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GUIDE

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Horizontal monitoring

WITHIN

the medium to very large
businesses segment

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This Guide is made available via the Netherlands Tax and Customs Administration's website and is intended to support the Administration's staff in their work. A draft version of the Guide was submitted to the Confederation of Netherlands Industry and Employers (VNO-NCW), the Federation of Small and Medium-sized Enterprises (MKB Nederland) and the participants in the *Beconoverleg* consultative body. Parts of the Guide were amended or clarified on the basis of their comments.

The primary contacts between the organisations in the MSB and VLB segments and the Netherlands Tax and Customs Administration are maintained via the account management teams at the various regional offices, where the initial contact person is the client coordinator. Should the organisation consider an escalation of an issue to be desirable then in the first instance this effected via the management line in the relevant region. If necessary, the management line notifies the implementation coordinators of the various segments. These coordinators are also the initial contact persons for general supervision issues relating to the segments (including issues relating to this Guide). The implementation coordinators are Peter Waas (VLB) and Dyon van Beek (MSB), who can be contacted via the secretariat, telephone number +31 (0)10-2905845.

Foreword

Please find enclosed the first Horizontal Monitoring Guide for the MSB and VLB segments, hereinafter referred to as 'individual account management'. The objective of this Guide is to ensure that our work is carried out in a uniform manner.

This Guide combines the experiences and best practices from the two segments. The Netherlands Tax and Customs Administration¹ has decided to develop the concept in practice, including making records of lessons learned.

The Guide specifies the framework for our activities in the segments and promotes a recognisable approach to our activities outside the Netherlands Tax and Customs Administration. For this reason this Guide is also published outside the Netherlands Tax and Customs Administration: our surroundings may and will call us to account for our working methods. We attach great importance to the recognisability of our activities, since we are of the opinion that this is essential for the successful further rollout of the concept. Self-evidently, some issues have yet to crystallise and additions will be made over the course of time. However, in principle we shall work in accordance with the Guide unless a special situation gives cause to customisation. When customisation is required then this shall be discussed with the organisation involved and a record of the variance, with motivation, will be made in our file. Consequently, although customisation remains feasible this will always be based on the concept specified in this Guide. The Guide has been formulated on the basis of a clear perception, namely justified trust as the principle for the design of our supervision activities.

During the past years the terms 'understanding' 'transparency' and 'trust' have played an increasingly pivotal role in our supervision activities, as a result of which horizontal monitoring is not an autonomous instrument. In fact, we refer to the *horizontalisation* of supervision. This Guide is intended for everyone involved in the horizontalisation of supervision within the individual account management segments, namely: client coordinators, type of tax specialists, management, collection specialists, audit specialists and accs², etc.

We hope that this Guide will be of assistance in your day-to-day work. We are also pleased to invite you to continue to discuss issues with each other and share experiences: this will contribute to the further development of the Guide. During the coming period both regional and national initiatives will be taken to provide you the necessary support. The Guide will be updated at periodic intervals.

We wish you success in your work.

Dyon van Beek (MSB core group) and Peter Waas (Chair of the VLB knowledge group)

¹ This Guide uses the term 'Netherlands Tax and Customs Administration' to refer both to the entire organisation and divisions within the organisation: the precise meaning will be evident from the context.

² 'Accs' are administrative/assistant client coordinators.

Introduction and contents of this Guide

This Guide has been prepared on the basis of the concept of horizontal monitoring and is primarily intended to specify the framework to be used in everyday practice: the Guide is *not* a code that prescribes precisely who must do what and when, how it must be done and the precise requirements to be met by the actions. However, the Guide *does* contain a description of the process and the objective to be achieved by horizontal monitoring. The description of the process is based on the position of individual account management within the Netherlands Tax and Customs Administration's enforcement tools.

We decided to divide the Guide into phases on the basis of the client profile specified in ATK+ (the individual account management application). These phases encompass a variety of practical steps that are each reviewed in a separate section. In practice, the work will often gradually shift from one phase to the next and some phases will be carried out simultaneously. However, throughout the process it is essential to continually be aware of the objective of each of the various steps.

A separate section is devoted to issues of relevance to the entire horizontal monitoring programme.

We recommend that readers begin by working through the entire Guide, since this will clarify the relationship between the various steps in the horizontal monitoring programme. The Guide's classification into sections will subsequently offer a useful reference book during horizontal monitoring activities, since each section contains information about the objective of and points for attention in the relevant step.

This Guide makes alternating use of the terms taxpayer, organisation, enterprise and business: these terms always refer to the party involved in the process. When 'organisation' is used the context will make clear whether the word refers to the 'organisation' or the officers representing the 'organisation'.

General

A brief summary of the general framework
and the steps involved in horizontal monitoring

1. Background to horizontal monitoring

Introduction

This Section contains a brief summary of the development and essence of horizontal monitoring. More background information is available in the professional literature (in the accountancy and tax fields), which regularly contain articles about horizontal monitoring.

History

The Scientific Council for Government Policy (WRR) published its *De toekomst van de Nationale Rechtsstaat* ('The future of law-based society') report in 2002,³ in which the Council provided recommendations on a more equal relationship between government and citizens in response to changes in international and social relationships.

The government adopted the WRR's recommendations in its *Programma Andere Overheid* ('Modernising Government Programme', PAO). The Netherlands Tax and Customs Administration began a pilot project at the beginning of 2005 which examined whether the supervision of organisations in the VLB segment can be designed on the basis of the principles laid down in the PAO. In 2006, this pilot project was expanded to include the SME segment. The Netherlands Tax and Customs Administration also gave an impetus to the enhancement of control with its *Toezicht dat ertoe doet* ('Supervision that matters') programme. At the end of 2007, a pilot project was also started for the MSB ('Medium-Sized Business') segment.

Horizontal monitoring has become the spearhead of the individual account management enforcement policy.

The essence, key values and principles of horizontal monitoring

Essence

The State Secretary expressed the essence in the following terms in his letter of 8 April 2005 to the House of Representatives of the States-General (DGB 2005/1109) (translated from the original Dutch):

"Horizontal monitoring refers to mutual trust between the taxpayer and the Netherlands Tax and Customs Administration, the more precise specification of each other's responsibilities and options available to enforce the law and the setting out and fulfilment of mutual agreements. In so doing, the mutual relationships and communications between citizens and the government shift towards a more equal position. Horizontal monitoring is also compatible with social developments in which the citizen's personal responsibility is accompanied by the feeling that the enforcement of the law is of great value. In addition, the horizontal monitoring concept also implies that enforcement is feasible in today's complex and rapidly changing society solely when use is made of society's knowledge."

Key values

Horizontal monitoring is based on three key values: mutual trust, understanding and transparency. *Transparency* refers to complete openness by the taxpayer and the Netherlands Tax and Customs Administration. The taxpayer is transparent about the taxpayer's tax strategy and the relevant tax issues.⁴ The taxpayer gives open answers to all questions. The Netherlands Tax and Customs Administration is open about the background to questions and the implementation of the Administration's supervision. Constructive cooperation is possible only when both parties *understand* the position and (on occasion, conflicting) interests of the other party. Mutual *trust* is necessary for the adoption of this method.

Trust within the context of horizontal monitoring refers to the relationship between the Netherlands Tax and Customs Administration and the taxpayer. Two elements of trust then play an important role:

- What expectations do the parties have of each other?
- Which risks are the parties prepared to accept?

³ The report is published on the WRR's website, <http://www.wrr.nl/content.jsp?objectid=2464>

⁴ Filed returns adopt no (material) standpoints that have not been discussed with the Netherlands Tax and Customs Administration.

These elements are included in the following definition of trust (translated from the original Dutch):⁵ *Trust is the expectation that people and things will not fail us, even though they can. Trust is the willingness to accept the risk (or devote no attention to the risk).*

Trust in the relationship is necessary since the parties' knowledge and/or information is unequal. If this inequality was not an issue then there would be no need for trust, since there would be certainty. Consequently, trust is always accompanied by a form of uncertainty. The information we do have – our client profile – together with the organisation's behaviour (supplemented by our intuition) supports our decision to work with an organisation on the basis of trust and justifies the acceptance of a degree of risk by doing so. There is also a relationship between the benefits obtained by trust, the resultant risks the parties incur and the degree to which the parties trust each other (Do I trust the organisation completely, in part, or only in certain circumstances?). Consequently, trust is in fact a form of rational action in which we justify 'knowing less' about the facts and figures by 'knowing more' about the organisation.

