COOPERATIVE COMPLIANCE AND THE DUTCH HORIZONTAL MONITORING MODEL

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Abstract

Cooperative compliance can be defined as the establishment of a trust-based cooperative relationship between taxpayers and the tax authorities on the basis of voluntary tax compliance leading to the payment of the right amount of tax at the right time. The Dutch Horizontal Monitoring (HM) model can be defined as a means of administrative supervision based on (informed) trust, mutual understanding and transparency between individual taxpayers and the Netherlands Tax and Customs Administration (NTCA). The authors elaborate on the principles of reciprocal trust, understanding and transparency. Subsequently, they assess the trust-based Horizontal Monitoring relationship and its establishment in the light of the principles of reciprocal trust, understanding and transparency. Furthermore, they evaluate these aspects of the Horizontal Monitoring model in the light of the Organisation for Economic Co-operation and Development’s (OECD’s) principles of a cooperative compliance model. First, the ensuing obligations are classified with a view to the reciprocal nature of this set of obligations. Secondly, these obligations are differentiated with respect to their statutory versus voluntary and extra-statutory nature. The research shows that the Horizontal Monitoring model fits into the OECD’s concept of cooperative compliance. A striking difference between the two models is that the OECD model mainly - but not only - addresses the obligations of the tax authorities. The Dutch model, however, creates obligations of a more reciprocal nature between tax authorities and taxpayers. Both models, however, aim to increase trust in the tax authorities and build a service climate in order to promote voluntary compliance. Changing views on tax enforcement, tax compliance and tax planning require continual reflection on further improvement of both the Dutch Horizontal Monitoring model and the general concept of cooperative tax compliance.

Keywords: Cooperative compliance, Dutch Horizontal Monitoring, (informed) trust, mutual understanding and transparency, extra-statutory obligations

1. INTRODUCTION

In 2005, the Organisation for Economic Co-operation and Development (OECD) launched an investigation into recent developments in the Netherlands, Ireland and the United States with regard to tax administrations’ risk management and compliance strategies. According to the OECD, the rapidly evolving social environment in which tax authorities operate leaves room for (aggressive) tax-saving structures (OECD, 2007e). Within the letter of the law, companies explore tax-saving opportunities which the legislator would have prevented if he had foreseen them. International concern about the use of tax-saving structures and the aim to develop solutions by which to improve the relationships between tax authorities, taxpayers, and

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\textsuperscript{3} The authors wish to thank the anonymous reviewers for their valuable comments on a previous draft of this paper.
financial and tax law specialists caused the OECD to decide to investigate their mutual relationships (OECD, 2008, p. 7; see also OECD, 2007c, p. 2).

Three years and six working papers later, the OECD published its 2008 report on “Enhanced Relationships”. In 2013, the OECD delivered the results of follow-up research: “From Enhanced Relationships to Cooperative Compliance”. In the report(s), the OECD developed the so-called cooperative compliance or Horizontal Monitoring (HM) model for relationships between companies and the tax authorities. Under this model, it is important that taxpayers: 1) agree to voluntary tax compliance; 2) establish a cooperation with the tax authorities; and 3) are willing to work together with the tax authorities in a framework based on trust. Research into advancing technological developments and the need to also engage smaller companies in tax compliance improvement resulted in the OECD releasing a further report in 2014: “Tax Compliance by Design”. In this report, the OECD developed a model based on various monitoring strategies fine-tuned to suit the specific features of a country, a tax administration, certain taxpayers, or business activities with the aim of obtaining tax-relevant information from third parties (OECD, 2014, p. 40). In 2016, the OECD released its report “Building Better Tax Control Frameworks” (OECD, 2016). This report provides guidance on the quality of a Tax Control Framework (TCF) to manage tax control for (large) companies and tax authorities participating in a cooperative compliance relationship.

The Netherlands participates in the OECD’s policy formation work. The team that prepared the “Study into the Role of Tax Intermediaries” worked closely with a core group of countries, including The Netherlands, that acted as a steering group for the work, and representatives of the Netherlands Tax and Customs Administration (NTCA) participated in a mid-term review (OECD, 2008, p. 3). The Netherlands was also a member of a task group that prepared the 2014 report “Tax Compliance by Design” (OECD, 2014, p. 3). In 2014, the Netherlands hosted a meeting of delegates from the tax authorities of several OECD countries “in order to further develop the TCF” (OECD, 2016, p. 10). This participation influenced the various reports. The influence of the Netherlands on the 2013 OECD report is, for example, “reflected in the emphasis on tax control frameworks which form the backbone of the version of cooperative compliance adopted by NTCA” (De Widt & Oats, 2018, p. 262). It is, therefore, difficult to draw a clear line between the OECD approach and the Dutch approach, since the Netherlands was a driver of the OECD approach.

In 2005, the Netherlands introduced the possibility for companies to enter into Horizontal Monitoring relationships with the NTCA. The model can be defined as a means of administrative supervision based on mutual (informed) trust, mutual understanding and transparency between individual taxpayers and the NTCA (Huiskers-Stoop & Diekman, 2012a, p. 231). In exchange for providing relevant tax information on a voluntary basis, taxpayers obtain fiscal certainty about their tax liability in advance and are – in principle – no longer subject to time and effort-consuming tax audits, sanctions and prosecution afterwards (Huiskers-Stoop, 2015, p. 439). Of course, random checks and audits can be carried out by the tax inspectors.

It goes without saying that parties do not trust each other blindly. They depend on information in order to assess each other’s trustworthiness. Informed trust depends on reciprocal transparency with regard to information provided by the tax authorities and taxpayer. How does the Dutch Horizontal Monitoring model work in practice, how can the NTCA be sure that it is sufficiently well-informed and does this model relate to the OECD’s concept of cooperative
compliance? These questions will be answered in this paper. We will first give a brief overview of the model, and then put forward and elucidate our research question and method.

1.1 The Horizontal Monitoring model

In the 1990s, the NTCA introduced its risk assessment strategy, allocating the available scarce resources to high taxpayer service and high-risk areas. Intervention was deemed necessary only in the event of an actual risk. As a result, each taxpayer category should get the appropriate attention. Just before the turn of the millennium, the NTCA introduced its compliance strategy in order to support and strengthen the willingness of taxpayers to observe their statutory obligations. In 2005, a new kind of arrangement with multinationals was included in this compliance strategy: Horizontal Monitoring (for the factors that incentivised the Dutch tax authorities to experiment with a different type of monitoring, see De Widt, 2017, pp. 8-10).

The Dutch Horizontal Monitoring model has no specific statutory basis. That being said, the NTCA is allowed, under Dutch law, to organise the enforcement process at its discretion and may (and even should) develop policies for the use of this discretion (Gribnau, 2015a, pp. 194-195; Happé & Pauwels, 2011, p. 228). Legal and constitutional theories may be helpful “in order to articulate concrete standards for the exercise of discretion” (de Cogan, 2011, p. 6). It is widely recognised that tax authorities have discretion that “permits an administrator to engage in settlements and tax amnesties, apply ambiguous and impractical laws in a fair and sensible way, and generally to exercise common sense where the legislation is deficient” (Dabner & Burton, 2009, p. 325; Dabner, 2012, p. 541, p. 546). The UK Commissioners for Revenue and Customs Act 2005 vests HM Revenue & Customs (HMRC) with such general discretionary power to undertake acts in relation to their responsibility for the “collection and management” of taxes and gives HMRC the power to “do anything which they think (a) necessary or expedient in connection with the exercise of their functions, or (b) incidental or conducive to the exercise of their functions” (Freedman & Vella, 2011, pp. 80-81). Discretion with regard to the enforcement process can be defined as the “elbow room” that the NTCA has to efficiently set up the taxation process in view of scarce enforcement resources and the different characteristics and risk profiles of taxpayers. Horizontal Monitoring is an enforcement strategy developed on the basis of this discretion (see also Bronzewska, 2016, pp. 357-364). In this respect, deploying scarce enforcement resources as efficiently and effectively as possible is an important consideration. The NTCA is free – within the framework of tax law – to apply supervision flexibly and to customise its approach towards taxpayers. There is a twofold check on this supervision: tax assessments and other legal decisions are subject to review by the courts, and the State Secretary of Finance is politically accountable to the Dutch Parliament.

Monitoring is all about assessing facts and their legal interpretation with regard to a possible tax liability. These facts and taxpayers’ interpretations thereof are presented in the form of tax returns. The Dutch Horizontal Monitoring model transferred the NTCA’s review process from carrying out checks after tax returns have been filed to monitoring taxpayers’ internal procedures preceding the filing of their tax returns. The focus thus shifts from the tax return, which contains positions based on actions taken by the taxpayer, to the beginning of the process, so before the taxpayer has even performed so-called tax-relevant actions. The individual compliance agreement states that tax-relevant actions apply to matters on which a difference of opinion may arise with NTCA; for instance, where there is a different interpretation of facts or matters of law (for the text of the standard covenant, see www.belastingdienst.nl – search for “individual compliance agreement” – or see this paper’s Appendix). The use of an interactive process between taxpayers and the NTCA ensures that
parties can discover their tax position faster, as it provides actual certainty with regard to tax decisions to be taken. The attention of both parties is focussed on the control of tax risks and the avoidance of errors, rather than on subsequent tax audits, sanctions and prosecution. As tax risks are discussed in advance and the taxpayer is open about his tax strategy, the tax return may be expected to contain no information unknown to the NTCA. Hence, the review of the tax return is usually a formality and a prompt imposition of the tax assessment may follow (NTCA, 2013, pp. 40-45). Nonetheless, companies in Horizontal Monitoring relationships can also be subject to tax return audits, although the frequency at which their tax returns are reviewed is substantially lower than that of companies which are not governed by Horizontal Monitoring (NTCA, 2013, p. 41).

In order to qualify for a Horizontal Monitoring relationship, taxpayers must be willing and able to comply with the tax laws and regulations (NTCA, 2013, p. 17). In addition, taxpayers and the NTCA go through a seven-step process to assess whether Horizontal Monitoring is feasible. Both the tax administration and the taxpayer can take the initiative to explore Horizontal Monitoring. The process starts with the NTCA gathering information about the relevant company and ends with an adjustment of supervision. Should parties subsequently decide to enter into a Horizontal Monitoring relationship, they confirm this by signing a compliance agreement (covenant; see Appendix). A taxpayer is free to choose whether or not to enter into Horizontal Monitoring; there is no legal obligation to do so. However, the NTCA might reject the taxpayer’s request. This might happen if the NTCA has insufficient confidence in the taxpayer’s tax strategy, its internal tax control system or its transparency on submission of relevant tax matters. The taxpayer will probably not, therefore, complete several of the steps preceding the conclusion of a Horizontal Monitoring covenant successfully (NTCA, 2013, p. 6; see section. 3.2). It goes without saying that most companies that do not meet these conditions will not apply for Horizontal Monitoring relationships. Thus, these steps (each with specific requirements), set out in published guidance, enable self-selection to take place among Horizontal Monitoring “candidates.”

The covenant contains principles which stipulate that parties will work together on the basis of trust, mutual understanding and transparency. The covenant applies to the levying of all Dutch national taxes and the collection thereof. The agreement aims to realise customised tax monitoring, actual tax collection, actual insight into the taxpayer’s tax position and a regular update of the tax compliance process (in other words, “real-time working” for both parties; see Section 3.3).

It is important to note that the covenant concerns the process (the working relationship) resulting in a tax liability and not the amount of tax to be paid. In this respect, we note that Horizontal Monitoring should not be confused with the Dutch ruling practice, under which advance agreements can be made about the position of the NTCA on international tax structures (e.g. international holding and financing activities). Bronzewska (2016) argues that a ruling practice is evidence of an advanced relationship between taxpayers and tax authorities, and is one step ahead of a minimalist relationship which lacks a kind of communication and dialogue (pp. 65-68). In this sense, Horizontal Monitoring is one step ahead of a practice of communication and dialogue limited to providing taxpayers with certainty – for example, in the form of rulings. Horizontal Monitoring deals with the way in which parties cooperate in the taxation process – the process from the completion of possible tax-relevant transactions up to the filing of the tax return and issuing of the tax assessment – and not with the amount of the tax liability. Empirical research shows that companies with HM covenants in place perceive that they have better working relationships with the NTCA (NTCA, 2017).
Furthermore, Horizontal Monitoring fits in with the political trend for more self-responsibility, i.e. for citizens and companies who are willing and able to do so to take responsibility for their tax affairs; the idea of the “participation society” has become commonplace, both in tax matters and more widely (Huiskers-Stoop, 2015, p. 437). Thus, Horizontal Monitoring symbolises a kind of “horizontalisation” of the tax relationship – cooperation on a more equal footing than in the traditional command and control model (Gribnau, 2015b, p. 208). Furthermore, Horizontal Monitoring implies a form of de-juridification, focussing on informal interaction between tax administration and taxpayers with an eye to shared interests, rather than on formal interaction which is primarily guided by legal norms and procedures (Gribnau, 2015a, p. 184, p. 190). Horizontal Monitoring also fits into the trend in academic theory towards the government’s interactive and responsive dealing with citizens. Empirical research shows that customised monitoring is more responsive to the needs and expectations of (corporate) citizens, creates more support and ensures better compliance (Huiskers-Stoop, 2015, pp. 337-354, pp. 381-384). Moreover, the voluntary character of the HM relationship provides a clear incentive for corporate taxpayers “to improve their internal tax control mechanisms, giving them greater control over their tax affairs and facilitating trust by the tax authorities” (De Widt & Oats, 2018, p. 273). Horizontal Monitoring also fits in with the international social trend in which regulatory compliance, rather than non-compliant behaviour, is increasingly the norm; it is in this sense that tax morality increasingly gains support.

