding such issues to speed up the audit process and resolve uncertain positions quicker.

Additionally, taxpayers are expected to give revenue body an entry to their control systems used to manage tax risks on the premise that if the revenue body is satisfied with those, there should be no need for them to carry out traditional audit of underlying transactions and tax judgments. So, based on the voluntary disclosure and entry to the control system, the revenue body applies a lighter touch compliance regime to eligible taxpayers. This offers a win-win solution incentivizing taxpayers to be compliant and allowing revenue bodies to focus their resources on a smaller group of potentially less-compliant taxpayers, effectively raising greater tax revenues with fewer resources available to do so.

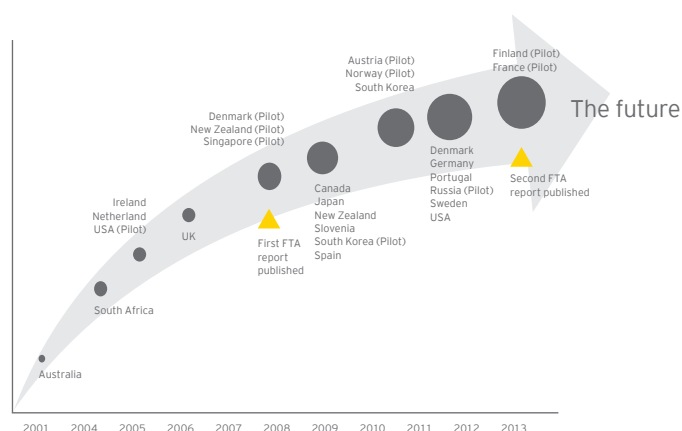
While there is no one universal co-operative compliance model, most of the existing approaches aim to achieve greater certainty of the outcome of the interaction between revenue bodies and taxpayers in exchange for greater transparency.

Importantly, co-operative compliance is not just about voluntary disclosure as it requires development of a number of tools and mechanisms that serve as safeguards and enablers, including for example, tax control framework (TCF), commercial awareness of revenue bodies, ultimately introduction of systems allowing real-time exchange of information in pre-defined format etc.

## 2. Evolution of co-operative compliance

The first country to introduce a formal co-operative compliance model was Australia in 2001. By 2008, a handful of countries, including South Africa, US, UK and Netherlands adopted their versions of co-operative compliance programs. Given the magnitude and the effect of this movement, in 2008, the Forum on Tax Administration (FTA) published a Study into the Role of Tax Intermediaries (the 2008 Study) which encouraged revenue bodies to establish a relationship with large business taxpayers based on trust and cooperation – the so-called “enhanced relationship.” Five years later, the FTA changed the term to “co-operative compliance.”

Overall, the 2008 study concluded that the value of the co-operative compliance approach has been established and it is notable how many countries have developed programs of this kind in the past five years.





### 3. Co-operative compliance and tax activism

Recently, in many countries, tax activism and media coverage is sparking broad public discussion and political focus on business taxation, with reactionary 'name and shame' campaigns against large multinational companies with lower effective tax rates.

While applying a co-operative compliance program by these large business taxpayers may support their 'fair tax regime,' the latest FTA report (2013 Report) on co-operative compliance highlights a concern raised by some commentators that the 'enhanced relationship' may call into question the fundamental principle of taxpayers' entitlement to equal treatment under the law.

Similar concerns have surfaced in the public 'fair tax' debates with questions over the appropriateness of co-operative compliance models and suggestions that revenue bodies' relationships with large business taxpayers may have become too 'cozy'. The OECD/FTA recognizes that public trust and confidence in the enhanced relationship/co-operative compliance model will have to be restored through strengthening the revenue body governance process around co-operative compliance. This process will require the revenue bodies to implement a framework which sets out the terms of the engagement, how decisions are made on who enters the program and for which period of time, how the review process will be undertaken etc. which will support the well-evidenced judgments by revenue bodies on the appropriate risk status of large businesses.