It is important to realise that we observe behaviour and collect information during the horizontal monitoring programme that justifies the favourable expectations we and the organisation have of each other, and demonstrates that the trust given to the other party is justified. This enables the organisation and the Netherlands Tax and Customs Administration to establish that their trust⁶ in the other party is justified, and that both parties are willing and able to assume their responsibility for compliance with the regulations.

In practice, organisations will occasionally make mistakes and, consequently, fail to report a tax issue or file a return that is not acceptable. The Netherlands Tax and Customs Administration can also make mistakes. However, a mistake does not automatically imply the total loss of trust. When we observe that an organisation has made a mistake then we need to exhibit an adequate response (with understanding). We begin by holding a meeting to discuss the causes of the mistake and the measures that have been implemented to prevent a recurrence. We then, depending on the outcome of the discussions, review the consequences for the client profile and the relationship of trust.

Principles

Pursuant to the aforementioned key values, the Netherlands Tax and Customs Administration wishes to cooperate in the present with taxpayers (and the parties involved) in maintaining and improving compliance. This cooperation is given shape in the MSB and VLB segments by the conclusion of agreements (individual compliance agreements) with individual taxpayers. The cooperation in the SME segment is based on collaboration with accounting firms and tax consultancies.⁷

The Netherlands Tax and Customs Administration's monitoring is based on the standard⁸ of acceptable returns. Horizontal monitoring places a greater emphasis on the responsibilities borne by both parties in the preparation of acceptable returns.

The organisation will then need to exhibit an appropriate attitude, behaviour *and* implement adequate internal controls. The wish to comply with the tax obligations shall primarily be demonstrated by the tone at the top. The organisation bears the responsibility for its internal control⁹ (including its control of tax matters). We expect organisations to strive to achieve continuous improvement of their internal control. The Netherlands Tax and Customs Administration can, within scope offered by the Administration's responsibility, encourage and support organisations: preliminary consultations play an important role, since the organisation can obtain advance clarity and certainty about their tax position. The Netherlands Tax and Customs Administration is responsible for adjusting its supervision strategy to the organisation's specific situation.

⁵ Nootboom, excerpt from: *Vertrouwen geven en in control zijn; gaat dat samen?* ('Giving trust and remaining in control: is this compatible?') brochure for the congress of the same name, 25 June 2009, Ministry of Finance.

⁶ The literature uses a number of terms to refer to trust within the context of horizontal monitoring, such as sophisticated trust, organised trust and well-founded trust, which all have the same meaning.

⁷ See also Section 16, Concurrence Covenants.

⁸ Within the context of monitoring an acceptable return is defined as a return that complies with the legislation and regulations and is free of material errors. The meaning of 'material error' is explained later in the Guide (including Section 19 and Section 2).

⁹ Inclusive of risk analysis.

2. Position of horizontal monitoring in the Netherlands Tax and Customs Administration's enforcement tools

Introduction

The Netherlands Tax and Customs Administration's objective is to promote the appropriate observance of tax, customs and income-related regulations: the maintenance and improvement of *compliance*. Compliance refers to the (in principle, assumed) willingness of taxpayers and persons entitled to benefits to fulfil their statutory obligations. Individuals and organisations fulfil their obligations when:¹⁰

1. they (justifiably) register to pay tax;
2. they file their returns (in time);
3. they file correct and complete returns;
4. they pay the tax stated in the return (in time).

The method the Netherlands Tax and Customs Administration uses to enforce compliance with legislation and regulations is based on the objective of maintaining and improving compliance by individuals and organisations and limit non-compliance. The Netherlands Tax and Customs Administration's enforcement activities are based on *trust*. When taxpayers betray the trust placed in them then the Netherlands Tax and Customs Administration responds by increasing the stringency of its supervision and taking decisive action.

The Netherlands Tax and Customs Administration has opted for a responsive enforcement strategy, whereby the Administration can choose from a variety of instruments such as preliminary consultations, current national or regional supervision actions, the provision of services, communication on enforcement and a range of forms of supervision (jointly referred to as the 'enforcement tools'). Preference is given to horizontal monitoring for the individual account management segment.

Responsive regulation

The Netherlands Tax and Customs Administration adjusts its enforcement in all segments to the motives (willingness) and ability of taxpayers to comply with the regulations. This is referred to as 'responsive regulation'. The approach to enforcement depends on the motives. Pursuant to the responsive regulation principle, the Netherlands Tax and Customs Administration forms an insight into the causes of non-compliance with the tax legislation and regulations. Taxpayers who usually fulfil their tax obligations and make an unintentional mistake deserve a response different from that to taxpayers who knowingly and wilfully seek the loopholes in the tax regulations or make misuse of the manner in which the Netherlands Tax and Customs Administration is organised. Responsive regulation entails Netherlands Tax and Customs Administration enforcement actions (supervision) that are not focused solely on the rectification of past errors but also – and above all – address the prevention of future errors. From the perspective of the taxpayers' future compliance, consultations with them on the prevention of errors in the future can be more effective than punishment.¹¹

The client's profile forms the basis for responsive regulation and the selection of the supervision approach in the individual account management segment, and for this reason we compile an up-to-date client profile for each group entity that serves as the basis for the strategic supervision plan. Our supervision duties relate to establishing the acceptability of the return in its entirety, whereby we focus on approval. We make the maximum possible use of the work that has already been carried out by the organisation and the relevant external specialists¹². Consequently, our ability to adjust the monitoring process increases with the visibility of the quality added to the development of the return. In addition, our processing of individual points for attention (for example, during the preliminary consultations or in the assessment procedure) also contributes to the perception of the acceptability of the return in its entirety.¹³

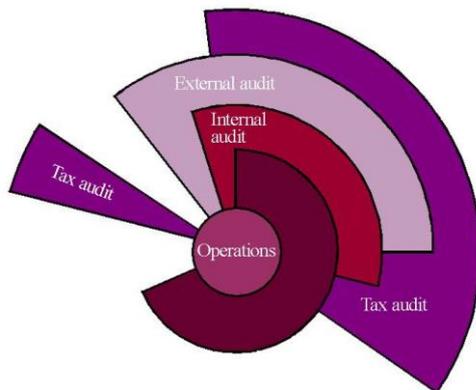
¹⁰ OECD, Monitoring Taxpayers' Compliance (2008) and EU, Risk Management Guide (2006)

¹¹ More information on adjustment and penalty issues is enclosed in Section 19 of this Guide.

¹² 'External specialists' are understood as all parties involved in the provision of services (ranging from recommendations for and the analysis and improvement of the TCF) and the monitoring of the organisation. Consequently, the term also encompasses tax consultants and the independent auditor.

¹³ This approach is fully compatible with the Netherlands Tax and Customs Administration Audit Approach (the CAB) and the onion model adopted in the approach.

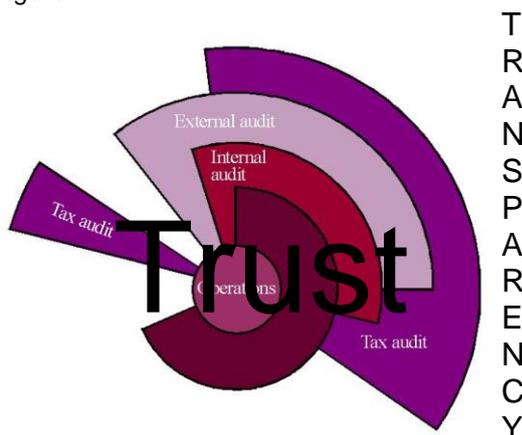
This approach is visualised in the following onion skin model.



The onion skin model

Horizontal monitoring

Our horizontal monitoring is based on the assumption that the organisation wants to file an acceptable return and, consequently, will optimise its onion skin model. This is manifested by the attention to and improvement of the internal control system, in particular the elements of the internal control system relating to tax processes, what is also referred to as the 'Tax Control Framework' (TCF). The supervisory duties of the internal control departments and/or external specialists are also of importance, since these duties contribute to the quality of the returns. In horizontal monitoring the relevant organisation has expressed its intention to be transparent about observed relevant material (tax) issues, pursuant to which the organisation agrees to actively seek preliminary consultations with the Netherlands Tax and Customs Administration on these relevant material tax issues. In effect, these client contacts result in the continual development and enhancement of trust between the organisation, the relevant external specialists and the Netherlands Tax and Customs Administration. The prior information received by the Netherlands Tax and Customs Administration enables us to adjust the form and intensity of our supervision, since we continually receive up-to-date information about the quality of the 'onion' and can observe whether the organisation actively shares relevant material tax issues with us.¹⁴ The organisation's approach to the preliminary consultations – together with the results from the consultations – jointly determines whether the entire return is acceptable. The relationship between the onion skin model and horizontal monitoring is shown in the following figure:



The onion skin model in horizontal monitoring

¹⁴ See Section 13 for an explanation of adjusted monitoring.