Horizontal Monitoring is not “a standalone” model, as the NTCA uses the classical command and control regulation in respect of non-compliant taxpayers. Horizontal Monitoring is only one of the approaches available in the NTCA’s strategy toolkit. The NTCA does not abandon traditional enforcement mechanisms (vertical supervision) but puts them on hold when dealing with compliant taxpayers who engage in Horizontal Monitoring. Enforcement of tax law cannot take place without a measure of deterrence – even in the background – after all (Shaw, Slemrod & Whiting, 2010, pp. 1115-1118). Even trustworthy tax authorities have a need for some measure of power, by way of audits and sanctions, in order to enforce compliance (Kirchler, 2007, pp. 203-205) – and rightly so, because not enforcing the law in cases where taxpayers are not compliant would be at the expense of the equal treatment of taxpayers and their trust in the NTCA. The NTCA has extensive powers under public law and can, when necessary, force taxpayers to submit relevant tax information so that it can assess them: e.g. Article 47 and, further, the General Taxes Act 1959 (Algemene Wet inzake Rijksbelastingen 1959; GTA). These powers compensate for the information asymmetry between the NTCA and taxpayers. The NTCA may request tax information, start an audit or – in cases where it suspects a criminal offence has taken place – enable the Fiscal Information and Investigation Service (FIOD), its investigative service which focusses on the detection of (serious) fiscal offenses, to confiscate data. These powers make legal asymmetry an important feature of the relationship between the NTCA and taxpayers. Horizontal Monitoring aims to create a more horizontal, trust-based relationship against the background of legal asymmetry – which, in itself, enables the NTCA to fall back on vertical supervision (Gribnau, 2015a, pp. 201-204). Horizontal Monitoring is one of the NTCA’s compliance-enhancing tools which uses behavioural insights to promote voluntary compliance (Boer & Gribnau, 2018). Thus, the NTCA, like other tax authorities, increasingly relies on the voluntary compliance of taxpayers in the context of the use of self-assessment systems, withholding taxes and third-party information reporting. The NTCA’s extensive powers to collect information in order to check tax assessments are still increasing. Tax authorities in the European Union (EU) cooperate to combat tax fraud and tax evasion (see Council Directive 2011/16/EU). Recently, reporting mechanisms have also been introduced in the fight against tax evasion and aggressive tax planning. Directive 2011/16/EU was recast to enable the (mandatory) automatic exchange of information on rulings (Directive
The directive was subsequently amended to provide for country-by-country reporting (Directive 2016/881/EU; see Seer & Wilms, 2016). Due to the increased international exchange of information among tax authorities and the disclosure obligations of taxpayers, the amount of information available to tax authorities which can enable them to enforce their tax laws effectively is growing dramatically. The OECD/G20’s Base Erosion and Profit Shifting (BEPS) project is another driver (OECD, 2016, p. 12). BEPS Action 12 goes quite far in this respect, providing recommendations regarding the design of mandatory disclosure regimes for aggressive or abusive transactions, arrangements or structures. The EU took a significant step forward by introducing the directive on mandatory disclosure of potentially aggressive tax arrangements and the automatic exchange among member states of information about this kind of cross-border arrangement (Directive 2018/822/EU; see Cachia, 2018).

1.2 Research question and method

This paper studies the way in which the Netherlands incorporated the concept of cooperative compliance in its taxation process, and contributes to the further development of compliance strategies and their functioning in practice. More specifically, the different steps to be taken in order to enter into an HM relationship are discussed so as to gain a better understanding of the operationalisation of the underlying concept of a trust-based relationship, and the HM covenant is analysed. The covenant entails a number of obligations, based on trust, mutual understanding and transparency, in order to provide real-time certainty with regard to tax affairs. The analysis of the covenant proceeds in two steps. First, the ensuing obligations are classified with a view to the reciprocal nature of this set of obligations. Secondly, these obligations are differentiated with respect to their statutory versus voluntary and extra-statutory nature. Moreover, it evaluates the establishment and content of the standard Horizontal Monitoring covenant against the principles of the OECD concept of a cooperative compliance approach. The principal research question is:

“*How does the trust-based Horizontal Monitoring relationship and its establishment relate to the OECD’s model of cooperative compliance?*”

The paper deals with the following questions: how is the OECD’s cooperative compliance model defined (Section 2); what are the different steps that need to be taken in the process of concluding a Horizontal Monitoring covenant and how do the voluntarily accepted Horizontal Monitoring covenant obligations relate to the mandatory obligations laid down in the Dutch legal tax system (Section 3); and does the Dutch Horizontal Monitoring model deliver on the principles of the OECD ‘s cooperative compliance model (with special attention being given to some issues of concern as voiced by the OECD) (Section 4)?

This research mainly focusses on the establishment of, and the cooperative tax relationship based on, a Horizontal Monitoring covenant, in order to set out some typical aspects of the Dutch approach and evaluate it against the OECD’s cooperative compliance principles. To answer the research question, we restrict ourselves to direct Horizontal Monitoring relationships as entered into by the NTCA and large and medium-sized companies (turnover exceeds about twelve million euros, assets about six million euros and staff fifty; see Articles 2:396-397 Dutch Civil Code and NTCA, 2014, p. 34). The NTCA does not limit Horizontal Monitoring relationships to large and medium-sized companies, but is also willing to enter into such relationships with small companies (and high net worth individuals), albeit indirectly, since these small companies do not have qualifying TCFs. This indirect HM relationship is mediated through financial or tax law specialists who monitor their clients’ control mechanisms.
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(NTCA, 2011; see Herrijgers, 2015, and Committee Horizontal Monitoring Tax and Customs Administration (hereinafter: Stevens Committee), 2012a, pp. 37-40). These indirect HM relationships fall outside the scope of this paper - apart from an isolated observation.

In respect of the description of the cooperative compliance model, we map shifting approaches in the developing OECD vision and use public reports with regard to “Enhanced Relationships, Cooperative Compliance” and “Building Better Tax Control Frameworks”. For the specification of the Dutch Horizontal Monitoring model, we use traditional legal sources, such as (tax) statutes and regulations, parliamentary history, published tax guidance and relevant academic articles.

This paper aims to contribute to the literature in various ways. It offers a critical comparison between the OECD’s cooperative compliance approach and the Dutch Horizontal Monitoring strategy. Moreover, in order to do so, it gives an overview of the steps to be taken in order to establish a trust basis for agreeing an HM covenant and analyses the various covenant obligations. Finally, it discusses some important issues of concern.

1.3 Core concepts

Cooperative compliance

Cooperative compliance can be defined as the establishment of a trust-based cooperative relationship between taxpayers and the tax authorities on the basis of voluntary tax compliance leading to the payment of the right amount of tax at the right time. Trust is built and maintained in the cooperative compliance relationship and is related to expectations of reciprocity. People put their trust in someone they find trustworthy. Relevant dimensions of trustworthiness in the trust-based cooperative compliance relationship are, first, competence and reliability, and, second, integrity, honesty and the commitment to concern and care. Taxpayers who are compliant and show they are willing to comply deserve more trust than taxpayers who will not or are not able to comply. Compliant behaviour evidences trustworthiness.

The cooperative compliance model

We construct the OECD’s cooperative compliance model by investigating the various OECD reports on the relationship between taxpayers and tax administrations, viz. “Enhanced Relationships, Cooperative Compliance” and “Building Better Tax Control Frameworks”, and define it as the voluntary tax cooperation between tax authorities and large companies based on six principles: the tax authorities must understand business activities, adopt an impartial attitude, respond proportionally, demonstrate openness and transparency - like taxpayers themselves, take enterprise-specific circumstances into account, and align supervision to the quality of a company’s TCF. A TCF can be described as an instrument of internal control specifically focussed on the tax function within a company (Bronzewska, 2016, pp. 293-299; Hoyng, Kloosterhof & MacPherson 2010, pp. 19-71). Thus, the model provides a theoretical description of the major principles of cooperative compliance. In Section 2, we will discuss the model in more detail.

The Dutch Horizontal Monitoring model

We define the Dutch Horizontal Monitoring model as: a means of administrative supervision based on (informed) trust, mutual understanding and transparency between individual
taxpayers and the NTCA. The requirement of trust, understanding and transparency shows the underlying value of reciprocity. In exchange for providing relevant tax information on a voluntary basis, taxpayers obtain certainty about their tax liability in advance and are—in principle—no longer subject to time and effort-consuming tax audits, sanctions and prosecution afterwards. Thus, the model provides a theoretical description of the working of Horizontal Monitoring. In Section 3, we will discuss the model in more detail.

2. DESCRIPTION OF THE COOPERATIVE COMPLIANCE MONITORING MODEL

This chapter focusses on the question of how the OECD’s cooperative compliance monitoring model is defined (see also Bronzewska 2016, p. 44-48). To answer this question, we will focus on the OECD’s views on cooperative compliance as developed in two reports: “Enhanced Relationships” (2008, Section 2.1), and “Cooperative Compliance” (2013, Section 2.2).

2.1 Investing in “Enhanced Relationships” (2008)

The 2008 report “Enhanced Relationships” should, first and foremost, be considered in the light of its origins. In 2006, the OECD had noted that the rapidly evolving social environment in which tax authorities operate leaves room for aggressive tax planning. The 2008 report referred to the Seoul Declaration of September 2006 which “sets out countries’ concerns about the rapid spread of aggressively marketed tax planning, and the link between “unacceptable tax minimisation arrangements” and tax intermediaries (OECD, 2008, p. 7, pp. 9-10; OECD, 2006, p. 3). This is a recurring concern, as the 2013 report shows: “greater emphasis has been placed on the importance of compliance with the spirit as well as the letter of the law and this is reflected in the 2011 revision of the OECD Guidelines for Multinational Enterprises” (OECD, 2013, p. 13). As a response, the OECD embarked on research as to how tax authorities might restrain such unwanted behaviour. Possible solutions included “enhancing relationships” with taxpayers who are willing and able to comply with the tax laws and regulations, while developing a risk management system to identify tax risks and differently approach taxpayers who are unwilling to comply (OECD, 2008, pp. 39-46; OECD, 2007e, p. 3. See also Alink & Van Kommer, 2000, pp. 63-67; Alink & Van Kommer, 2009, pp. 194-195). Risk rating, however, has its drawbacks (Bronzewska, 2016, pp. 334-335, pp. 359-361). Freedman (2010) argues that risk rating, whilst initially appearing to be a purely administrative device, can become a significant application of discretion, even going as far as to become an attempt to influence taxpayers to be over-compliant (p. 118; see also OECD, 2004).

An enhanced relationship goes beyond the traditional relationship between taxpayers and tax authorities, which is characterised by parties interacting solely based on what is legally required (OECD, 2008, p. 39). Taxpayers are legally required to file tax returns that disclose a limited amount of information as required and to pay the tax due in time (OECD, 2008, p. 40). The tax authorities are legally allowed to question taxpayers about the tax returns they have filed, to obtain additional information, to adjust the amounts payable and to collect taxes. In this traditional relationship, there is no incentive to provide more tax information than is mandatory.

An enhanced relationship, however, does provide that incentive. Taxpayers voluntarily enter into individual monitoring relationships, whilst voluntary and transparent regulatory compliance is rewarded with more certainty in advance and a reduction of (possible) subsequent tax audits, sanctions and prosecution, and thus lower compliance costs (OECD, 2008, p. 40). Certainty is key indeed. A recent International Monetary Fund (IMF)/OECD
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The report again highlights that tax certainty is an important priority for both governments and businesses, outlining a set of concrete and practical tools that can be used to enhance tax certainty. Cooperative compliance is mentioned as one of the tools which can be used to provide early tax certainty (IMF & OECD, 2017, pp. 50-52). For an enhanced relationship to exist, it is, according to the OECD (2008), essential that tax authorities, taxpayers, and their financial and tax law specialists start to trust each other and maintain that trust (p. 39). Trust being the focus, this specifically defined institutional relationship is based on “mutually expressed intentions and not on detailed rules” (IFA, 2012, p. 18). The OECD clearly understands that trust is an important determinant of cooperative behaviour in the relationships between tax authorities and taxpayers. Trust should be granted to taxpayers who are found to be trustworthy. Therefore, mechanisms by which to establish the trustworthiness of taxpayers are required.

To distinguish taxpayers who are willing and trustworthy from taxpayers who are not, tax authorities must, according to the OECD (2007f), invest in a risk management system (p. 1). Tax authorities should establish a tax risk profile for each taxpayer (risk assessment) which should enable them to organise a taxation process in view of the scarce enforcement resources and the different characteristics of taxpayers (risk-based resource allocation; see OECD, 2007e, p. 2). Taxpayers who behave transparently and represent a lower risk can reasonably expect the tax authorities to take a more cooperative approach and, therefore, to enjoy lower compliance costs, while taxpayers who are shown to represent a significant risk can expect to attract greater scrutiny and enforcement attention (OECD, 2008, p. 24; see also De Widt & Oats, 2017).