### 4. How does co-operative compliance work?

In a country with a co-operative compliance program, taxpayers who want to apply for the program need to offer disclosure and transparency (that go beyond their statutory obligations) via implementation of tax control framework (TCF) – system of internal controls that ensure that tax returns submitted to the revenue bodies are accurate and that transactions or positions giving rise to material tax uncertainty are disclosed. Taxpayer may also agree to submit additional information to the revenue bodies in pre-agreed format, including information on uncertain tax positions.

Within co-operative compliance, it is recognized that complex tax interpretation questions also require an open and constructive dialogue between taxpayers and revenue bodies exploring alternative interpretations of the law in relation to transactions in question. This more open, transparent approach is typically accompanied by pre-filing resolution programs and more robust domestic dispute settlement procedures.

Revenue bodies will assess monitoring, electronic business and accounting systems of the taxpayer to form an opinion on the effectiveness of its TCF. The way how such an assessment is done differs from country to country, but always forms an integral part of the process. If the revenue bodies are of the opinion that the TCF is effective, a co-operative compliance agreement should become available for the taxpayer.

### 5. Why would revenue bodies and taxpayers want to sign a co-operative compliance agreement

Revenue body	Tax payer
	Create a collaborative and trust-based relationship with a willingness to resolve disputes as soon as possible
Better informed of tax affairs of key taxpayers	Increased tax certainty achieved at earlier stage
Able to undertake more effective risk assessment	Reduce the need for (large) reserves for tax risks due to reduction of a number of open years
Increase compliance yield with reduced resources by focusing these resources on the most significant risks	Reduces stress in the system
Reduce administration costs of tax administration	Reduce compliance cost by reducing the need for revenue bodies to conduct intrusive audits
Demonstrate transparency in dealing with taxpayers	Demonstrate transparency in dealing with revenue bodies



Revenue body	Tax payer
Increase efficiency, effectiveness and fairness of tax administration and improved confidence in revenue bodies' ability to administer tax system	Reduce the risk of becoming known as an aggressive tax planning corporation
Improvement of taxpayer compliance	Better control of tax risks through introduction of TCF
Improvement of customer experience	Increase the ability to identify and bring problems to tax policy makers and tax administration in collaborative manner

## 6. Revenue bodies and co-operative compliance

### 6.1 Potential challenges

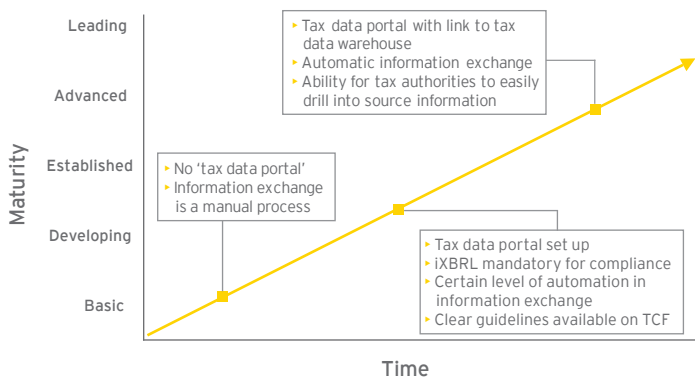
When implementing a co-operative compliance program, revenue bodies may want to consider the following challenges:

- ▶ What benefits should be offered to co-operative compliance participants, e.g., greater certainty, less frequent audits, possible materiality limits, open discussion of areas of risk, reduced penalties on behavioral grounds etc.
- ▶ Whether implementation of co-operative compliance requires a change of tax legislation. In this respect, it should also be taken into consideration that more and more taxpayers are looking at multilateral co-operative compliance approach, where the co-operative compliance is not limited to just one country. However, country-specific tax legislation may limit the same approach in different countries.
- ▶ Need for the revenue body to be open and transparent about its core values and approach to a co-operative compliance process as well as need to disclose some of the detailed rules and procedures. This will include standard working programs, based on legislation, ethical rules and core values and operating systems, including written guides to contribute to an unambiguous and predictable way of working.