3. Horizontal monitoring process in a nutshell

Introduction

This section contains a brief summary of the steps within the horizontal monitoring process. The explanation of the steps is based on the situation in which the account management team has yet to acquire a complete client profile of the organisation.

Specific steps can be completed more quickly when the client profile includes more details. Our communications with the client then state why we do not carry out specific work that is included in the Guide.

Phases in the ATK+ client profile

The Sections of this Guide are based on the phases of the client profile in the ATK+ application.¹⁵

These phases are as follows:

- phase 1: client profile;
- phase 2: horizontal monitoring is/is not feasible;
- phase 3: insight into the design and existence of the administrative organisation/internal control;
- phase 4: insight into the existence and operation of the administrative organisation/internal control;
- phase 5: adjustment of form and intensity of supervision;
- phase 6: covenant with a tax service provider (reviewed separately in Section 16).

Each of these phases encompasses a variety of practical steps. Once the steps have been completed the findings are recorded in ATK+. Each of the following sections reviews one of the steps. For the purposes of the Guide, phases 3 and 4 have been combined under the 'Administrative organisation and internal control' heading since, in practice, these phases are closely related to each other.

Steps in the horizontal monitoring process

A distinction is made between the following steps within the client profile phases 1 to 5 inclusive:¹⁶

- step 0: up-to-date client profile;
- step 1: horizontal monitoring meeting;
- step 2: compliance scan;
- step 3: resolution of pending tax issues;
- step 4: compliance agreement;
- step 5: analysis and improvement of the tax control framework (TCF);
- step 6: adjustment of supervision.

Two important issues require attention:

- the client's attitude and behaviour, and the underlying motives (the focus is placed on these issues throughout the process);
- the client's tax control (the focus is placed on this issue from steps 5 and 6).

Step 0: up-to-date client profile (Section 4)

Either the account management team or the organisation (or an external specialist involved with the organisation) can take the initiative to explore horizontal monitoring. This initiative can be taken at any time. The account management team takes into account the current client profile and the composition of the group entity in its up-to-date client profile.

Step 1: horizontal monitoring meeting (Section 6)

The objective of the horizontal monitoring meeting is to enable both parties to explore the feasibility of implementing horizontal monitoring for the organisation. This mutual exploration encompasses the key values and principles, the responsibilities and expectations, an outline of the steps in the horizontal monitoring process, the tone at the top and the experiences with the current contacts.

¹⁵ ATK+ is used as the permanent file for each of our clients in the MSB and VLB segments. ATK+ is the abbreviation (in Dutch) for 'individual account management application'.

¹⁶ These steps are worked through in chronological sequence. However, it is possible that elements of step 1 or step 2 are repeated after a change in the situation.

Step 2: compliance scan (Section 7)

The objective of the compliance scan is to carry out an assessment together with the organisation of the feasibility of horizontal monitoring. For this reason we wish to gain an insight into the tax attitude and behaviour of the organisation (and the parties involved), i.e. *willingness*. We also hold discussions with the organisation to review how the organisation takes its responsibility for the submission of acceptable returns. We and the organisation jointly determine whether the preconditions are met for the adequate control of tax matters, i.e. *ability*.

Step 3: resolution of pending tax issues (Section 8)

In resolving pending tax issues we clear the way for working in the present. In principle, as many of the pending issues as possible are settled prior to the conclusion of the compliance agreement: when this is not possible, the Netherlands Tax and Customs Administration and the organisation jointly reach appropriate procedural agreements. Within this context 'pending issues' are understood as tax issues or collection issues that are already known to the organisation and/or the Netherlands Tax and Customs Administration

Step 4: compliance agreement (Section 9)

The organisation and the Netherlands Tax and Customs Administration jointly evaluate the experiences acquired during the previous steps. When these experiences are favourable we reach agreement on the implementation of horizontal monitoring. In principle, this agreement is laid down in a compliance agreement. Both parties can call each other to account for compliance with the compliance agreement. This Section reviews points for attention relating to the content and scope of the compliance agreement.

Step 5: analysis and improvement of the tax control framework (TCF) (Section 11)

Step 5 focuses on improving of tax control. The organisation bears the primary responsibility for this improvement: the Netherlands Tax and Customs Administration actively encourages and supports the organisation in this process. Since the design of the tax control framework (TCF) depends on the organisation's size and complexity, the tax control framework is tailored to the specific organisation. The elements common to all tax control frameworks are reviewed in this Section.

Step 6: adjustment of our form and intensity of monitoring (Section 13 and Section 14)

We adjust the form and intensity of our supervision based on available information about the organisation. This prior information relates, for example, to the degree to which the organisation is in control of its tax processes and the work that is carried out by external specialists. Our supervision is tailored to the specific organisation and, consequently, involves customisation. Section 13 explains the effect of horizontal monitoring on a number of elements of the client processing procedure. Section 14 explains adjusting the form of our supervision through a tax audit.

Responsibilities

Monitoring of tax pivots on the responsibilities borne by both the organisation and the Netherlands Tax and Customs Administration. The organisation bears the responsibility for compliance with tax legislation and regulations by adopting a compliant attitude and behaviour and implementing an adequate design of its internal control framework. The Netherlands Tax and Customs Administration bears the responsibility for adjusting the Administration's supervision accordingly (responsive regulation). The Netherlands Tax and Customs Administration retains its supervisory role even when the organisation has brought its internal control and monitoring into order. We then adopt a transparent approach in explaining how the design of our supervision takes account of the prior information we have received about the organisation, for example by sharing our strategic supervision plan with the client.

Both parties need to be aware of which party bears the responsibility for which step in horizontal monitoring throughout the entire process. The table on the following page lists the allocation of responsibilities between the parties in each step of the process.

| Step | Responsibility |
|---|--|
| Step 0: up-to-date client profile | account management team |
| Step 1: horizontal monitoring meeting | management of organisation and management of the Netherlands Tax and Customs |
| Step 2: compliance scan | account management team and organisation |
| Step 3: resolution of pending issues | account management team and organisation |
| Step 4: compliance agreement | management of organisation and management of the Netherlands Tax and Customs |
| Step 5: analysis & improvement of tax control | organisation account management team |
| Step 6: adjusted supervision | |

In horizontal monitoring it is appropriate for one party to take a step back while the other party assumes its responsibility, since there is a risk that the organisation or the Netherlands Tax and Customs Administration allows its assumption of its own responsibility to depend on the initiatives taken by the other party. If, for example, the account management team plays an overly-active role in the analysis and improvement of the organisation's tax control then it is possible that the organisation begins to wait for the account management team's notification of relevant material tax issues and allows its own responsibility to be determined accordingly.¹⁷ However, the Netherlands Tax and Customs Administration is not responsible for the internal control of the organisation and does not issue any guidelines for its design other than the general requirements stipulated in Article 52 of the State Taxes Act.

For the Netherlands Tax and Customs Administration, working on the basis of its own responsibility also means that the manner in which we perform our duties is based on the relevant legislation and regulations.¹⁸ We attach importance to working on the basis of trust in and understanding for the position of taxpayers, but at the same time we need to make sure that we do not lose our ability to arrive at an independent opinion. This is also referred to as the risk of 'attachment'.¹⁹

Diagram of horizontal monitoring

The horizontal monitoring process and the relationship between the steps in the process and the phases in ATK+ are shown in the diagram on the following page.