In order to develop a so-called enhanced relationship model, the OECD used the models introduced by the Netherlands, Ireland and the United States in 2005 as examples (OECD, 2007f, p. 3). The research shows that all three models take voluntary regulatory compliance as a principle and focus on levying in (real) time, advanced tax cooperation, and fewer audits and the like after tax returns have been filed. The ultimate goal is to improve the tax regulatory environment for particularly large companies. According to the OECD (2007f), the models share two common features (p. 4):

I. the taxpayer is a large, often listed, company
II. the taxpayer has, or wants to have, a low tax risk profile.

Upon further investigation, the OECD enumerates five principles for a successful tax cooperation based on enhanced relationships:

1) a tax authority must understand business activities (commercial awareness)
2) a tax authority must adopt an impartial approach (impartiality)
3) a tax authority should respond proportionally (proportionality)
4) a tax authority should – like taxpayers themselves – be open and transparent (openness and transparency)
5) a tax authority’s responses should be tailored to enterprise-specific circumstances (responsiveness).

Taxpayers will find tax authorities to be trustworthy if they meet these principles. The five principles should therefore be operationalised in practice. With regard to commercial awareness, the OECD elaborates that large companies generally undertake transactions for
commercial reasons but structure them with a view to maximising profit after tax (OECD, 2008, p. 34). Without understanding the commercial drivers, tax authorities potentially misunderstand the broader context of a transaction, and may respond in a way that results in potentially costly disputes and uncertainty. Therefore, they need to understand: i) the “business of how to do business”, i.e. the broad context within which large companies operate; ii) the characteristics of the industry sector in which a particular taxpayer operates; and iii) the unique characteristics of the particular taxpayer’s business (OECD, 2008, pp. 34-35). This can be achieved, for instance, through development programmes and other ways of giving tax authority personnel a taste of life in business or participation in wider community activities (OECD, 2008, p. 69, Annex 7.1: Achieving Commercial Awareness).

The impartial approach requires tax authorities to resolve disputes consistently, objectively, and solely by reference to the merits of the case and reasonable legal positions (OECD, 2008, p. 74, Annex 7.2: The Impartial Approach). Moreover, if a tax inspector cannot maintain his position in court, it is inappropriate to leave the dispute unresolved. Court litigation is often “perceived as a battle which, by nature, can only have one winner”, so the other party is doomed to be the loser. The OECD points out that recent developments in the dispute resolution field have demonstrated that alternative dispute resolution (ADR) may be of assistance here. ADR refers to any form of dispute resolution that takes place separately from court litigation, such as mediation (OECD, 2008, p. 75).

Proportionality requires tax authorities to approach choices – in allocating resources, for instance – from a broad perspective which takes into account the characteristics of the taxpayer in question, the relationship between the tax inspector and the taxpayer, and the potential benefits of pursuing or not pursuing a line of enquiry (OECD, 2008, p. 35). According to the OECD (2008), proportionality can be achieved, for instance, by focussing attention on significant issues and only where there are sufficient reasons for doing so or only asking appropriately focussed questions that seek information that will lead to a conclusion of the audit (p. 36).

In addition, the OECD (2008) argues that taxpayers want to see openness and transparency from the tax authorities – for instance, with regard to advance tax ruling mechanisms in order to seek early certainty on the tax consequences of a particular set of circumstances or with regard to the tax authorities’ approach to risk management (p. 36). Taxpayers also want their collective voice to be heard through consultation on changes in the tax policy and the tax administration, with engagement taking place early enough to influence final decisions (OECD, 2008, p. 37).

What taxpayers prefer most in relation to tax is early and quick certainty (OECD, 2008, p. 37). The OECD rightly argues that tax authorities should therefore be responsive. Taxpayers should receive prompt, efficient and professional responses, and they may expect a fair and efficient decision-making process and definitive resolution of issues. Tax authorities, for instance, need to ensure that decisions taken at the operational level are consistent with the instructions and guidance of senior management.

When these five principles have been met, according to the OECD (2007f), the majority of taxpayers will be able to effectively and efficiently pay the right amount of tax in time (p. 13). Although the OECD abandoned the label "enhanced relationship“ in its cooperative compliance report of 2013 (see Section 2.2), it remains faithful to the five principles and even added a sixth one (OECD, 2013, p. 87):
6) companies must invest in a TCF and tax authorities must adjust their supervision accordingly (supervision adjustment to TCF).

In Section 4, we investigate whether the Dutch Horizontal Monitoring model meets these six principles.

2.2 “From Enhanced Relationship to Cooperative Compliance” (2013)

In 2013, the OECD abandoned the name “enhanced relationship”. According to the OECD, the label was chosen as a term that properly distinguished the new approach from a traditional obligation-based relationship (OECD 2013, p. 14). The term “enhanced relationship”, however, raised questions about connotations of preferential tax treatment (OECD, 2013, p. 14; De Widt and Oats, 2018, p. 262). Indeed, Dabner and Burton (2009) argue that “using the term “partnership” in Australia and New Zealand may have been unfortunate in that it perhaps created unreal expectations” (p. 326). They point at “the primacy of the ethical and contractual obligations of practitioners to their clients”. In the same vein, some tax advisors in the Netherlands worried that their enhanced relationship with the NTCA might be perceived by their clients as “too close”, in the sense that they would be seen as providing services to the NTCA, while, of course, their clients pay for their services. Although the OECD addressed the alleged unequal treatment – see Section 4.2 – the OECD abandoned the term “enhanced relationship” and replaced it with the term “cooperative compliance”, which would better represent the OECD’s tax compliance vision. According to the OECD:

the term ‘cooperative compliance’ describes the concept most accurately as it not only describes the process of co-operation but also demonstrates its goal as part of the revenue body’s compliance risk management strategy: compliance leading to payment of the right amount of tax at the right time (OECD, 2013, p. 14).

Moreover, the adjective “cooperative” emphasises the reciprocal nature of this relationship, which is aimed at enhancing compliance. Many tax professionals, however, already understood this. The 2012 International Fiscal Association (IFA) report, for example, recognises reciprocity as a common factor in enhanced relationship programmes: “Trust, mutual understanding, transparency, all with full reciprocity” (IFA, 2012, p. 17).

Key components of a cooperative compliance framework are transparency and disclosure on the part of both parties, resulting in the effective and efficient reduction of uncertainties over tax positions. According to the OECD, good corporate governance systems – supporting transparency and disclosure – have recently become more important as an integral part of cooperative compliance. Disclosure should include relevant information and tax risks. There are two key elements of disclosure and transparency by taxpayers. First, a robust, reliable TCF that gives the tax authority assurance and enables the taxpayer to know which tax positions taken are uncertain or controversial, and second, “the willingness to disclose those positions voluntarily” (OECD, 2013, p. 20-21). As a result, the extent of reviews and audits of the tax returns submitted to the tax authority can be reduced significantly. Because of the information disclosed by the taxpayer, the tax authority may rely on the returns submitted to it and trust that uncertain tax positions and other “issues of doubt or difficulty in the tax positions taken in that return will be brought to its attention” (OECD, 2013, p. 62). Of course, the tax authorities also use other sources to check the information provided by taxpayers. In this regard, international exchange of information is a growing source of such “counter-information.” Good tax governance regards corporate taxpayers but also the tax authorities. Good governance within
the tax authorities themselves is therefore also a driver of cooperative compliance, comprising transparency, openness and responsiveness, including, for example, real-time working.

While the pillars of an enhanced relationship were still considered to be valid, major new issues had emerged as the approach had matured and became more widespread. This included the development of compliance risk management strategies by tax authorities that focus on effectively influencing and improving taxpayer compliancy. In order to influence taxpayer compliancy, the OECD considered it important not only that tax authorities invest in risk management systems, but also that companies invest in TCFs (OECD, 2016 and OECD, 2013, p. 14; see also van der Enden & Bronzewska, 2014). In passing, we note that there are no sharp criteria and rules for a TCF. It is generally seen as a vague and open-ended standard. Bronzewska and van der Enden (2014), therefore, argue that “tax administrations should issue guidance on a TCF. Without further guidance on a TCF, the concept of cooperative compliance will fail under pressure of ineffective and inefficient audit processes and mismanaged expectations” (p. 640).

In passing, we mention that, in 2016, the OECD published follow-up guidance with respect to the investment in a TCF: “Building Better Tax Control Frameworks”. Again, disclosure and transparency are key. The latter refers to the sharing of information about the internal control system (including the design), and the implementation and effectiveness of the TCF which enables the taxpayer to be fully aware and “in control” of all the positions and issues that need to be disclosed (OECD, 2016, p. 14). Moreover, as a result of the BEPS project, it has become “even more crucial for multinational enterprises to be in control of tax risks today than when the 2013 Report was written.” (OECD, 2016, p. 12). Since it is not possible to prescribe a one-size-fits-all system of internal and tax control, the OECD (2016) identifies six essential building blocks: 1) tax strategy established; 2) applied comprehensively; 3) responsibility assigned; 4) governance documented; 5) testing performed; and 6) assurance provided (p. 15). The TCF and, more specifically, the building blocks are used as a mechanism by which to support the tax authority’s trust in the taxpayer. Nonetheless, regardless of whether or not a TCF is based on the aforementioned building blocks, according to the OECD (2016), tax authorities do not provide sign off on how the eventual tax return is produced and tax authorities are not obliged to approve the tax compliance process within the company (p. 24). As the focus of this paper is on the trust-based Horizontal Monitoring relationship and its establishment, we will not elaborate on the TCF (which is a key element of further cooperation among tax administrations. See the International Compliance Assurance Programme (ICAP), a programme for a multilateral cooperative risk assessment and assurance process (OECD, 2018).

Cooperative compliance is part of a broader compliance strategy developed by the OECD. In its 2014 report “Tax Compliance by Design”, the OECD focusses on the compliance improvement of smaller companies and presents a broader focus on tax monitoring. Cooperative compliance is only one of the tools that can be used to improve tax compliance. Smaller companies may, according to the OECD, be better served by tax administrations gathering information directly from third parties than larger companies that can entertain individual monitoring relationships. The idea is that when regulatory compliance in the environment of taxpayers is the norm, it is also easier for them to comply with the rules and more difficult not to comply (OECD, 2014, p. 21). Two different scenarios are described: 1) establishing a secured information chain (the secured chain approach); and 2) sharing information resources (the centralised data approach). For larger and medium-sized companies,
Cooperative Compliance and the Dutch Horizontal Monitoring Model

3. THE DESIGN OF THE DUTCH HORIZONTAL MONITORING MODEL

This section focuses on the question of how Horizontal Monitoring is incorporated into the Dutch tax legal system. What are the different steps to be taken in the process of concluding a Horizontal Monitoring covenant and how do the voluntarily accepted Horizontal Monitoring covenant obligations relate to the mandatory obligations laid down in the Dutch legal tax system? To answer this question, we will first present the key characteristics of the Dutch Horizontal Monitoring model (Section 3.1), then we will focus on the establishment of a Horizontal Monitoring relationship (Section 3.2) and, subsequently, analyse tax cooperation based on a covenant (Section 3.3).

3.1 Key characteristics of the Dutch Horizontal Monitoring model

The main characteristics of the Dutch Horizontal Monitoring model are:

1) discretion as the basis for supervision
2) tax cooperation based on a covenant
3) additional rules in published guidance
4) rights and obligations pursuant to traditional legislation and regulations remain applicable.

1) Discretion as the basis for supervision

Although Horizontal Monitoring has no specific legal basis, the NTCA may arrange the enforcement process on the basis of discretion and may develop public guidelines. The Ministry of Finance and the NTCA have – within the limits of tax law, jurisprudence and general principles of law, including the general principles of proper administrative behaviour and published guidance – the flexibility to arrange the enforcement process and to apply customised supervision (Stevens Committee, 2012a, pp. 93-95).

2) Tax cooperation based on a covenant

Although general rules on Horizontal Monitoring can be found in published guidance, the individual cooperation is based on a covenant, which may be classified a private mutual agreement (Huiskers-Stoop, 2015, p. 441, p. 182). The covenant contains agreements which go beyond actual statutory rights and obligations; these additional covenant obligations have no basis in public law. By classifying the covenant as a private agreement, the additional obligations not only bind the NTCA but also the taxpayers. The possibility of an appeal to the civil court provides taxpayers with an opportunity to gain an independent assessment of the functioning of the NTCA under Horizontal Monitoring (Huiskers-Stoop, 2015, p. 441, p. 208). For example, if the NTCA does not take an important deadline for responding to a tax-relevant question submitted by the taxpayer into account, the taxpayer may appeal to the civil court (in interim injunction proceedings). Where the bar on some aspects regarding the quality of the NTCA’s (extra-statutory) service is set higher – like fulfilling the covenant obligations “as soon as possible” – these aspects are not assessed by an administrative (tax) judge. The qualification of the covenant as a private law agreement allows for the civil court to assess these aspects. Nonetheless, if the NTCA and the taxpayer cannot solve problems among themselves and take
recourse to the court, the trust basis of their relationship will probably be seriously impaired, which may effectively mean the end of their Horizontal Monitoring relationship.