- ▶ Specifically, revenue body officers (and the revenue body in general) will have to protect themselves against allegations of special treatment of taxpayers within a co-operative compliance regime. The revenue body will have to be able to show that tax is applied fairly to all, with no inappropriate concessions to co-operative compliance taxpayers. There are opportunities to clearly publish settlement criteria, and to have open, transparent and robust governance procedures for settlements, including a potential role for parliamentary scrutiny.
- ▶ Potential resource implication as involvement of a second (or even more) pair of eyes will be required to assure decisions are not made by one individual and minutes of every meeting will be mandatory, and the content will need to be signed off by the taxpayer and the revenue body.
- ▶ Setup of training programs and programs of regular contact between experts to enable tax officers to learn together and to learn from each other.
- ▶ Make sure that field auditors are aware of the co-operative compliance regulations and not only the tax officers.
- ▶ Implementation of a formal rotation system to reduce the risk that tax officers lose their independence and professional attitude.
- ▶ Implementation of a monitoring system that is used to measure the quality of work done and provide insight in the way the taxpayer has been treated also in comparison to other taxpayers.
- ▶ Clear instructions should state how you select taxpayers you would like to invite to cooperate. The focus should be on the larger taxpayers to make it as cost-efficient as possible.
- ▶ How do you start a co-operative compliance program? Would it, for instance, be a task for the revenue bodies to "audit every single number" of a taxpayer for a certain period to make sure it feels comfortable with the TCF? And, if the taxpayer has passed the test how will the revenue body make sure the taxpayer stays "ok"?
- ▶ Agree on ways to measure the achievements and the "success" of a co-operative compliance program from external and internal perspectives.



- ▶ Selection of system for “tax data portal” which will link to tax data warehouse of a taxpayer? Achieving a high-performing automated data sharing environment to support the co-operative compliance program is best seen as a journey of continuous improvement.



## 6.2 How can EY assist a revenue body?

Introduction of a co-operative compliance strategy should be designed to deliver improvements to compliance outcomes and potential relocation of financial and human resources.

EY can assist in:

- ▶ Designing the business case for implementation of a co-operative compliance program and related implementation plan
- ▶ Identifying and designing the co-operative compliance program that best fits local country legislative and business environment based on the analysis of domestic legislation and practices, and best international practices
- ▶ Drafting legislation/regulatory documentation describing the co-operative compliance concept and rules
- ▶ Design and support a co-operative compliance pilot program
- ▶ Design of organizational structure for the departments that will deal with co-operative compliance program, including design of KPIs, rotation principles, etc.

- ▶ Design of program for verification of reliability of TCF prior to admission of a taxpayer into the program and on a regular basis
- ▶ Design of risk-orientated audit work programs, including set up of standard or industry-focused tax audit files (SAF-T) structure and content fit for a particular country and its legislation
- ▶ Training of the revenue bodies (including tax officers and field auditors)
- ▶ Support of the IT side of the co-operative compliance program, including development of protocols for data exchange, standardization of data exchange (e.g., through use of XBRL)

## 7. Taxpayers and co-operative compliance

### 7.1 Potential challenges

- ▶ Need to assess benefits offered under co-operative compliance program against potential costs of enrolling into the program and maintaining participation in it
- ▶ Need to develop robust TCF to take a more systematic approach to tax risk, to identify, assess and manage tax risks as early as possible, and allow the taxpayer to achieve its strategic objectives, including meeting the increased demands for disclosure and transparency requirements, improved controversy management and enhanced relationships with revenue bodies
- ▶ Develop a set of criteria that should be met to maintain participation in the program
- ▶ Potential resource implication as joining cooperative compliance program may require substantial investment in initial assessment/audit and maintenance of participation both from tax and other departments of taxpayer's organization
- ▶ Set up of training programs to ensure members of tax team are aware of the co-operative compliance regulations
- ▶ Implementation of a monitoring system that is used to measure the quality of work done and provide insight in the way the taxpayer has been treated also in comparison to other taxpayers