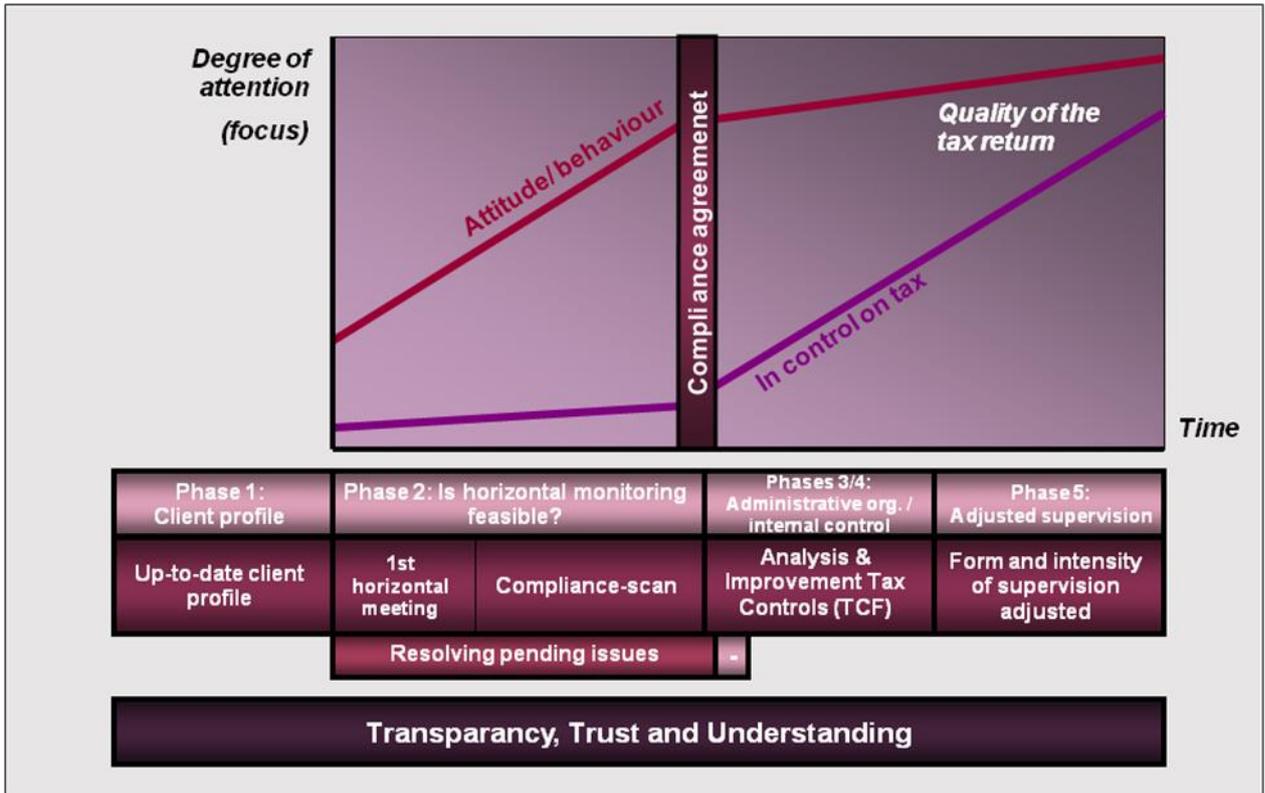
Explanation

During our contacts with the organisation and the further steps in the process our focus shifts from 'attitude and behaviour' to 'tax control'. During the initial period our primary attention is focused on the tax tone at the top as the basis for the new approach, followed by attention to tax control at a later stage. We then also obtain the information required for the effective adjustment of the supervision process. On the completion of each step the findings are recorded in the relevant phase of the client profile in ATK+.

¹⁷ This phenomenon is also known as 'moral hazard' and is used within disciplines and groups including economy, statistics and the insurance sector. A current example is the deposit guarantee system: since the government supervises banks and guarantee savings to a specific amount, savers are prepared to take more risks and transfer their funds to an account at a less well-known bank.

¹⁸ As a result, for example, we do not request documentation in excess of the documentation we are entitled to receive on the basis of our authority. Consequently, we do not request an inspection of tax recommendation files and limit requests for documentation to documents that, for example, support the compliance scan.

¹⁹ The risk of 'attachment' is also referred to as collusion or (regulatory) capture. The front-line staff of supervisory bodies are at the greatest risk of becoming attached: they often work away from their own organisation, at the organisation that is being monitored. Excellent examples are neighbourhood police officers and undercover agents. The front-line management by the police organisation, including intensive debriefings, is intended to ensure that the officers and agents do not become attached to their surroundings. The introduction of horizontal monitoring has increased the risk of staff of the Netherlands Tax and Customs Administration becoming attached, since we wish carry out our work by building up a relationship based on trust, with understanding for the taxpayers and understanding of the interests and objections of the taxpayers or the sector.



The horizontal monitoring process

Phase 1: client profile

We have developed an up-to-date and appropriate client profile and have recorded the information in ATK+. We have an insight into the organisation's legal and tax structure and the client's activities. We have paid a visit to the client to assess the present which has given us an impression of the client's compliance and tax issues. We are aware of which of the client's officers are of greatest importance to us and which parties are called in by the client for the client's fulfilment of the relevant tax obligations. We are also aware of the identity of any other supervisory bodies involved with the client.

4. Step 0: up-to-date client profile

Introduction

This Section reviews the internal preparations for a horizontal monitoring programme. The account management team analyses the current client profile and explores the relevant aspects of the profile. The client orientation serves as the point of departure for the horizontal monitoring meeting and the later compliance scan.

Initiative for horizontal monitoring

The account management team analyses the current client profile to assess whether the organisation comes into consideration for horizontal monitoring.²⁰ In many instances this will be followed by the client coordinator contacting the organisation. A natural time to raise the issue for the first time is, for example, a meeting with the organisation, a preliminary consultation meeting, the completion of an audit or the settlement of a notice of objection. When the organisation wishes to discuss the concept further then an appointment is made for a separate horizontal meeting (see Section 6).

On occasion, the organisation or the organisation's external specialist contacts the client coordinator with the request for an exploration of horizontal monitoring. It is also possible that an application is submitted for an organisation to participate in a tax service provider covenant. More information about this situation is given in Section 16.

Client profile

Irrespective of the party taking the initiative, the account management team begins with an internal discussion and analysis of the current client profile in which all types of tax are reviewed. We assume that the account management team will usually have a reasonable impression of the organisation. However, this exploration can give cause to supplementation and deepening of the client profile, although a complete client profile is not a stringent condition attached to the initiation of the horizontal monitoring process.

The following questions can be of relevance for the up-to-date client profile:

- What is the client's return and payment behaviour?
- Are any notices of objection being dealt with, and are there any procedures or preliminary consultations in progress?
- What is our impression of the organisation's attitude to tax contacts (audits/preliminary consultations/objections)?
- Who are the tax consultant and independent auditor and what is their role in the tax contacts (audits/preliminary consultations/objections)?
- What is the group structure? Do changes regularly take place?
- Does the organisation employ sufficient financial and tax staff?
- Who are the members of the executive board and the supervisory board? How is management effected?
- What are the organisation's operations and the organisation's known relevant material tax issues?
- What does the annual report contain (key figures, tax strategy)?
- Which type of auditor's opinion has been issued?
- Is there already an insight into the degree of tax control?
- For clients with international transactions within the business: Can the transfer pricing documentation be used to improve insight into the organisation?²¹
- Which other supervisory bodies are involved with the organisation?²²

Many of these questions are also included in the strategic supervision plan specified in ATK+. During the exploration the client it will prove worthwhile to assess the extent to which our profile of the organisation is complete and up to date. If necessary, the account management team can review how the strategic supervision plan can be supplemented.

²⁰ The analysis of the client profile can reveal unfavourable past experiences. These can offer opportunities for the programme.

²¹ Pursuant to Article 8, paragraph b, of the Corporation Tax Act clients must file transfer-pricing documentation for any international transactions. In general, this documentation will provide a good insight into the organisation's assignment of relevant duties to the various offices/operations. It is recommended that this documentation is reviewed in cooperation with a member of the Transfer Pricing Coordination Group (CGVP).

²² Customs may have information about other supervisory and enforcement bodies.

Types of tax

Horizontal monitoring concerns the Netherlands levy of all state taxes, their collection and (where relevant), the VAT compensation fund. The process is designed in maximum possible cooperation with Netherlands Customs, if and when interests coincide.²³

Parties subject to horizontal monitoring

The up-to-date client profile includes an analysis of the structure of the group entity. During the process the Netherlands Tax and Customs Administration and the organisation jointly determine which parties will fall within the scope of horizontal monitoring. We endeavour to include the entire group entity under horizontal monitoring, although this is always a question of customisation. We wish to impact at least the companies that carry out the organisation's core activities and the companies over which the organisation exercises a controlling influence.²⁴

Specific attention needs to be devoted to entities managed by directors/major shareholders. In principle, the tax affairs of a director/major shareholder who belongs to an group entity and bears the personal or joint responsibility for the tone at the top are included in the horizontal monitoring agreements.²⁵ The preparation of the up-to-date client profile and the horizontal monitoring meeting extend to a review of the position of directors/major shareholders.