3) **Additional rules in published guidance**

For taxpayers with individual covenants, the guidance published by the NTCA is the most important communication to rely on. Good guidance plays a critical role in building trust; transparency with regard to the interaction process breeds trust in the NTCA and voluntary compliance (Kirchler, 2007, p. 203; Siglé, Goslinga, Speklé, van der Hel & Veldhuizen, 2018, pp. 13-14). Moreover, the NTCA is bound by publishing its guidance (Huiskers-Stoop, 2015, p. 441, pp. 134-135); thus, soft law becomes binding on the basis of the General Administrative Law Act. Conversely, guidance on Horizontal Monitoring, like all policy rules issued by the (tax) administration, cannot legally bind the taxpayer; a general binding character is missing (Gribnau, 2007).

4) **Rights and obligations pursuant to legislation and regulations remain applicable**

Not only do rights and obligations that already existed before a covenant has been concluded remain applicable, such as a granted postponement of tax payment, statutory tax rules still apply in a covenant situation. The latter leaves space for the NTCA to adjust its supervision when the taxpayer’s attitude and behaviour indicate that the principle of being willing to fulfil its statutory obligations is no longer satisfied. Therefore, the soft approach is backed by sanctions, audits and the like.

3.2 **The establishment of a Horizontal Monitoring relationship**

The primary task of the NTCA is to levy the proper amount of tax. Nowadays, this task consists not only of levying and collecting taxes, but also of the promotion of compliance. Horizontal Monitoring is an important means by which to promote compliance. General rules on Horizontal Monitoring can be found in published guidance, while the individual cooperation is based on a covenant. Nonetheless, the relationship between the taxpayer and the NTCA is embedded in public law because the NTCA is a public body exercising a public task. Thus, the covenant has a somewhat hybrid character, merging public and private law obligations. Of course, Horizontal Monitoring itself is also a hybrid form of oversight or governance, since both the tax authorities and taxpayer are responsible for tax enforcement. Sharing responsibility is in strong contrast with traditional, vertical, tax supervision. The hybrid character of the covenant makes private law on top of public law applicable. We will return to this aspect in Section 3.3.

Taxpayers and the NTCA go through seven steps in order to enter into Horizontal Monitoring relationships (NTCA, 2013, with reference to NTCA, 2010, p. 11; see also Bronzewska, 2016, pp. 137-141; Stevens Committee, 2012a, p. 40-42; Veldhuizen, 2015, pp. 150-153, De Widt & Oats, 2017, reduce the seven steps to three steps, pp. 230-249. See also De Widt, 2017, pp. 12-15):
The process begins with an update of the *client profile* by the NTCA gathering information on the relevant taxpayer (NTCA, 2013, pp. 10-14). On the basis of a positive client profile, the NTCA develops a strategic supervision plan. This supervision plan forms the basis of the process towards the establishment of a Horizontal Monitoring relationship and consists of four parts: obtaining an up-to-date client profile; the analysis of the client profile; the supervision strategy; and intended supervisory activities.

In this context, a case team from the NTCA gathers information about the company’s tax attitude, behaviour and internal (tax) control. The determination of the desired effect on behaviour and tax control, and the selection of instruments to be deployed to achieve this effect in the most efficient manner are important in this respect. The aim of the process is to answer the question of whether the company’s tax attitude, behaviour and tax control inspire the NTCA’s trust. In Section 3.3, we will focus on the definition of trust in more detail. In this phase, it is important for taxpayers to demonstrate their willingness to disclose tax-relevant information, including tax planning strategies, on a voluntary basis. Even before concluding a covenant, transparency – one of the key elements of Horizontal Monitoring – is crucial.

The objective of the *Horizontal Monitoring meeting* is to explore the feasibility of implementing Horizontal Monitoring. The meeting consists of an exploration of the key principles by the NTCA, an exchange of information about favourable and unfavourable elements of the existing contracts, a mutual assessment of the tone at the top, confirmation of the responsibilities and expectations of each party, and the reaching of an agreement about the next steps in the process (NTCA, 2013, pp. 14-17). The *compliance scan* is carried out by interviewing a number of the company’s key officers and yields an improved insight into the tax attitude (the willingness to comply) and the fulfilment of preconditions attached to the achievement of adequate tax control (the ability to comply) (NTCA, 2013, pp. 17-22). Topics to be discussed include: strategic objectives; internal control environment; information systems; tax function; external monitoring and advice; and the tax attitude and behaviour of the organisation.

*Resolution of pending tax issues* deals with issues which are known at the start of the Horizontal Monitoring process (NTCA, 2013, pp. 22-24). Settling pending issues clears the way for real-time working. As a result, the Horizontal Monitoring relationship can be laid down in a covenant (NTCA, 2013, pp. 24-28). A standard text has been developed for individual covenants (see Appendix). The standard text, however, contains no agreements regarding, for example, contact persons, procedural aspects and similar items. Such working agreements are recorded in a separate consultation report.

After conclusion of the covenant, there is still room for *analysis and improvement of the tax control system* (NTCA, 2013, pp. 28-36). The company bears primary responsibility for the improvement. However, the NTCA actively encourages and supports the company in this process. Each company has a unique TCF as part of a more extensive business control.
framework (Stevens Committee, 2012a, pp. 42-44; for the relation between TCF and business control framework, see Bronzewska & van der Enden, 2014, p. 639). It is argued that the “TCF is the prime focus in the horizontal monitoring programme” (van der Enden, de Groot, & van der Stroom, 2010, p. 337). The TCF should – based on organisational factors and decisions on the required scope and quality of the internal control framework – be customised to the specific company. The NTCA has formulated eight sub-processes to optimise the tax control process (NTCA, 2013, p. 28-30). These sub-processes, however, do not provide minimum requirements for the establishment of a tax control process, but they point to the result of the tax control process; such as an overview of relevant tax events in the various segments of the company, a tax planning strategy that fits with the company’s compliance strategy, and identification and management of tax risks (Huiskers-Stoop, 2015, p. 446, pp. 151-153).

The final step of the Horizontal Monitoring process is the adjustment of supervision. In this step, the NTCA adjusts the form and intensity of its supervision based on available information about the company. Preliminary information about the company’s tax strategy, tax control and transparency (the client profile) is of particular relevance to the reduction of the tax authority’s monitoring workload (NTCA, 2013, p. 40. See also Stevens Committee, 2012a, pp. 44-47).

The NTCA has been very successful in concluding covenants. It should be noted, however, that not all companies want to engage with the NTCA’s trust approach and some therefore refrain from participating in joining the HM programme. In particular, foreign multinational enterprises (MNEs) originating from tax cultures with more adversarial relationships between the tax administration and (corporate) taxpayers tend to stay out of Horizontal Monitoring more frequently. Finally, due to its rapid expansion and the higher than expected administrative demands, Horizontal Monitoring “has been unable to generate clear administrative efficiencies” (De Widt, 2017, p. 22).

3.3 Tax cooperation based on a covenant

Besides the general provisions on parties, duration, commencement date, evaluation and termination, the covenant or compliance agreement consists of an introduction expressing the intention to achieve an effective and efficient mode of operation, basic principles and agreements.

3.3.1 Basic principles

The covenant contains three basic principles:

1) Parties base their relationship on trust, mutual understanding and transparency.
2) Rights and obligations pursuant to legislation and regulations are and will remain applicable without limitation.
3) The agreement is applicable to levying of all Dutch national taxes and collection.

The first principle is that parties base their relationship on trust, mutual understanding and transparency. This principle reflects the underlying value of reciprocity, since it has to be observed by both parties. Modern government leaves room for citizens and companies to bear responsibility. This is not “blind” trust, as we know in personal relationships, but a more business-like trust or “informed” trust. To trust someone in a personal relationship means to
“accept vulnerability to the actions of another party based on the expectation that the other will perform a particular action important to you, irrespective of the ability to monitor or control that other party” (Six, 2004, pp. 179-180). Accepting this vulnerability is taking a risk. A rational actor perspective on trust assumes that individuals will rationally place trust on the basis of a cost-benefit analysis (Coleman, 1990, p. 104). Gangl, Hofmann and Kirchler (2012) do not emphasise the utility maximisation dimension of trust (calculating profits and gains) that much. They use the conception of reason-based trust, which corresponds to “trust developed by a rational actor who trusts that there are good reasons to expect the other will forgo opportunistic goals” (Gangl, Hofmann & Kirchler, 2012, p. 8; “reason-based trust” results from a deliberate – i.e. rational – decision grounded on four criteria: goal achievement, dependency, internal factors and external factors). Yet another definition is provided by Baier (1995): “letting other persons (natural or artificial, such as firms, nations, etc.) take care of something the trustor cares about, where such “caring” involves some exercise of discretionary powers” (p. 105). A final, broad definition of trust is “the willingness to take some risk in relation to other individuals on the expectation that the others will reciprocate” (Walker & Ostrom, 2003, p. 382). These different definitions emphasise various aspects of trust that are relevant here, as will be shown.

Trust is an important determinant of cooperative behaviour in social relations and social organisations. Such activity requires the cooperators to do their part. The deep and important value of trust is often taken for granted (for some facets of the relationship between trust and taxation, see Peeters, Gribnau & Badisco, 2017). Indeed, trust in trustworthy people to do their bit in some worthwhile cooperative enterprise, the benefits of which are fairly shared among all the co-operators is, to most people, “an obviously good thing, and not just because we get better bread that way” (Baier, 1991, p. 110). Trust thus motivates cooperation in a worthwhile enterprise in which the trusting and trusted parties are involved (Baier, 1991, p. 111). Once trust is established, people are willing to assume greater risks, to work harder and to reciprocate (Dirks & Skarlicki, 2004, p. 27). This also requires openness when expectations are not fulfilled; to report, explain, discuss, and solve problems that arise. Indeed, trust is to be seen as a dynamic “process, of gaining, maintaining and restoring trust when it breaks down” (Nootenboom, 2018, p. 30).

Parties taking unilateral action or undertaking a transaction invest resources while running the risk that they will not receive an expected return; they make themselves vulnerable. One takes a risk that depends on the performance of another actor. Thus, trust involves “the incorporation of risk into the decision of whether or not to engage in the action” (Coleman, 1990, p. 91). Trusting someone therefore implies that there is some risk of suffering “a loss if that someone does not fulfil your trust after you have acted on that trust” (Hardin, 2006, p. 28). However, the risk to be taken concerns costs as well as benefits of possible actions. Net (long-term) benefits may be gained since individuals are willing to take risks by placing trust in others to behave in cooperative and non-exploitative ways. Proactive voluntary disclosure may involve such a risk from the perspective of a company. Trust placed in others depends on information that comes from personal experience of an individual with particular others. The choice of a partner who we decide to trust is therefore highly informed (Rus, 2005, p. 83).

Trust may, in general, be a good thing, but it is not always the right thing. Trustworthiness is therefore an important requirement, enabling one to decide whether or not to place trust in someone. Trust is granted to people we find trustworthy. There is some empirical evidence that there are at least two relevant dimensions that compose our judgments of trustworthiness. These intertwined dimensions are: (1) competence or reliability; and (2) motivation, which
consists of the following components – integrity, honesty and the commitment to “do no harm” (or concern and care). Both dimensions are related to trust based on cognitive-rational processes. The first dimension, often referred to as cognitive-based trust, entails one’s competence (ability) to perform what one is trusted to do and reliance on someone being capable of performing the actions required (Hardin, 2006, p. 36). Competence can be “technical, concerning the available means, knowledge and skill” (Nooteboom, 2018, p. 33). The various aforementioned steps (Section 3.2) serve to assure the NTCA of a taxpayer’s competence and reliability. For example, previous evidence collected through recent audits and the company’s improved tax controls may show competence and reliability – the company is actually performing what it is trusted and expected to do. Competence requirements for tax officials regard, for example, their technical knowledge of tax regulations, communication skills, business awareness, ability to treat taxpayers as customers, network and support within the tax administration, and ability to quickly resolve issues raised by companies (Björklund Larsen, Bol, Brögger, Kettunen, Potka-Soininen, Pellinen, Brehm Johansen & Aziz, 2018, pp. 64-65). With regard to the second dimension, the motivation to perform, the commitment to do no harm (or concern and care) is sometimes replaced by “benevolence”. Benevolence is defined as “the extent to which a trustee is believed to want to do good to the trustor, aside from an egocentric profit motive” (Mayer, Davis & Schoorman, 1995, p. 718; Schoorman, Mayer & Davis, 2007, p. 345). This factor is also at work in a Horizontal Monitoring relationship (see also Björklund Larsen et al., 2018, pp. 95-97). The tone at the top, for example, may show the motivation, the willingness to be (proactively) compliant and transparent, that convinces the NTCA to take further steps towards a covenant.

The two dimensions are closely related: actual behaviour expresses taxpayers’ intention to cooperate (Kasper, Kogler & Kirchler, 2013, p. 4). The three components of “the motivation to perform-dimension” deserve special attention in so-called power-asymmetric relationships, such as the traditional one between the tax inspector (with extensive legal powers) and the taxpayer. In a relationship in which there is a power difference between the actors, it may be difficult to develop trust (for symmetric and asymmetric trust relations, see Coleman, 1990, pp. 178-180; Dusarduinj, 2018, p. 67). The more powerful actor’s behaviour can substantially diminish trust, unless he or she reflects honesty and integrity (Gerbasi & Cook, 2009, p. 223). Note that the NTCA’s client managers have to become a new type of tax official: “T-shaped knowledge experts”, having an understanding of technical tax issues, the organisation and working practices of the NTCA, and “the culture and operational practices of the large corporate and the external world in which the large corporate operates.” (Tuck, 2010, p. 593).

