

Tax Administrators, Taxpayers and Their Advisors: Can the Dynamics of the Relationship Be Changed?

In this article, Jeffrey Owens, the former Director of the Centre for Tax Policy Administration, OECD and now Senior Tax Policy Advisor to the Vice Chair – Tax of Ernst and Young gives his opinion on how to improve the relationship between tax administrators, and taxpayers and their advisors.

1. Introduction

When you are on the front line of tax compliance, whether as the head of a large business unit in a tax administration or the head of a tax department in a multinational company (MNC), it is sometimes difficult to separate underlying trends in tax compliance from “bumps in the road”. Today, we stand on the threshold of a change in the relationship between tax administration, taxpayers - especially large MNCs which account for the bulk of corporate revenues - and tax advisors. The question is, can we pass over this threshold to move towards a relationship which is more open and one characterized by trust and understanding?

Over the last two decades, we have seen many governments move towards tax systems that are more business-friendly and encourage entrepreneurship:

- Top rates of personal income tax have been cut, in some cases more than halved. A number of economies in transition have moved to flat rate taxes. Capital gains taxes have either been eliminated or reduced. Net wealth taxes have almost disappeared (two decades ago, 17 OECD Member countries had these taxes, today only three). Many countries have abolished inheritance taxes or significantly scaled them back.
- Corporate income tax rates have been drastically cut and corporate tax systems have shifted away from worldwide systems to territorial systems.
- Tax structures have shifted from direct taxes to consumption taxes with a tripling in the number of countries that now have a value added tax.
- Under the leadership of the OECD and the UN there has been a concerted effort to achieve greater consistency in the application of international tax arrangements and to put in place procedures that try to avoid cross-border tax disputes and to resolve them more

quickly when they do arise (mandatory arbitration is a standard feature of the OECD Model (2010)).¹

- Tax administrations have accepted that getting high levels of tax compliance requires not only robust enforcement but also improved taxpayer service. They have developed more sophisticated risk management tools, a greater willingness to group taxpayers into high and low risk groups, and a “lighter touch” audit approach to those classified as low risk. Today, many tax administrations are actively increasing levels of commercial awareness and industry specialization and many of the tax authorities’ auditors now have a better awareness of how business operates. We have also seen many countries move towards pre-filing resolution programmes (the Compliance advance program (CAP) in the United States and horizontal monitoring in the Netherlands² as leading examples, with more nascent processes elsewhere) and more robust domestic dispute settlement procedures.

Overall, these changes have made tax systems more business-friendly than they were in the 1980s, for example. How have taxpayers responded to these changes? Have they become more compliant and more risk averse to engage in aggressive tax planning? The experience of many countries suggests that this has not been the case. Certainly between 1990 and 2010 tax administrations were coming across schemes that were increasingly complex, increasingly creative and detached from underlying economic realities. Over these two decades, and particularly over the last three years, we have seen a greater media focus on the tax affairs of both MNEs and High Net Worth Individuals (HNWIs). Non-governmental organizations (NGOs) have succeeded in putting non-tax compliance on the front pages of newspapers and this in turn has led to a greater political focus on tax evasion.

.....
* Senior Tax Policy Advisor to the Vice Chair – Tax of Ernst and Young. The views expressed in this article do not necessarily reflect those of Ernst and Young. The author can be contacted at jeffrey.p.owens@gmail.com.

1. *OECD Model Tax Convention on Income and on Capital* (22 July 2010), Models IBFD.
2. For more on this topic, see L. van der Hel-van Dijk & M. Pheijffer, *A Tailor-Made Approach to Fiscal Supervision: An Evaluation of Horizontal Monitoring*, 66 Bull. Intl. Taxn. 10 (2012), Journals IBFD.