Does the organisation have to be in control of tax?

Organisations do not need to have complete and visible control (of all their divisions) at the beginning of the process as a condition for considering horizontal monitoring. However, from the very first contact onwards we do request organisations to give attention to their willingness to work on the improvement of their tax control. Organisations need to demonstrate their intention to control the tax matters of all parts of the group entity and their intention to continually improve the design of their business processes and tax elements of those processes. In addition, the organisations need to be in a position to fulfil this responsibility, either with the assistance of their staff or of external specialists.

The improvement of the organisation's tax control is a particular point for attention in the following situations:

- *Newly-acquired participations*
It is conceivable that the organisation does not yet have a full insight into the performance of newly-acquired participations.
- *Directors/major shareholders*
There may be limitations in the control of the tax affairs of directors/major shareholders and their personal holding companies and, consequently, in possibilities for adjusting our supervision. The work carried out by external specialists can add quality. The key values of horizontal monitoring and the agreements arising from those values remain in full force, such as transparency on relevant material tax issues, conducting preliminary consultations and the rapid provision of certainty.

²³ See Section 21 for an explanation of cooperation with Netherlands Customs.

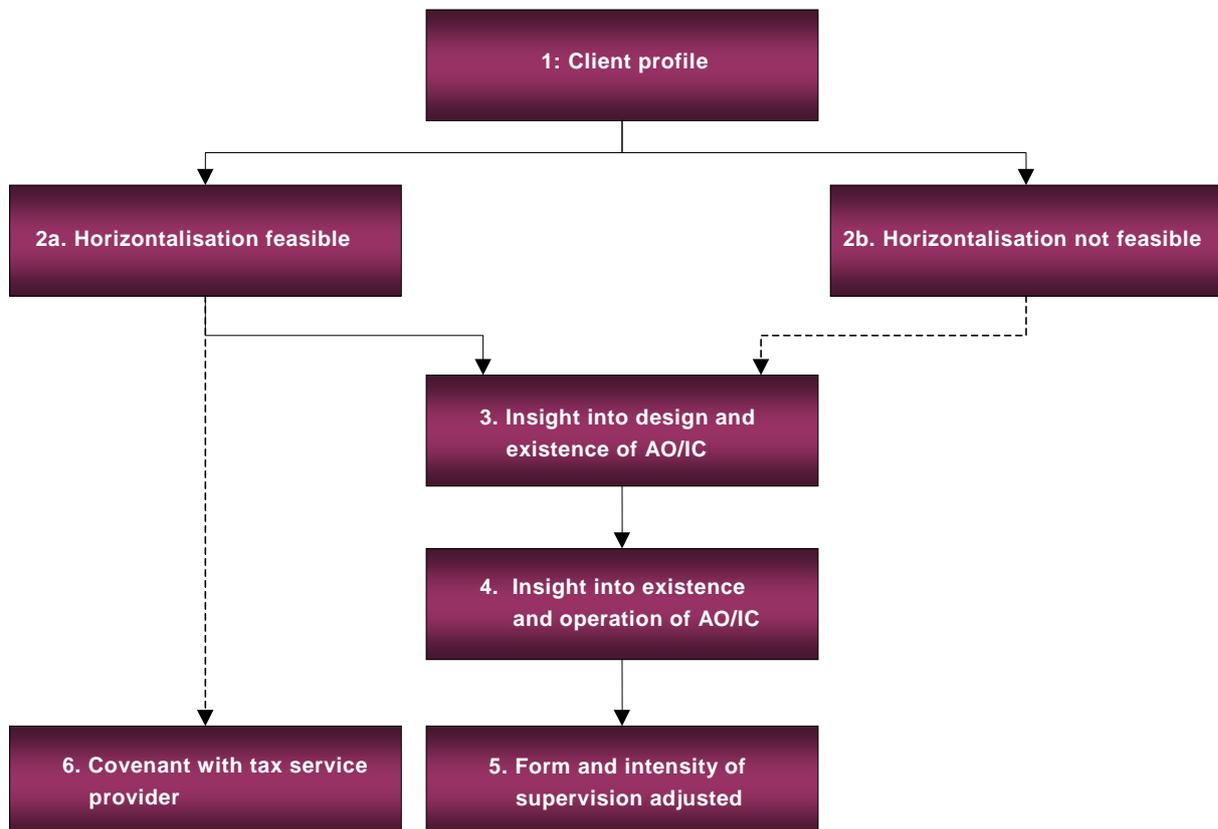
²⁴ See also Section 9, Step 4: compliance agreement.

²⁵ Consequently, this does not include the directors of businesses without a shareholder relationship, since they are not incorporated in the (same entity governed by) individual account management. Although they determine the tone at the top they are not, in contrast to directors/major shareholders, an independent party to the covenant.

5. ATK+ processing

General

A client profile is essential if we are to be able to determine a risk management strategy tailored to the relevant client. Within this context, individual account management within the MSB and VLB segments differs from the mass client processing within the SMB and Private Individuals segments. We need to be able to specify our knowledge of each client in the MSB and VLB segments. We specify this information in the ATK+ Processing Plan, in (sections including) the Client Profile phase tab. The various phases are shown in the following chart:



Our intention is to carry out a joint review with each client in the MSB and VLB segments to assess the feasibility of horizontal monitoring. We adjust the form and intensity of our supervision on the basis of the degree to which the client provides for the design, existence and operation of the administrative organisation/internal control and assumes the responsibility for filing acceptable returns.

Phase 1: client profile

We wish to have an up-to-date profile of all clients in the MSB and VLB segments, irrespective of whether they are governed by horizontal monitoring. As a result, all clients will at least be assigned to Phase 1. This phase entails:

- a. the collection and updating of information on:
 - the core activities;
 - the legal and tax structure;
 - the client's important officers (the directors, supervisory directors and internal tax specialists, where relevant);
 - external specialists;
 - other supervisory bodies involved with the client.
- b. paying a visit to the client to assess the current situation and discuss the aforementioned information so that we gain an insight into the client's compliance and the tax issues.

Relationship between Phase 1: client profile and Step 0: up-to-date client profile

Phase 1 serves as the point of departure for our decisions on monitoring the client, irrespective of whether we will proceed to horizontal monitoring. Any internal analysis of a client to assess whether the client comes in consideration for horizontal monitoring carried out in Step 0 is based on the client profile drawn up in Phase 1. It may prove necessary to expand the client profile during the up-to-date client profile phase.

ATK+ Compliance agreement phase

In addition to specifying the client profile in the profile of the client phase, a record is also made in ATK+ stating whether discussions have been held with the client to review the conclusion of a compliance agreement and, if so, when the compliance agreement was concluded.

This is carried out in the 'Compliance agreement phase' section, when the following options are available:

- phase 1: not in discussion
- phase 2: in discussion
- phase 3: compliance agreement has been concluded
- phase 4: compliance agreement is not feasible

When solely the client profile has been drawn up (phase 1: client profile) then discussions on the conclusion of a compliance agreement have yet to take place. In this instance Compliance agreement phase box 1, 'not in discussion' is checked.

Output from Phase 1

The output from Phase 1 can include the following:

- an updated client profile and strategic risk management plan in ATK+;
- a report of the discussion with the organisation/visit to assess the current situation.

Phase 2: is horizontal monitoring feasible?

We and the client's management have reviewed horizontal monitoring (in a horizontal monitoring meeting) and discussed the roles and responsibilities to be fulfilled by us and the client. During our meeting with the client we have discussed the client's willingness to cooperate with us on the basis of the horizontal monitoring principles ('willingness') and the feasibility of the client working on the (further) improvement of internal control of the tax processes ('ability'). We jointly - on the basis of the client profile, the horizontal monitoring meeting and our compliance scan - reach a conclusion on the suitability of horizontal monitoring for the relevant client.

6. Step 1: horizontal monitoring meeting

Introduction

This step is focused on the (first) horizontal monitoring meeting. These meetings should be held with the organisation's most senior management²⁶ (we do not always meet with the senior management in 'traditional' client processing). Managers from the Netherlands Tax and Customs Administration attend the horizontal monitoring meeting. The agenda of the horizontal monitoring meeting should preferably be restricted to horizontal monitoring, since a meeting that extends to a discussion on a wide range of pending issues can also result in confusion and distract attention from the introduction of horizontal monitoring.