This tax administrator needs to have detailed technical knowledge (competence) of the increasingly complex tax legislation (the vertical part of the T shape) and “a new broader knowledge of “soft skills” such as non-confrontational meeting skills, customer service skills, and treating taxpayers as customers, in addition to greater specialist knowledge” of multinational companies (the horizontal part of the T; Tuck, 2010, p. 594). Multinational companies are indeed becoming increasingly complex organisations with group operations worldwide, and complex internal structures and decision-making procedures. A trust approach therefore requires a rather different mindset from tax officials who are often used to relying on traditional, hierarchical interactions with taxpayers. This does not come naturally. Some staff have shown that they find it difficult to change from adopting an antagonistic approach with an emphasis on control to establishing a cooperative trust relationship (Stevens Committee, 2012a, p. 973; De Widt, 2017, pp. 21-22; see also BMF, 2016, p. 63).

Trust is linked to the concept of mutual understanding. To build trust, parties engage in actions explicitly designed to lead the other party to place trust in them. To be successful, these actions
must be based on “an understanding (intuitive or explicit) of the potential trustor’s basis for deciding whether or not to place trust” (Whiting, 1998, p. 179, referring to Coleman, 1990). Mutual understanding comes quite close to empathy. Empathy is the capacity to accurately understand the position of others – to feel that “this could happen to me” (Trout, 2009, p. 21). When people empathise with others, they try to understand their inner states by placing themselves in their situation or taking their perspective. In order to judge trustworthiness and its limits, one must understand what determines actions and their outcomes. According to Nooteboom (2018), this insight enables empathy: “the ability to put yourself in the shoes of the other, to see where you can help, to prevent problems, but also to assess the risks you run” (p. 34). The principle of (reciprocal) understanding, enabling empathy, reflects the commitment to concern and care, a component of the second dimension involved in judgments of trustworthiness. One party showing a commitment to concern and care is a condition for the other party’s acceptance of vulnerability to the actions of that party. In the asymmetric relationship between the tax authorities and the taxpayer, the powerful tax authorities bear special responsibility in this respect.

Note that large companies possess superior economic and political power entailing a kind of power symmetry which may (partially) counterbalance the legal asymmetry, that is, the legal power of the NTCA. “Thus, even if large organisations perceive tax authorities to be powerful, they may be less likely to feel ‘threatened’ by this power” (Siglé et al., 2018, p. 14). Indeed, the NTCA’s aim to increase knowledge amongst tax officials about the way businesses operate and the administrative needs this generates amongst corporate taxpayers contributed to an increase in mutual professional understanding. These taxpayers reciprocate by putting effort in, making it credible to the NTCA that they hold genuine intentions of cooperating with the NTCA on the basis of 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” (De Widt, 2017, p. 31.)

Thus, in a Horizontal Monitoring relationship, the taxpayer and the NTCA do not place trust blindly. As argued, they engage in actions designed to lead the other party to place trust in them. In a tax context, these actions may, of course, consist of the exchange of information. Mutual transparency, referring to openness between the taxpayer and the NTCA, is of special importance in this respect. A taxpayer’s transparency and openness with regard to relevant information (facts, actual or potential views on positions over which the NTCA may disagree, et cetera) promotes cognitive-based trust. The provision of information and services by tax authorities helps taxpayers to trust the tax authority (Gangl, Muehlbacher, de Groot, Goslinga, Hofmann, Kogler & Kirchler, 2013). Transparency in the sense of communicating openly with taxpayers in order to inform and educate them about their rights and obligations may also fortify the NTCA’s trustworthiness (see Cipek, 2018, p. 1). Both taxpayers and tax authorities show their trustworthiness, that is, their capability to perform the task of providing information and, by doing so, that they can be relied on to provide one another with relevant information. It is also a matter of being open in the sense of “telling the truth about what can be expected” (Nooteboom, 2018, p. 33). Moreover, when a problem arises, one should report it immediately, explain what went wrong, offer to help to solve it, and take measures to prevent such problems from arising in the future. Furthermore, having a transparent and open attitude with regard to relevant information expresses the motivational components of integrity and honesty. When something goes wrong, one should give the other party the benefit of the doubt – be willing to listen and allow him or her to explain and make amends (Nooteboom, 2018, p. 33). Transparency is therefore a key value to be reciprocally observed in a Horizontal Monitoring
relationship. Thus, the various procedural steps to conclude a covenant are taken by the NTCA and the taxpayer in order to establish and secure a trust-based relationship. The Horizontal Monitoring relationship illustrates that trust is related to expectations of reciprocity. To obtain the NTCA’s trust, the taxpayer will reciprocate trust by fulfilling his legal obligations. Important factors affecting the cooperative decisions are the parties’ capacity to learn more about each other’s characteristics, viz. competence, reliability and motivation, which consists of the components integrity, honesty and the commitment to do no harm, and the ability to build reputations for being trustworthy (keeping promises and “performing actions with short-term costs but long-term benefits”) (Ostrom, 2003, p. 43). Trust is thus an expectation about another’s future cooperation based on reputations for trustworthiness. In short, with regard to reciprocal behaviour, “both the past (through reputations) and the future (through expectations) matter” (McCabe, 2003, p. 150).

Although the NTCA also accepts vulnerability in respect of the actions of taxpayers, relying on taxpayers’ voluntary provision of tax-relevant information, under the covenant, it “trusts” by “knowing less” about the facts and figures but “knowing more” about the company (NTCA, 2010, p. 8). By receiving information from the company on its tax strategy, tax control and transparency (the client profile), the NTCA reduces its vulnerability and seeks to run (only) a reasonable risk. Here, the two dimensions of trustworthiness are at play: the taxpayer’s demonstration of competence, reliability, integrity, honesty, and its commitment to “do no harm” enables the NTCA’s acceptance of vulnerability to the taxpayer’s actions. The NTCA calls this (degree of) trust “justified trust” and defines that as “the favourable expectations of the behaviour of the other party that have in part developed as a result of the observed behaviour and the information that is collected” (NTCA, 2010, p. 77).

Given the importance of the mutual gathering of information – to reduce the risk of damaging established trust – we prefer to use the term “informed trust”. This term has no other meaning than the term “justified trust” used by the NTCA, but emphasises the mutual gathering of information as the basis for building and justifying trust, and thus establishing, reinforcing and securing the trust-based relationship. Therefore, we consider “trust” in a Horizontal Monitoring relationship as informed trust and describe it as follows (Huiskers-Stoop, 2015, p. 158): “Informed trust can be referred to when both NTCA and taxpayer accept vulnerability to actions of each other, based upon the expectation that both will perform actions important to the other, while parties try to reduce their vulnerability back and forth by gathering information from or about the other”, and moreover, discuss their diverging qualifications of this information.

The NTCA describes mutual understanding as the willingness to put oneself in the other’s place and to understand the other party’s perspective (NTCA, 2013, p. 7). It is therefore important that the NTCA understands the commercial interests of the company and relevant deadlines. Within a Horizontal Monitoring relationship, it is also important that the NTCA understands the circumstances in which financial and tax law specialists act; these specialists must entertain good relationships with the client, on the one hand, and with NTCA, on the other (NTCA, 2013, pp. 54-56; see also Stevens Committee, 2012a, pp. 99-100). In addition, mutual understanding plays a pivotal role in the consultation of appropriate solutions; parties are expected to respond to mistakes with understanding (Stevens Committee, 2012a, pp. 97-98). This implies the parties’ willingness to enter into discussion about the cause of the mistakes (and the best way to redress them) and about measures necessary to prevent mistakes from being made in the future (NTCA, 2013, pp. 51-54; see also Stevens Committee, 2012a, pp. 97-98). The challenge is to tackle mistakes while maintaining the mutual relationship. Because serious mistakes
should be fined according to the law, both the NTCA and the taxpayer may perceive a fine or another sanction as a serious threat to a good working relationship.

Mutual transparency refers to openness between taxpayers and the NTCA. The taxpayer must be transparent about its tax strategy and relevant issues, and must provide open answers to questions (NTCA, 2013, p. 7). The NTCA must be open about the background of its questions and the implementation of its supervision. The NTCA expects taxpayers with covenants to be so transparent that they always give clear presentations of their tax affairs. Indeed, empirical research shows that companies with HM covenants are more transparent, have better tax control mechanisms, and file correct and complete tax returns more often than companies without covenants (NTCA, 2017).

The second principle is that rights and obligations pursuant to legislation and regulations are and will remain applicable without limitation. This does not only imply that rights and obligations that already existed before concluding the covenant remain applicable, but also that statutory tax rules and partly unwritten principles of proper administrative behaviour will apply in a covenant situation (see Section 4.1).

The third principle is that the covenant is applicable to the levying of all Dutch national taxes and the collection thereof. To qualify for a covenant, taxpayers should be subject to one or more Dutch national taxes, such as VAT or corporation tax. The covenant, subsequently, refers to all national taxes to which the taxpayer is subject.

3.3.2 Mutual covenant agreements

In addition to the principles, the covenant contains four categories of mutual agreements:

1) agreements on the realisation of customised tax supervision
2) agreements on actual tax collection
3) agreements on actual insight into the taxpayer’s tax position
4) agreements on updating the NTCA on the taxation process (real-time working).

The agreements help to effectuate willingness towards regulatory compliance into tax behaviour and to ensure the taxpayer’s and the NTCA’s trustworthiness. The reciprocal proactive provision of information enhances transparency and is essential to the formation and maintenance of trust. Parties being proactively transparent (beyond what the law requires) show their capability to provide information (competence) and reliability in fulfilling their promise to do so. Actual behaviour reflects the parties’ intention to cooperate. Thus, by actually providing their partner with relevant information, their motivation to perform the (voluntary) obligation of providing information comes to light and, with it, its components of integrity, honesty and the commitment to “concern and care”. Thus, the cognitive and motivational dimensions that are relevant to parties’ judgments of trustworthiness are “fleshed out” in concrete agreements and obligations.

The covenant contains voluntary agreements which go beyond the taxpayer’s and the NTCA’s actual statutory rights and obligations. These additional covenant obligations have no basis in public law; they are voluntarily agreed upon. The trust-relationship, rather than traditional tax law, is the source of parties’ compliance with these extra-statutory obligations. By classifying the covenant as a private agreement, the obligations legally bind not only the NTCA but also
Cooperative Compliance and the Dutch Horizontal Monitoring Model

1. Agreements on the realisation of customised tax supervision

Taxpayers are obliged to implement systems of internal control, internal audit and external audit aimed at preparing and filing acceptable tax returns. A taxpayer is statutorily obliged to keep records and books in such a way that there are clear rights and obligations for taxation at all times (Article 52 GTA 1959). The NTCA may inspect the financial administration and the taxpayer is obliged to cooperate. This cooperation does not only include making records, books and other data available, but also providing insight into the organisational mechanisms to identify and control tax risks (Parliamentary documents (Kamerstukken) II, 1988/89, 21 287, nr. 3, p. 12). The complete set of administrative procedures and techniques, as well as the product of the administrative process, are part of the administration (NTCA, 2013, p. 43). This obligation to have an administration under Horizontal Monitoring does not differ under the statutory legal Dutch framework. The procedures and techniques to take care of a system of internal control, internal audit and external audit are also part of the administration.

So far, with regard to the scope of the administration, there is no difference between Horizontal Monitoring and the traditional legal requirements. However, there is a difference in the level of tax control. The level of tax control is higher under Horizontal Monitoring than under the existing legal framework. Taxpayers participating in Horizontal Monitoring are assumed to bear more responsibility, which is expressed through taking additional tax control measures. “Additional” depends on the nature, size and complexity of the company. In so far as the company has to take additional tax control measures, the scope of the administration increases compared to traditional monitoring.

In addition, the corresponding obligation to adjust the form and intensity of the supervision to the quality of the system of internal control, internal audit and external audit goes beyond traditional tax monitoring and the actual statutory rights and obligations. Under traditional monitoring, the NTCA makes a risk assessment and aligns the monitoring. Under Horizontal Monitoring, the NTCA is committed to adjust the form and intensity of the supervision to the quality of the internal control framework, internal audit and external audit. As a consequence, under Horizontal Monitoring, the NTCA has to take additional measures in order to take enterprise-specific circumstances into account as well.

2. Agreements on actual tax collection

In our view, the agreements concerning actual tax collection do not go beyond the actual statutory rights and obligations: the obligations to ensure timely payment of tax debts and refunds are not different from traditional tax monitoring (Article 9 in conjunction with Article 2, paragraph 2, sub-paragraph e, Tax Collection Act 1990; see also NTCA, 2013, pp. 45-47).