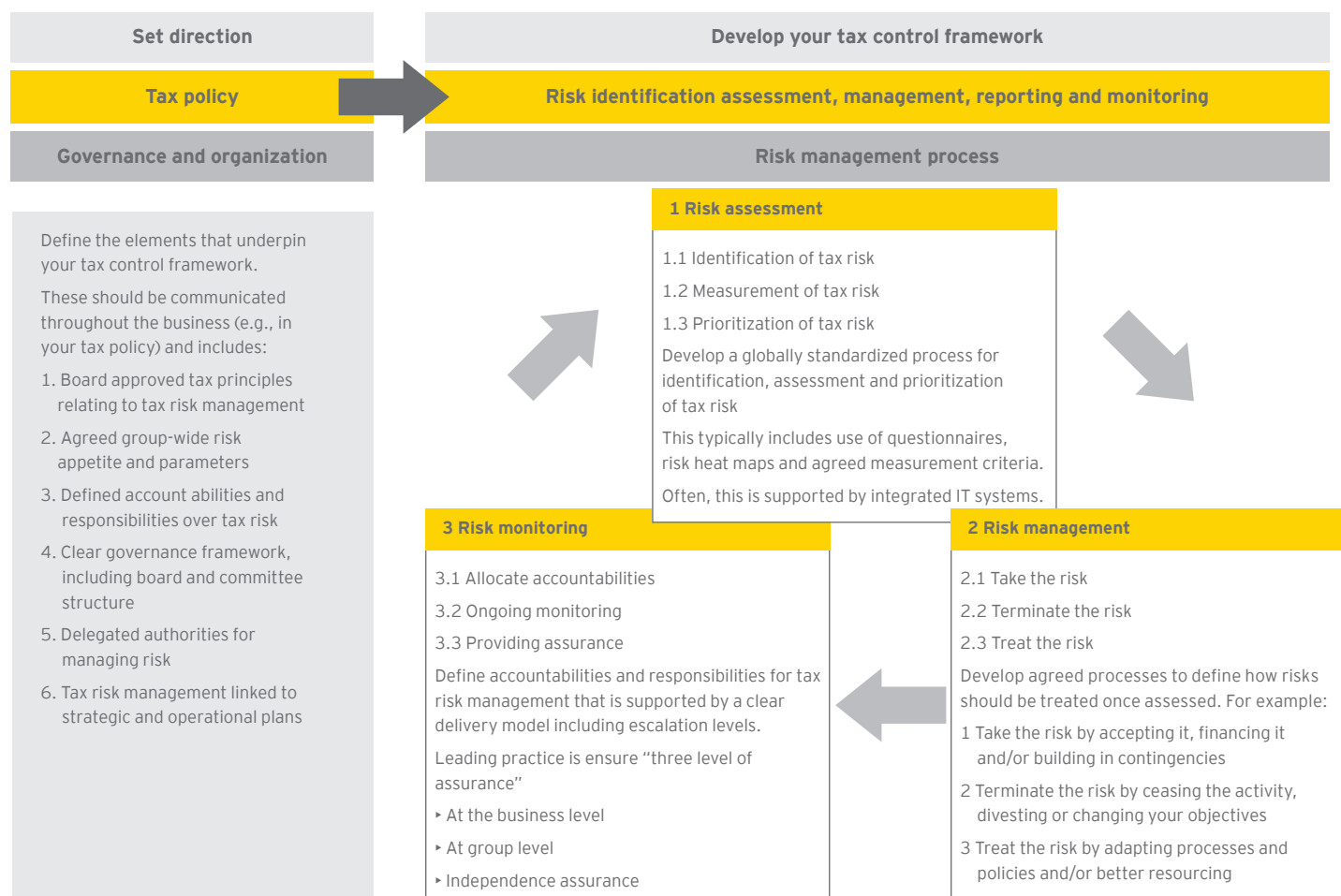


## 7.2 What is a tax control framework

- ▶ Currently, publicly disclosed guidelines from revenue bodies both in terms of defining a TCF and the criteria they adopt in assessing the scope and effectiveness of a TCF is not readily available.
- ▶ Ensuring strong tax governance and tax risk management are the two pillars of the TCF. As in the diagram below, the first

step in developing TCF is to set tax policy and the principles that define strategic objectives and governance for overall tax activities in the business.

- ▶ From there, a taxpayer can strengthen its controls putting in place robust tax risk management framework to pro-actively manage all tax risks arising in its business.