Objective

The objective of the horizontal monitoring meeting is to enable both parties to explore the feasibility of implementing horizontal monitoring for the organisation. Elements of this mutual exploration are:

1. an explanation of the key values and principles;
2. the responsibilities and expectations of each party;
3. an outline of the steps in the horizontal monitoring process;
4. the tone at the top at both the organisation and the Netherlands Tax and Customs Administration;
5. the favourable and unfavourable experiences with the current contacts.

Items 1, 2 and 4 are explained below. During the meeting the issues will be illustrated by means of the two parties' experiences.

Key values and principles of horizontal monitoring

The general key values and principles of horizontal monitoring are explained in Section 1 of this Guide.

Note

In practice, many organisations have heard about horizontal monitoring but do not always have an idea of the concept that is in line with our intention. For this reason organisations must be asked what they already know about horizontal monitoring and their impression of the concept.

Responsibilities and expectations²⁷

The first meeting must devote explicit attention to the parties' responsibilities and the expectations the parties may have of each other, since this will enable the organisation to give careful consideration to its decision whether it wishes to explore the feasibility of horizontal monitoring. As outlined in Section 1, the organisation bears the responsibility for the filing of an acceptable return. The organisation will only be able to file an acceptable return when it gives consideration to the design and operation of its tax control framework (TCF). The Netherlands Tax and Customs Administration bears the responsibility for the design of the supervision and for the rapid adoption of a standpoint on tax issues submitted to the Administration for consideration. These responsibilities are also reflected in the text of the compliance agreement. The Netherlands Tax and Customs Administration does not adopt the responsibility for filing an acceptable return and does not act as a consultant. Both the organisation and the Netherlands Tax and Customs Administration bear the responsibility for promoting working in the present.

A number of subjects relating to responsibilities and expectations are listed below. We tackle these subjects actively during the compliance scan. For this reason we do not yet need to have a clear impression of the following at the time of the horizontal monitoring meeting:

- the organisation's attention to tax matters;
- the general and tax strategic objectives;
- the internal control, internal auditing and external auditing systems, in particular in relation to tax matters;
- the expectations with respect to the analysis and improvement of the tax control framework;
- the initial ideas on the organisation of the preliminary consultations and working in the present, together with the additional needs the parties may require to do so;
- the Netherlands Tax and Customs Administration's adjustment of supervision on the basis of the quality of the internal control, internal audits and external audits.

²⁶ These include, for example, the CEO, CFO, director/major shareholder and the officers of non-profit organisations bearing the political responsibility for the organisation's actions.

²⁷ See also Section 3 under the heading 'responsibilities'.

Tone at the top

The discussion of the tone at the top and the organisation's tax strategy needs to take due account of earlier experiences with the client (both favourable and unfavourable). When the management's statement of the tone at the top is not compatible with earlier experiences with the client then it is desirable to open this to discussion.

Some special situations may require specific attention, such as an organisation with one or more directors/major shareholders,²⁸ a non-profit organisation or an organisation belonging to an group entity with a parent company established outside the Netherlands. In the last situation it may prove difficult to gain an insight into the tone at the top and the continuity thereof. Moreover, there may be differences in culture. It is necessary to be aware of these issues and to actively seek opportunities for adopting a positive approach.

Self-evidently, appropriate discussions of this issue can be conducted only when the horizontal meeting is held with officers representing the organisation's tone at the top, and for this reason we prefer to hold meetings with the organisation's most senior management. The presence of an external specialist can offer added value.²⁹ The delegates from the Netherlands Tax and Customs Administration include at least the client coordinator and the manager bearing the responsibility. Earlier experience has revealed that contacts at management level are a critical success factor for both parties. The presence of an external specialist offers a number of benefits: the Netherlands Tax and Customs Administration gains a better impression of the organisation's management board, which is important since the expectations with respect to horizontal management not only impact the individual client coordinator, but also impacts the entire organisation. Their presence constitutes the management's endorsement of a strategic choice by the Netherlands Tax and Customs Administration. In this initial phase it is also important that the organisation gains an insight into *our* tone at the top. Involving the managers in the process also offers the benefit that it is simpler to call on them in the event of any of difficulties during the process.

Points for attention during the horizontal monitoring meeting

- Confirm the appointment for the meeting, preferably in writing.³⁰
- Do not issue a questionnaire prior to the meeting or after the meeting.
- Give consideration to requesting a colleague who will carry out the compliance scan to attend the meeting.
- Jointly seek the benefits offered to the organisation. As an impetus, you can state that the evaluation of the VLB pilot³¹ revealed the following benefits:
 - an improvement of the tax business climate;
 - an effective and efficient method;
 - working in the present;
 - the Netherlands Tax and Customs Administration's more rapid adoption of standpoints;
 - openness between both parties;
 - reduction of tax uncertainty;
 - management involvement in the individual account management.

Consultations on the follow-up

After the meeting both parties review whether they wish to begin the process. Practice has revealed that a second (and, occasionally, third) meeting to discuss the principles may be required. Self-evidently, the organisation is free to exercise its discretion in deciding whether to continue. When the management board states that it does not have a need for horizontal monitoring then ask the board why they have reached this decision and discuss the arguments with the board: you can return to this discussion later on.

²⁸ Situations can arise in which directors/major shareholders indicate that although they endorse the concept they do not wish to take part in the agreements on horizontal monitoring (for the time being). This does not need to be an impediment to reaching agreement on the entity's other divisions (companies). The director/major shareholder, in his or her role as director, remains responsible for the tone at the top but does not need to be a party as a shareholder. However, it is necessary to review whether the director/major shareholder's arguments are compatible with the concept.

²⁹ The organisation determines whether an external specialist attends the meeting.

³⁰ If so required, the confirmation can be accompanied by documentation about horizontal monitoring, such as the publications available at www.belastingdienst.nl.

³¹ This evaluation is included in the State Secretary's letter to the Senate of the States-General of 12 April 2007 (DGB 2007-1685M).

7. Step 2: compliance scan

Introduction

The objective of the compliance scan is to gain an insight into the tax attitude and behaviour of the organisation (and the parties involved), i.e. willingness. We also hold discussions with the organisation to review how it assumes its responsibility for the filing of acceptable returns. We and the organisation jointly determine whether the preconditions are met for the adequate control of tax matters, i.e. ability.

Objective of the compliance scan

The objective of the compliance scan is to carry out a joint assessment with the organisation on the possibility for horizontal monitoring. When this results in the conclusion that horizontal monitoring is feasible then we can subsequently rely on the organisation's statements on, among others the quality of the (internal) control and the relevant tax issues. For this reason the compliance scan has a direct relationship with Step 5: analysis and improvement of the tax control framework' (see Section 11). The compliance scan focuses on the organisation's attitude and behaviour. Step 5 pivots on the organisation's specific implementation of (the improvement of) compliance.

Internal preparations³²

The various disciplines in the account management team cooperate in the compliance scan. The client coordinator directs the work from his or her central position. The account management team uses the current client profile and the findings from the horizontal monitoring meeting to assess the additional work required before a conclusion can be reached on the feasibility of horizontal monitoring.³³

Preparations with the organisation

The compliance scan is preceded by joint preparations with the organisation. A brief kickoff meeting will prove effective in reaching agreement with the organisation on the objective, the method, the required scope and the required depth.

The determination of the depth of the compliance scan takes account of the work already carried out by external specialists in this field and of the knowledge and experience we have already acquired on the organisation.³⁴ This can give reason for limitation of the work carried out in the compliance scan. We are transparent about the work we would have done if we had not received prior information but do not need to carry out now, as well as the favourable prior information we have taken into account in limiting the scope of the work.

We ask the organisation to inform us of the key officers we can contact to obtain an increased insight into the degree of attention devoted to tax matters and control. We make written records of the process agreements reached during the kickoff meeting.

Performance of the compliance scan

The compliance scan is comprised of a number of interviews with key officers (depending on the size of the organisation).³⁵ These interviews devote specific attention to the 'wish to control'. The Netherlands Tax and Customs Administration's observation that the organisation fulfils its obligations pursuant to the legislation and regulations (including Article 52 of the State Taxes Act) on the basis of its wish 'simply to do it properly' is of importance. The interviews will then primarily be comprised of open questions to review the organisation's attention to control. If necessary, the organisation can illustrate its answers with documentation.