3. Agreements on the actual insight into the taxpayer’s tax position

The agreements relating to updating the NTCA’s insight into the tax position of a taxpayer go beyond the actual statutory obligations. Companies with covenants are required to disclose their actual or potential views on relevant tax issues (the HM covenant states: “view, taken or to be taken, on relevant (tax) matters”) to the NTCA and the NTCA is obliged to provide
answers (NTCA, 2013, pp. 36-40). Under the agreement, taxpayers do not only have the right to submit questions to the NTCA about its view on the application of the law, but also have an obligation to – especially with regard to actual or potential views on which the NTCA may disagree. The obligation to submit relevant tax positions to the NTCA goes beyond traditional tax monitoring. Under the existing legal framework, this obligation does not exist.

In the same vein, the corresponding obligation to (periodically) discuss (relevant) tax and other matters submitted by the taxpayer, as far as possible in consultation with the taxpayer, while relevant terms are taken into account, goes beyond statutory rights and obligations. In addition to the traditional practice of answering legal questions, under Horizontal Monitoring, the NTCA must also discuss and answer factual and mixed questions (regarding facts and the law), while the relevant deadlines for taxpayers should be taken into account (with regard to answering factual and legal questions, see De Widt, 2017, pp. 29-30).

4. Agreements on updating the NTCA on the taxation process (real-time working)

Finally, the agreements about keeping the NTCA up to date on the tax process go beyond statutory rights and obligations. Although a taxpayer who is subject to traditional monitoring is also obliged to file a tax return and to provide information, the covenant requires that the obligations are fulfilled as soon as possible. The transparency-based cooperation also implies that the NTCA may expect taxpayers to deal more generously with the provision of tax relevant information. The fiscal transparency bar is higher under Horizontal Monitoring than under traditional monitoring.

Under Horizontal Monitoring, the NTCA imposes tax assessments according to the existing legal framework. For that reason, the process is similar to traditional monitoring, but this is not the case in respect of its obligation to impose assessments as soon as possible and as much as possible in consultation with the taxpayer.

In addition, the obligation to explain why certain information is requested does not, in our view, go beyond traditional tax monitoring, as it is comparable to the existing legal obligations (Articles 3:47 and 3:48 of the General Administrative Law Act (Algemene wet bestuursrecht; GALA). Under traditional tax monitoring, the NTCA must likewise underpin that the requested information might be of significance to the levying of tax of the person the information is requested from, and the request must be reasonably and clearly indisputable (Supreme Court 8 January 1986, BNB 1986/128). However, the obligation to determine deadlines for providing the information in consultation with the taxpayer goes beyond traditional tax monitoring. Under the existing legal framework, the tax inspector determines the deadlines (Article 49 GTA 1959).

Table 1 provides an overview of the four categories of reciprocal covenant agreements. The parts of the agreements which go beyond taxpayers’ actual statutory obligations are in italics.
Table 1: Overview of additional voluntary covenant obligations

<table>
<thead>
<tr>
<th>Categories of covenant agreements</th>
<th>Additional obligations for the taxpayer</th>
<th>Additional obligations for NTCA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Realisation of customised tax monitoring</td>
<td>To provide a system of internal control, internal audit and external audit aimed at preparing and filing acceptable tax returns</td>
<td>To adjust the form and intensity of the supervision to the quality of internal control, internal audit and external audit</td>
</tr>
<tr>
<td>2. Actual tax collection</td>
<td>To ensure timely payment of tax debts</td>
<td>To ensure timely payment of tax refunds</td>
</tr>
</tbody>
</table>
| 3. Actual insight into the tax position of taxpayer | To submit its view, taken or to be taken, on relevant (fiscal) matters to the Tax Administration as soon as possible | - to issue 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 the taxpayer, while relevant periods are taken into account
- to (periodically) discuss (relevant) fiscal and other matters (submitted by the taxpayer), in particular matters on which a difference of opinion may arise from the NTCA’s point of view |
| 4. Update of the taxation process | To promote real time working:
- tax returns and declarations will be filed as soon as possible; and
- any information requested by the Tax Administration will be provided as soon as possible, (generous) in full and unambiguously | To promote real time working:
- assessments will be imposed as soon as possible after filing of tax returns and in consultation with the taxpayer as much as possible; and
- to clarify and explain why specific information is requested, and mutually agree on the response period |

Source: Huiskers-Stoop 2015, p. 166.

The additional covenant obligations have no explicit basis in public law – although, of course, the NTCA has discretion with regard to its compliance strategy. Moreover, according to current views, the NTCA is authorised to achieve goals under public law through private law (Huiskers-Stoop 2015, pp. 167-169). The individual covenant can be classified as a mutual private agreement designed to fulfil the public task of tax collection (Article 6:261, paragraph 1, Dutch Civil Code). Absent disputes, the legal qualification of the covenant does not seem to be important. It is of greater importance, however, in situations in which disputes about the voluntary obligations arise and cannot be resolved in an informal way.

The additional covenant obligations ensure that both taxpayers and the NTCA must make more effort and produce more results under Horizontal Monitoring than under traditional monitoring. This entails that the bar is set higher under Horizontal Monitoring than under the existing legal
framework. We distinguish four reciprocal covenant obligations which result in the bar being set higher than it is in the actual legal framework (Huiskers-Stoop, 2015, pp. 183-186):

1) To take (when necessary) additional tax control measures and align monitoring (more responsiveness).

2) The mandatory submission of (tax) relevant positions and the obligation to give a view on it (more transparency).

3) The consultation obligation with regard to (tax) positions, the view on submitted positions, the imposition of the tax assessment and the response period (more interactivity).

4) The speed at which not only additional covenant obligations but also the obligations arising from regular (tax) legislation must be performed (more speed).

In principle, the covenant is concluded for an indefinite period of time. However, parties are free to terminate the agreement, in which case the other party will be informed of the reasons, in writing, in advance. Moreover, termination will not take place before oral consultation. The agreement may be terminated with immediate effect.

4 HORIZONTAL MONITORING AND COOPERATIVE COMPLIANCE COMPARED

This section focusses on the question of how the Dutch Horizontal Monitoring model delivers on the principles of the OECD model of cooperative compliance. To answer this question, we investigate whether the Dutch model meets the six OECD principles for a cooperative compliance monitoring model (Section 4.1) and we will address issues of concern regarding a compliance-based monitoring model (Section 4.2).

4.1 “Testing” the Dutch model against the OECD’s principles

As described in Section 2, a cooperative compliance monitoring model can be defined as voluntary tax cooperation between tax authorities and large companies based on six principles: commercial awareness, impartiality, proportionality, openness and transparency, responsiveness, and supervision adjustment to TCF. In this section, we analyse how the NTCA has fleshed out these OECD principles into the Horizontal Monitoring model.

The process of establishing a cooperative tax relationship enables the NTCA to understand the activities of companies eligible for Horizontal Monitoring. In addition, the principles of commercial awareness and openness and transparency are expressed in the principles of the individual covenant: parties base their relationship on mutual transparency, mutual understanding and trust. The process undertaken in order to enter into a Horizontal Monitoring relationship – especially the first three steps (the update of client profile, Horizontal Monitoring meeting and compliance scan) – enables the NTCA to understand the company’s business activities. Thus, commercial awareness enables understanding. Companies, for their part, must also be aware that the NTCA has to levy taxes and that deadlines are inherent to the taxation process. The NTCA’s commercial awareness, on the one hand, and businesses’ awareness of NTCA’s statutory powers, obligations, procedures and responsibilities, on the other, creates mutual understanding. The NTCA’s obligation to provide openness and transparency is also expressed in the covenant; the NTCA is obliged to discuss and respond to tax positions declared by taxpayers. Reciprocal understanding and transparency will fortify trustworthiness and trust.
The covenant also provides for the importance that the OECD attaches to obtaining fast certainty for the taxpayer: the NTCA must give – as soon as possible after receipt details of a position taken or to be taken and, as far as possible, in consultation with the taxpayer – its view on the legal consequences of the position and take relevant deadlines into account. Taxpayers should, according to the OECD, be given responses to their questions promptly, efficiently and professionally (OECD, 2008, p. 37). This also expresses the principle of responsiveness, contributing to the NTCA’s trustworthiness.

The principle of proportionality concerns a balanced use of monitoring measures (OECD, 2008, p. 35). The obligation that the NTCA must adjust the form and intensity of monitoring to the quality of internal and tax control provides for this. Additionally, the obligations to develop a qualifying TCF and for the NTCA to align its monitoring follow from the covenant. The taxpayer must provide a system of internal control, internal audit and external audit aimed at the preparation and filing of acceptable tax returns. The principle of responsiveness is also expressed in the alignment of supervision.

With regard to the OECD’s principle of impartiality, we feel the Dutch Horizontal Monitoring system may fall a bit short. According to the OECD (2008), impartiality means that tax authorities should adopt an impartial approach in settling disputes and determining the tax debt (p. 35). Impartiality, or neutrality, contributes to procedural justice, taxpayers’ perceived fairness of procedures in the broad sense (including their treatment and the provision of information) which, in turn, is a major factor in establishing and maintaining trust in tax authorities (Kirchler, 2007, pp. 84-87). This is not only about the perceived justice of one’s own treatment but also of the treatment of others (see OECD, 2014, p. 24).

In this regard, regulatory capture is a risk of Horizontal Monitoring, for tax inspectors may lose their ability to form objective opinions. Tax officials must remain impartial and maintain a critical attitude towards the taxpayer, and the information and tax risks that it discloses. Failure to maintain a professional critical attitude could have a damaging effect on overall trust in tax authorities (OECD, 2016, p. 28. See also Gribnau, 2015a, p. 212; Stevens Committee, 2012a, p. 51). Tax officials, however, also need the room to take an impartial approach of public and private interests in relation to those to whom they are accountable. Pressing political and economic demands on the tax administration may hinder such an impartial approach (Stebbings, 2017, pp. 222-223). In this vein, Brooks (2014) argues that, in the UK, the political goal, for example, of applying “not just a light touch, but a limited touch” to business regulation and the administration of tax puts pressure on the tax authorities to favour large businesses (p. 175, quoting the former UK Chancellor of the Exchequer, Gordon Brown). In contrast, politics may also interfere when tax authorities seem to be prompted or instructed to be tough on business, eroding the trustworthiness of the tax authorities.

Moreover, the NTCA’s impartiality seems to be somehow endangered, because the NTCA falls – possibly unlike tax authorities in other countries – under the direct responsibility of the Finance Minister (and, in practice, the State Secretary of Finance). As a consequence, the NTCA has to act on the instructions from the Minister of Finance or his State Secretary. This could make having an impartial attitude more difficult than, for example, when the NTCA would have been an independent agency (the legislature is also biased towards the NTCA, having a (budgetary) interest in maintaining an efficient tax administration which may go at the expense of taxpayers’ interests, such as legal protection; see Gribnau, 2010, p. 162). With independent government agencies, a further political distance seems to create more room for an impartial approach of public and private interests. Though politically responsible for the
NTCA, the Minister of Finance and his State Secretary are, in principle, not allowed to interfere with the assessment of an individual taxpayer, since it is the tax inspector’s statutory competence (Article 11 GTA 1959). Nonetheless, the possibility of political interference, especially with regard to the Horizontal Monitoring relationship with multinational companies, cannot be dismissed out of hand. Integrity of government officials is, however, high on the political agenda. Alink and Van Kommer (2009) rightly argue that breaches of integrity undermine citizens’ trust in the government and may adversely impact compliance (pp. 30-35).

With regard to political influence, the Netherlands seem to be situated somehow between, on the one hand, Anglo-American countries and Scandinavia, “where the public sector is most amenable to political control”, and, on the other, countries with “a strong state and a high prestige-bureaucracy, for example Germany, Japan and Spain” (Hague & Harrop, 2007, p. 367, referring to Hood, 1996). Moreover, there is a strong and centralised bureaucracy in the sense that each government department is largely autonomous (Andeweg & Irwin, 2009, p. 179).

Nevertheless, Dutch tax laws and regulations – as well as “the general principles of proper administrative behaviour” (algemene beginselen van behoorlijk bestuur) – governing the NTCA’s actions provide (legal) protection to ensure that the NTCA takes an impartial attitude in the settlement of disputes and determination of the tax liability. The NTCA must apply the law objectively, even if it results in the levying of lower taxation than could have been levied on the basis of a subjective opinion. After all, the NTCA represents the public interest and not a private interest. Correctly applying the law also implies that a covenant partner is not treated more favourably than other taxpayers in similar circumstances. The equality of treatment is another aspect of the requirement of impartial application of the law. Consequently, the NTCA’s actions must not only have a statutory basis (by virtue of the principle of legality) but the exercise of its powers is also bound by unwritten legal standards, like the mentioned principles of proper administrative behaviour. These principles of proper administrative behaviour originate in case law and are further developed by the judiciary. Some of these principles have been codified. They offer legal protection to the citizen with regard to administrative bodies’ improper actions and decisions. These principles comprise procedural norms but also substantive norms and provide extra legal protection to taxpayers in addition to the protection embodied by statute law (Happé and Pauwels, 2011, pp. 247-248; Gribnau, 2015a, pp. 205-207; Gribnau, 2007, pp. 301-308).