### 7.3 Managing data requirements of co-operative compliance

- ▶ Taxpayers will be expected to have in place a system that can meet the “automatic” data exchange requirements from revenue body’s perspective and, at the same time, make sure that the revenue body will not have access to more data than necessary.
- ▶ For example, the TCF should include the following elements:
  - ▶ Procedures to ensure the reliability of electronic records
  - ▶ Facility to export data for further analysis
  - ▶ Integration of internal and tax protection controls

### 7.4 Will co-operative compliance disadvantage the taxpayer?

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

### 7.5 How can EY assist a taxpayer?

- ▶ Design business case for enrollment into a co-operative compliance program and related implementation plan, assessment of “readiness” of a taxpayer to enter a co-operative compliance program on all relevant aspects, including:
  - ▶ Historical tax risks/technical positions review to identify the list of “critical risks” that would be subject to discussion with revenue bodies on “clean slate” stage/entering the co-operative compliance program. It will allow to do an inventory of uncertain tax positions and identify the “external” cost of entering a co-operative compliance program for a taxpayer (i.e., how big are the tax issues the taxpayer will need to disclose/settle with the revenue body).
  - ▶ An estimation of the additional “internal” cost of entering a co-operative compliance program and maintaining it (additional FTEs, IT budgets, etc.).
  - ▶ A TCF readiness assessment and a cost estimation of its remediation to the required/desired standard (please see below for more details).
  - ▶ An IT readiness assessment and cost estimation of its remediation (including setting up Audit file and its IT-related cost of implementation).



The result of this project should produce:

- ▶ A “hit map” of tax technical issues and roadmap/strategy of their advance resolution
- ▶ A data/IT/TCF readiness assessment and a roadmap to remediation
- ▶ An estimate of the “cost of the co-operative compliance program” (both external and internal) for a taxpayer
- ▶ An estimation of short- and long-term benefits (internal costs/ reduced cost of tax controversy)
- ▶ A conclusion on whether co-operative compliance is feasible to enter and if yes, a recommended timing
- ▶ Evaluate the existing TCF: The ‘essence’ of co-operative compliance is that the revenue bodies reduce tax audits and general scrutiny by ensuring that there is a transparent and appropriate TCF for the taxpayer.

This requires taxpayers to have:

- ▶ An operating and transparent TCF, underpinned by strong tax governance and a clear tax policy
- ▶ A continuous monitoring program for the TCF
- ▶ Transparent and open relationships with the revenue bodies that are able to clearly demonstrate this strong control environment
- ▶ Typically, our review of the effectiveness of an existing TCF involves benchmarking an organization’s TCF against best practice and our experience with co-operative compliance programs in multiple countries. We do this through:
  - ▶ A review of existing documentation such as tax policy or strategy documents, tax reporting and compliance procedures, formal control documentation, and any internal tax guidance

- ▶ Questionnaires and/or interviews with your tax and ‘shadow tax’ team as well as other key stakeholders
- ▶ If necessary, we can also perform more in-depth file reviews to validate our understandings of what we heard
- ▶ Managing data and use of technology is a key element of our review and we evaluate and consider the benefits of:
  - ▶ Workflow and information management solutions
  - ▶ Data storage solutions
  - ▶ Tax provision and tax compliance reporting solutions
  - ▶ eXtensible Business Reporting Language (XBRL) and taxonomy
  - ▶ Tax data warehouse set up and systems options to allow real-time exchange of information in pre-defined format
- ▶ Design and implementation of the TCF: Based on the findings from current state analysis and benchmarking review of the existing TCF, we make recommendations on how best to improve and/or operationalize elements of the TCF to ensure there exists a transparent and ‘assessable’ TCF for revenue bodies to review.
- ▶ Design and implementation of the Tax Audit file structure.
- ▶ Assist in communication with the revenue bodies in every stage of the process.

# EY co-operative compliance specialists

Over the last few years, EY has built up a team of experts around the world that has worked with governments, their revenue bodies and taxpayers on establishing co-operative compliance programs. This team has been able to identify best practices on both the part of revenue bodies and taxpayers. The team has an open dialogue with revenue bodies and has the experience required to adapt co-operative compliance to the specific circumstances of a particular country and of different sectors within a country where required.



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