During the compliance scan we continually check to ensure that the organisation understands the horizontal monitoring principles: if necessary we return to the issues discussed during the horizontal monitoring meeting and explain them to the client, whereby we clarify the Netherlands Tax and

³² This Section contains practical tips for the work that can accompany the compliance scan. More information about the underlying theoretical models such as COSO and Simons is given in the *Tax Control Framework - Van risicogericht naar 'in control': het werk verandert* ('Tax Control Framework – from a focus on risks to being in control: a different approach') document.

³³ Since our perception needs to be objective it is preferable that a number of officers are involved in both the preparations for and evaluation of the exploration of compliance.

³⁴ Reports from accountants or tax assurance providers may be available.

³⁵ Experience has revealed that the on-site scan of a relatively unknown client in the MSB segment will take about three days and involve between three to five interviews.

Customs Administration's expectations with respect to the filing of acceptable returns. These expectations need to be clear to organisations so that they can assess their 'ability'.

Although this is not the purpose of the compliance scan, on occasion one or both parties can identify points for improvement, for example with respect to the tax control framework (TCF). The manner in which the organisation recognises these points and deals with their improvement also gives an insight into the organisation's attitude and behaviour and, ultimately, degree of compliance.³⁶

Themes for discussions

As stated in Section 1, compliance encompasses four aspects. These four compliance aspects are reflected in the following themes for discussions:

- strategic objectives;
- internal control environment;
- information systems;
- tax function;
- external monitoring and advice.

The following subsections give an explanation of each theme together with a number of points for attention. These points can be addressed during the interviews, but do not need to be discussed exhaustively. The selection of issues in combination with the current profile results in a suitable assessment of the organisation's 'willingness and ability'.

Strategic objectives

The pivotal question is: How is the organisation's attention to compliance with the regulations reflected in the strategic objectives (both in their design and implementation)? Attention can then be given to:

- the organisation's mission and vision and the resultant strategic objectives;
- the operational objectives and performance indicators (performance goals);
- the compliance objectives (the wish to comply with legislation and regulations, including the legislation and regulations relating to tax matters);
- the board's attitude to (tax) risks (risk appetite);
- the organisation's tax policy;
- the organisation's remuneration policy;
- the management's assessment of the achievement of the objectives;
- the attention to (potential) conflicts between the various objectives.

These issues can be discussed with the management board (CEO/CFO), the controller and/or the compliance officer.³⁷

Internal control environment

This pivots on the question: How does the organisation pay attention to tax matters in its control environment? Points for attention can then be:

- the organisational responsibility for internal control, including the tax function³⁸;
- the cooperation between the various parties involved (controllers, tax specialists, accountants and other external specialists);
- the discussion of risk control (at which time and by which layers);
- the membership of the supervisory board;
- the discussion of and compliance with ethical regulations and integrity standards;
- the design of the transparency of (tax) activities and behaviour;
- the provision of assurances for the operation of the internal control;
- the identification and tackling of points for improvement in the (tax) control.³⁹

Possible parties for these discussions include the management board, supervisory board, the

³⁶ Within this context it is possible that parts of returns filed in the past were not acceptable. We then consult with the organisation on a solution for the past. More information is given in Section 8 of this Guide.

³⁷ The strategic objectives can be reflected in a code of conduct, tax guidelines, management reports, reports giving account for the strategic objectives and performance indicators, and audit reports prepared by internal and external parties (internal audit reports, SOX reports and environmental reports, etc).

³⁸ See later in this Section and Annex 3.

³⁹ Such as recommendations in management letters and the findings from past tax audits.

controller, the tax manager and/or the internal auditor.⁴⁰

Information systems

The pivotal question is: to what extent does the organisation give attention to the information systems? A number of points for attention are then:

- the importance of tax matters in the information systems;
- the importance of control of the information systems;⁴¹
- the importance of the general information security requirements.⁴²

These points for attention can be discussed and detailed in an interview with the IT manager or controller. It is recommended that this discussion be held in cooperation with an EDP audit specialist.⁴³

Tax function

The arrangements for the tax function can range from an accountant who also prepares the tax returns to a large tax department within the concern. The size and design of the tax function are usually related to the size of the organisation and the complexity of its tax issues. The arrangements for the tax function can be an indication of the quality of the administrative organisation and internal control of relevance to issues.

This element pivots on the following question: How has the organisation given shape to the tax function? Points for attention can then be:

- the assignment of tax responsibilities;
- the work of the tax department;
- the contracting of external specialists (who, when and why);
- the performance of work related to tax matters by departments other than the tax department;
- the integration of the tax function within the business processes;
- the degree to which tax knowledge is up to date and the assurances for up-to-date knowledge;
- the manner in which the officers responsible for tax matters are kept up to date with developments within the organisation, occasional occurrences or decisions made by the management board;
- the recognition and covering of tax risks;
- the preparation of the various tax returns.

Officers who can be interviewed include the controller, the tax manager, the manager of the human resources department, the salary accountant (payroll tax) and/or the VAT accountant.⁴⁴

External supervision and advice

The key question is: What is the role of external supervisors and specialists in the organisation's tax control and compliance? Points for attention include, for example:

- the roles, duties and assignments of external supervisors and specialists (such as the tax consultant and the auditor);
- the frequency of the work carried out by the external supervisors and specialists;
- the policy for the consultation of external specialists (proactive, or in response to problems);
- the performance of audits and the results from the audits;
- the follow-up given to identified points for improvement;
- the attitude of the external supervisors and specialists towards the horizontal monitoring concept.

We carry out this stage on the basis of our wish to collect as much information about the organisation's 'willingness' and 'ability'. In some instances the information we obtain from the interviews reveals that the organisation is unable to control its tax matters in autonomy and, consequently, calls on external specialists for this purpose. We then need information about the roles and duties of these external specialists.⁴⁵ A discussion with the tax consultant and/or independent

⁴⁰ Information about the internal control environment is specified in documents including the annual report, social annual report, management letters/auditors' reports, code of conduct and minutes of the meetings of the management board and supervisory board. Our (audit) files can also contain information about the degree of tax control and compliance.

⁴¹ This includes, for example, working with master files and the associated risks (in relation to the completeness and correctness of the registered transaction data).

⁴² Such as backups, passwords and authorisations.

⁴³ Attention to IT can be reflected in the form of strategic information security objectives or in management letters or IT audit reports.

⁴⁴ Tax process specifications can provide support for the verbal information.

⁴⁵ Information about the duties of the external specialists is, for example, stated in management letters, auditor's reports and minutes of board of director meetings. It may prove worthwhile to discuss the findings from the study of these documents with the board of directors.

audit can then offer the necessary added value. We do not request permission to inspect the auditor's audit file⁴⁶ during the compliance scan.

Evaluation

We and the organisation carry out a joint assessment to conclude whether horizontal monitoring is feasible. This conclusion is largely determined by the organisation's willingness and ability to control tax matters and, when doing so, adopts a transparent approach to tax issues. During the process we will have observed that the organisation, including its key officers, has explicitly expressed its 'willingness'. The organisation has given specific examples to illustrate its tax attitude. It is also important that all the relevant officers are thoroughly familiar with the expectations for horizontal monitoring and the associated responsibilities. Should any impediments to the willingness and/or ability to control tax matters have been revealed during the compliance scan then the organisation will need to make clear that it can remove these impediments.

Reports

The findings from the compliance scan are recorded in a report. This report serves two purposes: firstly, we can share our findings with the organisation in a structured manner and, secondly, the account management team can be informed and the strategic risk management plan in ATK+ can be updated. The report can be of a limited size and contains, tailored to the organisation's specific situation and the client profile already known to us, information about:

- the objective and scope of the compliance scan;
- the conclusion whether horizontal monitoring is feasible;
- the agreements reached on the basis of the findings;
- the work that was carried out and the findings.

The most important element of the report is the statement of the joint assessment of the feasibility of horizontal monitoring.

⁴⁶ See Section 20: external specialists.

8. Step 3: resolution of pending tax issues

Introduction

This Section explains the resolution of pending tax issues. What do we understand as 'pending issues' and how do we deal with them in practice? In principle, as many of the pending issues as possible are settled prior to the conclusion of the compliance agreement: when this is not possible, the Netherlands Tax and Customs Administration and the organisation jointly reach appropriate procedural agreements. The current issues are, for as far as possible, settled with due regard for all the horizontal monitoring principles.