International initiatives and regulations may also add to the NTCA’s impartiality. Moreover, several international initiatives have been taken to map existing national practices and identify good practices of efficient and effective tax administration. The European Commission has published various documents with regard to tax authorities' benchmarking resulting in increased EU scrutiny of national tax administrations (Végh & Gribnau, 2018, pp. 58-60). The NTCA should also act impartially by abstaining from the preferential treatment of particular taxpayers as part of international tax competition. There are initiatives designed to counter harmful tax competition among states in order to promote a level playing field. Tax authorities may give favourable tax rulings allowing a particular sector to operate with a lower effective tax rate than other sectors (see Van de Velde, 2015). The OECD and the EU, in turn, try to counter these harmful tax practices (OESO, 2015b; European Union, 2015).

Given the analysis above, the Dutch Horizontal Monitoring model meets the basic principles for a successful tax cooperation as formulated by the OECD; the Dutch Horizontal Monitoring model is also governed by concepts such as trust, mutual understanding, impartial attitude, proportionality, fiscal transparency and responsiveness. A striking difference is that the OECD’s model mainly – but not only – addresses the obligations of the tax authorities. The
Dutch model creates obligations of a more reciprocal nature between tax authorities and taxpayers. The ways in which parties act with regard to the agreements and to fulfilling their obligations enable reciprocal judgments of trustworthiness, which fuel both parties’ trust in the actual cooperative quality of their relationship.

4.2 Addressing issues of concern to a compliance-based monitoring model

In Chapter 3 of the 2013 report, the OECD expressed its view on issues of concern regarding a compliance-based monitoring model (OECD, 2013, pp. 41-57):

1) the wider compliance strategy
2) overcompliance by persuasion
3) settlement of disputes
4) alleged conflict with the principle of equality.

We discuss below how both the OECD and the Dutch Horizontal Monitoring model address these issues of concern.

1. The wider compliance strategy

In response to the 2008 report, the OECD was criticised about the disclosure of information beyond what taxpayers are statutorily obliged to provide (“wider compliance”; OECD, 2008, p. 41. Compare Björklund Larsen, 2016, p. 37). A taxpayer’s compliance strategy should include all information necessary for the tax authorities to undertake a fully informed risk assessment. The commitment to be transparent should be reflected in a risk management system (OECD, 2013, p. 57). In order to create a situation of transparent tax information, the OECD considers it important that companies invest in qualifying TCFs. A qualifying TCF enables a company to report tax risks and voluntarily submit them to the tax authority (OECD, 2013, p. 20; OECD, 2016). In addition, qualifying TCFs help companies to bear responsibility for the timely, correct and complete submission of tax returns, and the timely payment of the taxes due. Furthermore, TCFs give the tax authorities trust regarding the accuracy of tax returns. In the Dutch situation, the taxpayer’s obligations to build and use a qualifying TCF and the NTCA’s obligation to align supervision follow from the covenant. It also follows from the covenant that companies must be transparent and provide tax-relevant information liberally. This means that companies voluntarily provide more tax-relevant information than they are statutorily obliged to.

2. Overcompliance by persuasion

In response to the 2008 report, the OECD received firm criticism about the allegedly insufficient attention paid to the interpretation of the law. Dabner and Burton (2009), for example, believe that when tax authorities encourage taxpayers to voluntarily settle and pay the right amount of tax, this is the amount of tax from the perspective of the tax authorities (pp. 318-319). If taxpayers do not wish to accept the tax authorities’ views, they are considered to be noncompliant, or at least less compliant. But what should be understood as the “right” amount of tax? The law can be interpreted in different ways, with taxpayers and tax authorities having opposite interests. According to Dabner and Burton, a tax authority’s goal is to maximise government revenue (to our minds, however, it should be to collect the right amount of tax), whilst a tax professional’s/taxpayer’s goal is to minimise it. Dabner and Burton criticise the OECD with regard to whether there is room for differences of opinion and how possible
disputes about legal interpretation should be resolved. In the same vein, Freedman (2011) argues that the “use of persuasion to encourage compliance beyond that which might be required by law could result in unequal or disproportionate burdens on taxpayers who are not actually disobeying the law” (p. 637).

It should be noted that the NTCA aims to levy the “the right amount of tax.” This aim may contribute to its legitimacy. Björklund Larsen (2018), for example, argues that the Swedish revenue collection agency has acquired legitimacy by levying and collecting “the ‘right’ – not the maximum – tax and minimising taxpayers errors” (p. 12). In the same vein, D’Ascenzo (2018) refers to the “proper and impartial administration of the tax law” (p. 248).

In response to the interpretation issue, the OECD indicates when “tax planning” should be addressed:

Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences. Taking a position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law (OECD, 2013, p.48).

In the first situation, there is tax planning that, according to the OECD, does not violate the letter, but the spirit of the law. In passing, we note that the OECD apparently uses the term “letter of the law” as shorthand for tax planning that exploits the technicalities or differences between tax systems by making use of “a bewildering variety of techniques (e.g. multiple deductions of the same loss, double-dip leases, mismatch arrangements, loss-making financial assets artificially allocated to high-tax jurisdictions)” (Piantavigna, 2017, p. 52; see also Gribnau, 2015, pp. 234-236). In the second situation, there is tax planning that may be contrary to the letter of the law, while no openness has been given. Moreover, from a taxpayer’s perspective, a more neutral definition of tax planning, in the sense of taking into account the tax consequences of one’s actions, would make sense. It may well be argued that, given the complexity of the tax system, companies, like all taxpayers, have to engage in some kind of tax planning. They want to know the impact of taxation and tune their behaviour to account for this impact as they want to be in control of their finances (Gribnau, 2015, pp. 226-227).

The OECD’s view that companies should not only act in accordance with the letter but also in the spirit of the law has been firmly criticised. Freedman (2011) argues that abiding by the “spirit of the law” may simply mean compliance with the proper intention of the legislature as found by the courts by purposive construction. But that is altogether different from the spirit of the law as something that “may be found outside the decision of the courts, in terms of what is acceptable to the revenue authorities or current government, or perhaps even nongovernmental organisations” (Freedman, 2011, p. 635). The upshot would be a lack of space in which to disagree on the interpretation of the law by the tax authorities. Consequently, companies working within a cooperative compliance model would have to pay more tax than taxpayers not participating in cooperative compliance programmes. As shown above, according to critics, implementation of a cooperative compliance model would lead to “over” compliance (see also OECD, 2013, p. 48.) The complexity of business operations and tax laws is such that there is room for legitimate differences of opinion about what constitutes “aggressive tax planning” and which tax outcome is truly consistent with the spirit of the law (OECD, 2013, p. 49). If cooperative compliance does not allow for such differences of opinion and access to the courts to settle disputes, taxpayers entering into covenants with the tax
authorities are effectively agreeing to accept that, in instances of conflict, the tax authorities’ views prevail.

In response, the OECD (2013) indicates that there must be room for taxpayers and tax authorities to have differences of opinion on the proper tax treatment of some transactions (p. 50). This can be accommodated within the framework of cooperative compliance, as long as the taxpayer is open and transparent about its position. Essential to the relationship is, therefore, the disclosure of those occurrences when the taxpayer has taken a position in the tax return that is contrary to the view of the tax authorities. Although court proceedings could interfere with the mutual relationship, the OECD deems that, in practice, the number of disputes that arise in the context of a cooperative compliance relationship is likely to be self-limiting.

A taxpayer that takes up a series of positions that conflict with the view of the revenue body, pursues those positions through the courts, and loses most or all of the cases, is likely to rapidly reassess its tax strategy. By the same token, a revenue body that frequently challenges positions taken by the taxpayer but is frequently unsuccessful before the courts will have to adjust its view of the law (OECD, 2013, p. 50).

To what extent is there room for interpretation of the law in the Dutch Horizontal Monitoring model? In the OECD's view, tax planning should be addressed if it does not violate the letter, but the spirit of the law. In the OECD's view, tax planning should also be addressed when it may be in violation of the letter of the law, while no openness is given. The requirement that, in the event of possible violation of the letter or the spirit of the law, openness must be given, goes beyond traditional Dutch tax monitoring. In the existing legal framework, a taxpayer may not act in a way which is contrary to the letter of the law, but no openness has to be given in case of doubt. Openness must, however, be given under Horizontal Monitoring. That follows from the voluntarily concluded covenant. It also follows from the covenant – at least from the risk of termination in cases of (ongoing) aggressive tax planning – that companies should not structurally violate the spirit of the law (Gribnau, 2015a, pp. 213-214. See also Bronzewska, 2016, pp. 372-374). The flexibility that companies have for tax planning under Horizontal Monitoring is, therefore, limited compared to the flexibility that companies which do not participate in HM relationships have (Huiskers-Stoop, 2015, p. 441, p. 304). Tax planning in accordance with the spirit of the law is allowed; however, aggressive tax planning with the aim of paying a minimal amount of (corporate income) tax should be avoided due to the risk of the covenant being terminated (see, in this respect, Minister of Finance (2010, p. 3)).

Thus, the covenant leaves considerable room for tax planning – even for some aggressive tax planning – as long as the taxpayers proactively inform the NTCA. Nonetheless, taxpayers may sometimes feel persuaded to comply beyond the level which they think is required by substantive tax law. They may perceive this as being a reasonable price to pay for a Horizontal Monitoring working relationship which is, overall, attractive. However, the relationship will be out of balance if they feel persuaded to take tax positions that they would rather not take. As a result, the trust base will be weakened since over-compliant taxpayers may find the NTCA to be less trustworthy and to lack understanding (commitment to concern and care).

3. Settlement of disputes

Even when in a cooperative compliance relationship, taxpayers and tax authorities should be able to submit disputes to court. According to the OECD, there are two types of disputes (OECD, 2013, p. 51):
Entering a cooperative compliance relationship implies that existing disputes are resolved as far as possible. This can be done by concluding agreements (OECD, 2013, p. 52). In order to settle disputes that arise afterwards, the OECD explicitly points to the Dutch possibility of a so-called agree to disagree appeal: in a situation where there is no difference of opinion on the facts and only the interpretation of the law divides parties, the parties may jointly consult the tax court (OECD, 2013, p. 52; see also Stevens Committee, 2012a, pp. 99-100). In addition, in a situation of non-compliance with the additional covenant rights and obligations, parties may also appeal to the civil court (Huiskers-Stoop, 2015, p. 441, pp. 189-192). Covenant parties may ask the civil court to impose fulfilment of the additional covenant obligations and, in exceptional cases, compensation of damage – but, of course, structural failure to comply with voluntary obligations probably shows that the trust base of their relationship has been seriously eroded.

4. Alleged conflict with the principle of equality

The principle of equality entails that citizens in the same situation should be treated in the same way and any differences of treatment should be the rational result of objective differences in the circumstances of a particular case (OECD, 2013, p. 45). With regard to Horizontal Monitoring, the question of whether there is a conflict with the principle of equality if certain taxpayers are treated according to the principles of a cooperative compliance model and other taxpayers are not arises (cf. Björklund Larsen, 2016, pp. 38-39 and Bronzewska, 2016, pp. 375-382). The OECD concludes that there is no conflict with the principle of equality. The common goal of tax cooperation based on cooperative compliance strategies is to secure the timely payment of the correct tax. The OECD does not think that this raises any issues in terms of equality before the law, as the outcome of cooperative compliance – in terms of the tax that is payable by a company – should be the same as that when a more traditional audit or enquiry approach is taken (OECD, 2013, p. 46). Regarding the other benefits offered by cooperative compliance, such as obtaining certainty faster or reducing tax compliance costs, the OECD thinks that the decision to offer cooperative compliance to taxpayers who can demonstrate they are of low risk is an integral part of the risk assessment process – a process that is consistent with the principle of equality (OECD, 2013, p. 47). According to the OECD, the existence of an effective TCF together with a taxpayer’s explicit willingness to meet the requirements of disclosure and transparency that go beyond their statutory obligations provide an objective and rational basis for a (procedurally) different treatment. The tax authority can place a justified reliance on the tax returns it receives from taxpayers who meet the requirements, and can be confident that material tax risks and uncertainties will be brought to its attention (OECD, 2013, pp. 46-47).