2. How are Governments Responding to these Pressures on Their Tax Systems?

An early reaction – which we see continue to play out – was to put in place more aggressive anti-abuse legislation, reinforcing controlled foreign company (CFC) legislation and thin capitalization rules. Many countries, particularly in the European theatre continue to move to limit the deductibility of interest. We also saw a general shift towards the introduction of general anti-avoidance rules (GAARs), both in OECD Member countries (the United Kingdom has just issued a discussion draft) and non-OECD countries (India has said that it intends to introduce a GAAR).

These legislative changes have been accompanied by an intensification of international tax cooperation. The OECD's Forum on Tax Administration (FTA), which now brings together 43 countries, including all the G20 countries, has been at the forefront of this improved cooperation. A network of information exchange agreements continues to grow and support the now universally endorsed exchange on request standard. Recently, we have seen a renewed interest in automatic exchange of information, and 2014 will see many further developments in this area. Mutual assistance is being extended beyond just exchange of information to cover the service of documents and the collection of tax and increasingly this is taking place in a multilateral not bilateral framework. Many countries are now moving beyond cooperation to greater coordination of their actions to promote better tax compliance and we are seeing countries beginning to explore the use of joint audits. Most recently, we have seen the launch of the "Tax inspectors without borders" programme by the OECD, aiming to up-skill the tax audit capabilities of emerging markets in particular. Overall, tax administrations are now more joined-up than in the past and are far better placed to quickly identify schemes that facilitate non-compliance with both the letter and the spirit of the law.

3. Breaking the Cycle

So what is the solution? Perhaps, rather than governments using their fingers to block holes in the tax dike, taxpayers and governments should be asking themselves if the dike is in the right place. Or, put another way, can we change the relationship between taxpayers, their advisors and tax administrations?

Moving the relationship towards a true partnership based on openness, a mutual understanding and a willingness to engage in a constructive and frank dialogue is not easy, whichever lens you view it through, and very few countries have achieved this transformation. Nobody is suggesting that the relationship between taxpayers and tax administrations will be free of conflict and tension, but it should be possible to manage this tension and to recognize that there are many areas of common ground.

Behavioural change is always more difficult than legislative change. But now is the time to make a sustained effort to move from a "basic relationship" to what the FTA calls an "enhanced relationship" (see Box 1). The enhanced rela-

tionship concept is founded on transparency and cooperation on the behalf of taxpayers throughout the year and a highly collaborative approach between the taxpayer and the tax administrator. As such, it can be characterized as a form of voluntary disclosure: the taxpayer promises actively to notify the tax authorities of any issues with a possible or significant tax risk and to disclose all facts and circumstances regarding the issues without hesitation or reservation. In return for full disclosure, the tax authority endeavours to provide timely advice on significant positions, taking into account real commercial deadlines when doing so. This approach provides the taxpayer with increased timeliness and certainty and, hopefully, a reduction in the volume of open issues and controversy.

An enhanced relationship is certainly not limited to only comprehensive, contemporaneous processes such as the CAP or horizontal monitoring though. The basic concepts could apply equally to pre-filing agreements for one issue, or equally to the post filing audit process for another. It is a holistic, cultural approach to working together that is supported by processes, not based upon them.

Box 1: Enhanced relationships

- A new cooperative way of building tax compliance:
 - Moving away from a basic relationship:
 - Operating only by reference to legal requirements
 - Limited disclosure and no signals of uncertainty
 - Low levels of trust
 - Towards an enhanced relationship:
 - Establishing and sustaining mutual trust
 - Disclosure and transparency from taxpayers
 - Revenue body approach based on commercial awareness, openness and responsiveness

So what could taxpayers and tax administrations expect to gain from such a relationship? Box 2 summarizes what business could expect and, while some companies have struggled to derive full value from the enhanced relationship in its formative years, the overall response from corporates has been very positive. The main advantage is greater certainty and predictability, two features that are very important in today's uncertain economic environment. "I would say that in a couple of the major jurisdictions in which we do business, we have entered into these enhanced relationships, which are delivering significantly greater certainty and, I would say, also significantly reduced cost", as one MNC tax director has said.