Is there a conflict with the principle of equality in the Dutch case, as taxpayers who are willing and able to comply with the laws and regulations are treated procedurally differently from taxpayers who are not able to and/or will not comply? Horizontal Monitoring is a strategy aimed at deploying scarce enforcement resources as efficiently and effectively as possible, and is based on differentiating between non-compliant (representing a high risk) and compliant taxpayers (representing a low or negligible risk) as part of the NTCA’s compliance risk management strategy. Where two taxpayers are in identical situations in fact and legally, in principle they are both entitled to a covenant or not (identical cases). Insufficient trust in the anticipated willingness to comply voluntarily may, for the NTCA, however, be a reason to
enter into an agreement with one taxpayer and not with another (actual inequality) (Huiskers-Stoop, 2015, p. 445). The actual unequal treatment can be objectively justified by the (informed) trustworthiness of taxpayers (Gribnau, 2015a, pp. 210-212). Again, this differentiated treatment should not lead to a different, more favourable outcome in terms of the tax payable by a taxpayer (Boer & Gribnau, 2018, pp. 232-233). Therefore, the principle of equality is (theoretically, at least) not violated when Horizontal Monitoring is applied (see also Filipczyk, 2017, pp. 333-334; Gribnau 2015a, pp. 210-212; Stevens Committee, 2012a, p. 96). Moreover, the principle of equality is served by the NTCA’s HM guidelines to guarantee uniform treatment. However, transparency is lacking in this respect, for the confidentiality principle (fiscal secrecy) applies to tax affairs, entailing a lack of information with regard to the actual execution of the NTCA’s general compliance strategy and its treatment of taxpayers ((anonymised) court cases are, of course, an exception). This sometimes makes it difficult to assess the NTCA’s actual behaviour – also in the HM framework (Bronzewska, 2016, pp. 381-382). The Stevens Committee, which evaluated developments relating to Horizontal Monitoring at the request of the Minister of Finance, also looked into the principle of equality. The Committee reported that its discussions and the information it received have not revealed any solid evidence to substantiate the conclusion that preferential treatment has been an issue (Stevens Committee, 2012a, p. 50; discussing and giving recommendations with regard to the “risk of regulatory capture”, a loss of a professional critical attitude). This is important, as media coverage sometimes suggested the existence of “sweetheart” deals, which might have an impact on the general public’s trust in the NTCA. It may also affect the perceived power of the NTCA to enforce the law and, consequently, have an impact on taxpayers’ intended tax compliance (Kasper, Kogler & Kirchler, 2013). In addition, state aid rules help tax authorities not to give away “presents” by favouring certain groups of taxpayers over others (European Union, 2016). When a tax measure confers certain companies with favourable tax treatment which improves their financial situation compared to other taxpayers who are in the same position and there is no justification for this, there is an issue of prohibited state aid. Preferential treatments would also not encourage traditional tax officials who take hierarchical and antagonistic approaches to change their mindsets and endorse cooperative trust relationships. The NTCA would be well advised to pay attention to the field of tension between professional ethics and trust in order to avoid regulatory capture (BMF, 2016, p. 67).

The NTCA’s trust is based on positive expectations of the taxpayer’s behaviour: “a good client profile”. Being a “good client” assures the NTCA that it will receive current and actual information about the company’s tax strategy, tax control and transparency. “These are the elements of the NTCA’s client profile of the relevant organisation. This information enables the NTCA to adjust its supervision and restrict its activities solely to those required to validate Horizontal Monitoring” (NTCA, 2013, p. 6). To counter arbitrary treatment of taxpayers, the “good client profile” should be capable of being assessed objectively. In our opinion, with sub-processes to optimise the tax control process (next to four general control objectives) and the details of the expectations regarding the outcome of these processes, the NTCA meets the requirement for more (objective) clarity to sign up to Horizontal Monitoring (Huiskers-Stoop, 2015, p. 446; NTCA 2013, pp. 28-30; OECD 2016, p. 15; Stevens-Committee 2012a, p. 51). The policy to treat companies who are willing and able to comply with the tax law and regulations (by having their internal and tax systems up to standard and behaving responsibly with regard to taxation) differently from taxpayers who cannot or will not comply does not conflict with the principle of equality (actual inequality) (Huiskers-Stoop, 2015, p. 441; Stevens-Committee 2012a, p. 93, pp. 96-97). In order to be a trustworthy partner, a company must adopt a willing attitude towards the voluntary disclosure of tax-relevant information,
should not use tax aggressive or minimalistic structure (at the risk of termination the covenant), and must meet the requirements for a qualifying TCF (NTCA, 2013, pp. 28-32).

5. CONCLUSION AND DISCUSSION

This paper summarises how the OECD’s cooperative compliance model can be defined, how Horizontal Monitoring is incorporated in the Dutch legal tax system and enforcement process, and how the Dutch Horizontal Monitoring model relates to the OECD’s view on cooperative compliance. The principal research question is:

“How does the trust-based Horizontal Monitoring relationship and its establishment relate to the OECD model of cooperative compliance?”

We have examined this question on the basis of three sub-questions, which we answer as follows.

1. **How is the OECD’s cooperative compliance model defined?**

The OECD’s monitoring model for cooperative compliance can be defined as the voluntary tax cooperation between tax authorities and large companies based on six principles: commercial awareness, impartiality, proportionality, openness and transparency, responsiveness, and supervision adjustment to TCF.

2. **What are the different steps to be taken in the process of concluding a Horizontal Monitoring covenant and how do the voluntarily accepted Horizontal Monitoring covenant obligations relate to the mandatory obligations laid down in the Dutch legal tax system?**

Taxpayers and the NTCA follow seven steps to get a Horizontal Monitoring relationship. These steps fit in well with two dimensions of trustworthiness: first, competence and reliability, and, secondly, integrity, honesty and the commitment to concern and care. These dimensions enable the assessment of the trustworthiness of a party which, in turn, enables the other party to place trust in that party. The process begins with an update of the client profile by the NTCA gathering information about the taxpayer and ends with adjustment of supervision. The basis for tax cooperation between the taxpayer and the NTCA is the individual covenant. Besides the general provisions on parties, duration, commencement date, evaluation and termination, this covenant consists of an introduction expressing the intention to achieve an effective and efficient mode of operation, basic principles and agreements. The principles stipulate that parties should base their relationship on (informed) trust, mutual understanding and transparency, that rights and obligations pursuant to legislation and regulations are and will remain applicable, and that the covenant is applicable to the levying of all Dutch national taxes and collection. The covenant agreements are designed with the aim of realising customised tax supervision, actual tax collection, actual insight into the tax position of taxpayers, and an update of the taxation process (real-time working), which may help to convert willingness towards regulatory compliance into actual compliant behaviour and ensure the taxpayer’s trustworthiness (NTCA, 2017, finds that enterprises with covenants are less focussed on tax avoidance – and are, therefore, more compliant – than enterprises without covenants).

What characterises the Dutch model is the absence of an explicit statutory basis and the discretion of the NTCA as the basis for the Horizontal Monitoring model. The covenant
expresses both parties’ willingness to cooperate, and commitment to trust, mutual understanding and transparency. In addition, the published guidance gives the taxpayer certainty with regard to the behaviour of the NTCA under Horizontal Monitoring. The principle that rights and obligations pursuant to traditional tax monitoring remain applicable enables the NTCA to adjust its supervision when the taxpayer’s attitude and behaviour indicate that the principle of willingness to fulfil statutory obligations (voluntary compliance) is no longer satisfied.

The covenant contains agreements which go beyond the actual statutory rights and obligations. These additional covenant obligations, which have a reciprocal nature, have no statutory basis in public law. The additional voluntary obligations entail that both taxpayers and the NTCA must provide more commitment and effort, and produce better results, under Horizontal Monitoring than under traditional monitoring.

3. How does the Dutch Horizontal Monitoring model deliver on the principles of the OECD’s model of cooperative compliance?

The Dutch Horizontal Monitoring model meets the principles for a successful tax cooperation as formulated by the OECD. Both the OECD and the Dutch Horizontal Monitoring model address issues of concern about the wider compliance strategy, (forced) over-compliance by persuasion, the settlement of disputes, and alleged conflict with the principle of equality. In the Dutch Horizontal Monitoring model, it follows from the covenant that companies must be transparent and provide tax-relevant information liberally. In addition, the flexibility for tax planning under Horizontal Monitoring is more limited than under the existing legal framework. Tax planning in accordance with the spirit of the law is allowed; however, consistently aggressive or minimalistic tax planning should be avoided at the risk of termination of the covenant. Moreover, in a situation where there is no difference of opinion on the facts and only the interpretation of the law divides parties, the parties may jointly appeal to the tax court, starting a public law procedure (they “agree to disagree”). Furthermore, covenant parties may ask the civil court to impose fulfilment of the additional covenant rights and, in exceptional cases, compensation of damage. Finally, the policy to treat proactively transparent companies who are willing and able to comply with the tax law and regulations (by having their internal and tax systems up to standard and showing a responsible attitude towards taxation) differently from taxpayers who cannot or will not comply does not conflict with the principle of equality (actual inequality with regard to compliance).

Based on the above, we give the following answer to the principal research question:

A cooperative compliance model is defined as voluntary tax cooperation between tax authorities and large companies based on six principles: the tax authority must understand business activities, adopt an impartial approach, respond proportionally, demonstrate openness and transparency (like taxpayers themselves), take enterprise-specific circumstances into account, and align supervision to the quality of the company’s TCF. The Dutch Horizontal Monitoring model qualifies as a cooperative compliance model and is based on voluntary cooperation between the NTCA and taxpayers based on (informed) trust, mutual understanding and transparency, which does not, in itself, have a specific statutory basis but which is derived from the discretion of the NTCA to efficiently establish the tax enforcement process – in view of the scarce resources. The willingness to cooperate and the major voluntary obligations are laid down in an individual
covenant. The NTCA provides transparency with regard to its view on the Horizontal Monitoring relationship in published guidance.

The research shows that the Dutch Horizontal Monitoring model meets the basic principles for a successful tax cooperation as formulated by the OECD. The Dutch Horizontal Monitoring model fleshes out principles and concepts such as trust, mutual understanding, impartial attitude, proportionality, fiscal transparency and responsiveness. The issues of concern, as discussed and addressed by the OECD (Section 4.2), do not present insurmountable problems in the Dutch model. A striking difference between the two models is that the OECD model mainly – but not only – addresses the obligations of the tax authorities. The Dutch model, however, creates obligations between tax authorities and taxpayers of a more reciprocal nature (Section 4.1). The voluntary nature of the HM relationship incentivises companies to improve their internal tax controls facilitating trust by the NTCA. When the principles of the cooperative compliance model have been met, according to the OECD, the majority of taxpayers will be able to effectively and efficiently pay the right amount of tax in time. Taxpayers, in turn, find tax administrations to be trustworthy if they meet these principles, so the principles should be operationalised in practice to underpin this trust (Section 2.1).

Concluding a covenant with the NTCA is not easy. With taxpayers showing their willingness and trustworthiness to comply with the tax laws and regulations voluntarily, the NTCA may enter into tax cooperation relationships based on trust, mutual understanding and transparency. In our opinion, the seven-step model offers the tax authorities sufficient guarantees to judge a taxpayer’s willingness to voluntarily comply with the tax laws and regulations (Section 3.2), to assess the trustworthiness of the taxpayer, and thus to establish and secure a trust-based relationship (Section 3.3) and to trust that acceptable tax returns will be filed by the company. As described, the NTCA’s trust is based on positive expectations of the taxpayer’s behaviour: a good client image. In our opinion, with various sub-processes to optimise the tax control process and the details of the expectations regarding the outcome of these processes, the NTCA meets the requirement for more (objective) clarity to join horizontal tax monitoring (Section 3.2). The sub-processes are currently published in public policies which only bind the tax authorities and not the taxpayers themselves. The disadvantage is that taxpayers might see the published requirements as maximum requirements, which might diminish their motivation to optimise the tax control process.

The decision of the NTCA, however, to trust a taxpayer and to conclude a covenant could be further substantiated by providing more clarity about the requirements for tax control (De Widt, 2017, p. 21; Burgers & Van der Meer, 2018, p. 389). The NTCA rightly differentiates with regard to the trustworthiness of taxpayers, but taxpayers, of course, want to know what they can expect and which conditions they have to fulfil in order to qualify for a covenant. Additional guidance on the design of the so-called tax control framework, will enable companies to better assess for themselves whether they qualify for Horizontal Monitoring on the basis of an individual covenant or not (enabling self-selection). Given, in addition, that a relatively large number of covenants have already been concluded by the NTCA, resulting in a high demand for the NTCA’s resources, it is expected that access to the Dutch Horizontal Monitoring model will not be unlimited. Hence, it is also important for the NTCA itself to have a clear view on the level of tax control required for an individual cooperative tax relationship in order to draw a line between taxpayers who may opt for individual covenants and those who may enter into indirect covenants mediated through financial or tax law specialists.
In addition, international guidance, such as that provided by the OECD or the EU based on their experiences in other countries, will help tax administrations to further improve the concept of cooperative compliance. Compliance programmes have the common aim of increasing trust in the tax authorities and providing high-quality services in order to promote voluntary compliance (Enachescu & Kirchler, 2018). However, public perceptions of compliance strategies of tax administrations should not be underestimated. The Horizontal Monitoring model and its goals should therefore be properly explained and understood by citizens; the focus on reciprocal cooperation and mutual trust, understanding and transparency could otherwise be misperceived. Misinformed citizens might associate Horizontal Monitoring with corruption and sweetheart deals between taxpayers and the NTCA. This would eventually erode trust in the tax authorities.

In conclusion, a voluntary cooperative tax relationship on the basis of trust, mutual understanding and transparency not only offers benefits for the tax authorities, enhancing the payment of the right amount of tax at the right time, but also offers benefits for particularly large companies, leading to them having greater certainty about their tax positions and maintaining better relationships with the tax authorities. Nevertheless, in the light of changing views on tax planning, mandatory disclosure, international information exchange, tax compliance and impartial enforcement, permanent reflection is required for the further improvement of both the Dutch Horizontal Monitoring model and the general concept of cooperative tax compliance.

REFERENCES


APPENDIX: INDIVIDUAL COMPLIANCE AGREEMENT (COVENANT)

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 National Taxes¹ and collection.

¹ Where appropriate this may 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 (tax) 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 facts and circumstances, its views 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 without ambiguity.

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 periods;
• 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, 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) (Name)
(Position) (Position)
(Date) (Date)