Box 2: What business wants from an enhanced relationship

- Certainty and clarity in relation to tax issues
- A joined-up coordinated service
- Awareness in revenue bodies of business compliance costs and of the need to focus on reducing these
- Commercial and business awareness in tax administrations
- Access to the decision makers in tax administrations
- Rulings systems or other real time mechanisms for speedy resolution of issues
- More customer centred, better coordinated activity within tax administrations
- Consultation on tax policy issues

Box 3 shows what the gains for governments might be. Here, the key is transparency and a willingness to go beyond respecting just the strict letter of the law and a willingness of business to educate tax administrations on the realities of new business models.

What are the main obstacles in achieving this change in behaviour? Improving levels of trust and getting tax administrations and taxpayers to the point where they have sufficient confidence in each other so that they are each prepared to commit time and resources to moving their relationship onto a new footing are both key. Much depends on the attitudes at the top of the tax administration and in the boards of companies. The advisory profession also has a key role to play in facilitating the dialogue and acting as a bridge between taxpayers and tax administrations.

Moving to an enhanced relationship is not without risks, of course. Commissioners who embrace such a relationship may be accused of “going soft” on taxpayers – particularly in the current media climate – and vice presidents of tax may be accused of failing to maximize shareholder value through aggressive minimization of effective tax rates. There is also the shared risk that the change in attitudes will not go beyond the Commissioner office or the corporate board room and that neither side will devote the resources initially required to facilitate the necessary cultural change. The behavioural change also needs to extend down the chain of command to those that are engaged in audit activities, and this communication between executive and field office has long been a source of frustration for tax administrators and taxpayers alike.

Box 3: What tax administrations want from enhanced relationships

- Transparency and disclosure by business
- Respecting “the spirit of the law”
- Volunteering information which may highlight significant differences of opinion on interpretation
- Open and transparent dialogue
- Cooperation in tax risk assessment
- Assistance in understanding business and in developing commercial awareness
- Assistance in understanding governance and risk management systems in the business
- Tax issues considered at Board level and accepted as a dimension of good practice in corporate governance

I believe the time is now ripe for a new push forward to achieve a more mature attitude towards tax compliance: one that accepts that this need not be a “you win, I lose” situation. In some ways, the current crisis may help, as, in a very uncertain economic environment, most CEOs

and CFOs would probably welcome greater tax certainty and an ability to resolve tax issues before they become tax controversies. Governments that are facing budgetary pressures may also find such a relationship useful as a way of providing greater predictability in the collection of tax and enabling them to focus their diminishing resources on high-risk taxpayers. Such an approach could also be attractive for governments as a way of minimizing the negative impact of tax on long-term growth.

Both governments and business may also find that a shared perspective on tax compliance may be the most effective way to respond to the criticisms from NGOs and the media of current tax practices. The FTA has just launched a review of the progress made in implementing the enhanced relationship, as it is now five years since it launched this concept. “There is a genuine interest in improving compliance through discussions at the time of filing instead of years later” says Pascal Saint-Amans, my successor as Director of the OECD Centre for Tax Policy and Administration. “But ‘enhanced relationship’ doesn’t translate well into non-English languages. If we had another term for it, it might be more convincing for the Germans, the French and some others. We may need a re-branding of this very good concept, or maybe use some better words.”

The International Fiscal Association (IFA) has also taken up the cause, and has established a group to examine the experience of business in this area and will report back at the IFA Boston Congress in September 2012.

4. Conclusions: How To Execute Change

Communities that are successful in designing and implementing change do so by developing a strategy and executing it well. While there is certainly much work remaining to be done by all parties, the enhanced relationship can help reduce the incidence of controversy, facilitate closure of disputes and the resolution of issues, often without costly and time-consuming litigation. This should be welcomed by all parties.

Working together, it should be possible to overcome the lack of trust and to move from the traditional tax culture of confrontation towards a culture of constructive engagement. With so much activity and change occurring in this area, now is a very good time for companies to consider engaging with tax administrators to ensure that the processes supporting the enhanced relationship are designed with full commerciality in mind.