The settlement of tax issues from the (recent) past can occasionally be complicated by hardened mutual standpoints resulting from disruptions of the process or relationship. Opening these disruptions to discussion can often speed up the progress in the settlement of the issues. A relationship-oriented approach based on the key values trust, transparency and mutual understanding often brings solutions closer.

Objective of the resolution of pending tax issues

In settling pending issues we clear the way for working in the present. Working together on the settlement of past issues and the manner in which we work together also supplements our client profile, in particular with respect to the opportunities for cooperating on the basis of mutual trust.

Overview of pending issues

Within this context 'pending issues' are understood as tax issues or collection issues that are already known to the organisation and/or the Netherlands Tax and Customs Administration, such as current audits, outstanding returns and notices of objection that are still being dealt with, as well as procedural issues such as arrears on the part of either party. The Netherlands Tax and Customs Administration and the organisation jointly draw up a list of the current issues and assign priorities to their settlement. In addition, the parties preferably reach agreement on the work and responsibilities, as well as the associated schedule.⁴⁷

Solutions

Both parties need to adopt an active approach and exhibit mutual understanding for the settlement of the pending issues. Both parties need to have the intention to discuss the existing uncertainties and make an inventory of the issues. This exploration reveals both the issues that can be settled and the tax issues about which the parties continue to differ in opinion. The account management team has a certain degree of discretionary scope in seeking a solution for the tax points in discussion, in particular with respect to the interpretation of the facts and the valuation and resolution of uncertainties. The general framework continues to be specified by the correct application of the legislation, regulations and case law.

It should be noted that the objective of the resolution of pending tax issues is not as such to reach agreement on all the points in discussion: it is possible that we cannot reach agreement on a solution and agree to disagree, as a result of which the parties may jointly decide to submit a point of dispute to the courts.

Adjustments and penalties

The settlement of past issues may result in the need to adjust returns filed in the past, for example in the form of supplementary returns or additional tax assessments. Section 19 reviews our approach to these adjustments and the associated penalty issue.

⁴⁷ The analysis and improvement of the tax control framework can reveal gaps in the tax control that may have consequences for the past. We refer to Section 19 for an explanation of the approach the Netherlands Tax and Customs Administration adopts in situations of this nature.

9. Step 4: compliance agreement

Introduction

The previous steps have been completed and the Netherlands Tax and Customs Administration and the organisation have carried out a joint evaluation of the feasibility of horizontal monitoring. Both parties have a clear insight into the horizontal monitoring process, the division of responsibilities and what will be needed to give further shape to the process. The client has stated that the client wishes to work in accordance with the horizontal monitoring principles ('willingness') and (if necessary) is in a position to work on the (further) improvement of the tax control framework ('ability'). The Netherlands Tax and Customs Administration has, on the basis of the client profile, the horizontal monitoring meeting and the compliance scan, reached the conclusion that horizontal monitoring is appropriate for the client. We can then reach agreements with the client and lay them down in a compliance agreement.

Use of the standard text

A standard text has been developed for individual compliance agreements in the MSB and VLB segments.⁴⁸ There are two variants: one in which both the Netherlands Tax and Customs Administration and the Customs Administration of the Netherlands are parties (the 'blue/green' compliance agreement) and one in which solely the Netherlands Tax and Customs Administration is a party (the 'blue' compliance agreement). The first variant is used when the Netherlands Tax and Customs Administration and the Customs Administration of the Netherlands are jointly involved in the process.⁴⁹ The text of the compliance agreement is drawn up in general terms and is universally applicable. Pursuant to the equality of rights, efficiency and neutrality (the level playing field) requirements variances from the standard texts are not permissible. Variances are permissible solely in very exceptional circumstances and then solely in consultation with the account management team, the management and the national coordinators.⁵⁰

Explanatory notes to the compliance agreement

- The compliance agreement is signed by the manager of the Netherlands Tax and Customs Administration on behalf of the Administration. A member of the Netherlands Tax and Customs Administration's management team also signs compliance agreements concluded with companies listed on the AEX.
- The compliance agreement is signed by a director (CEO, CFO, director/major shareholder) of the organisation.
- The compliance agreement does not contain individual (tax) agreements. When agreements other than those in the compliance agreement need to be reached, for example about the pending issues, then these are laid down in a separate settlement agreement.
- The standard text does not include any explicit submission or response deadlines: this is a carefully-considered decision, and the compliance agreement states solely that the parties shall take account of each other's interests. Specifying deadlines would not be compatible with the spirit of the compliance agreement.
- The compliance agreement does not include explicit requirements for the organisation's internal control since this is the responsibility of the organisation.⁵¹
- The compliance agreement contains a footnote under the Principles heading relating to the Netherlands levy of all state taxes. This footnote states that: *As the occasion arises this is also understood as the application of the VAT compensation fund.* This footnote is relevant when the group entity is a non-profit organisation or government body. The footnote can be omitted when this is not the case.
- When an English-language version of the compliance agreement is drawn up then the Dutch-language version of the compliance agreement is signed. The English-language version of the compliance agreement is enclosed in an annex.

⁴⁸ The prevailing version can be consulted at www.belastingdienst.nl/convenanten.

⁴⁹ See Section 21.

⁵⁰ Text varying from the standard text must, if so requested anonymised, be made public in its entirety (Government Information (Public Access) Act). Proposals for variances from the standard text are reviewed in advance. The criteria for this review include: (1) the variance adds substance, (2) the customisation is necessary, (3) the agreement cannot be reached in another manner, and (4) the variance is not in conflict with the concept.

⁵¹ See also Section 3 under the heading 'responsibilities'.

Customisation

In principle, the horizontal monitoring agreements are laid down in a compliance agreement. However, in some situations clients may decide that they wish to cooperate in accordance with the principles but are unwilling or unable to conclude a compliance agreement.⁵² When this is the case we discuss the reasons with the client and review the feasibility of nevertheless concluding a compliance agreement (where relevant, at a later point in time). When the conclusion of a compliance agreement is not feasible⁵³ then both parties will need to understand that horizontal monitoring without a compliance agreement requires the parties to cooperate in accordance with *all* the horizontal monitoring principles. This is applicable to both attitude and behaviour ('willingness') and the (improvement of the) internal control of the tax processes within the business ('ability').

Forming entities⁵⁴

The parties jointly determine which taxpayers fall under the scope of the compliance agreement. We endeavour to involve the entire economic entity in horizontal monitoring. We impact at least the companies that carry out the organisation's core activities and the companies over which the organisation exercises a controlling influence.

Group entities will frequently be comprised of more taxpayers than those that carry out the core activities, such as directors/major shareholders, holding companies and sister companies. We can discuss also horizontal monitoring for these taxpayers. In principle, directors/major shareholders with a decisive influence are included in the compliance agreement. When a director/major shareholder puts forward arguments for refraining from taking part in a compliance agreement then we give careful consideration to the compatibility of the situation with the concept. When joint ventures are an issue then the account management team holds internal consultations with the account management team competent for the joint venture, for example in the event of a participating interest of which the organisation does not have complete control.

Director/major shareholders

The standard text states that the compliance agreement governs the bodies in which the signatory company has a controlling influence. Natural persons (directors/major shareholders) who are part of the group entity are, in principle, included in the horizontal monitoring agreements. When there is more than one director/majority shareholder then they are all included in the agreement. The 'Parties' heading then lists the individual natural persons. They sign the compliance agreement as directors of the group and as private individuals.

The Parties

This covenant is concluded between:

- [Signatory company 1] with its registered offices at ..., represented in this matter by ...
 - [Signatory company 2] with its registered offices at ..., represented in this matter by ...
 - [Signatory company 3] with its registered offices at ..., represented in this matter by ...
 - [Director/major shareholder 1], domiciled at ...
 - [Director/major shareholder 2], domiciled at ...
- and the Netherlands Tax and Customs Administration, represented in this matter by
- ... (name, position, Netherlands Tax and Customs Administration)

This covenant relates to the natural persons and bodies of which the aforementioned directors/shareholders have control. The parties have agreed, in consultation, the identity of the natural parties and bodies to which this relates. These natural persons and bodies are hereinafter jointly referred to as "*the X group*".

Publicity on the conclusion of a compliance agreement

We regularly observe that organisations wish to publicise the conclusion of a compliance agreement

⁵² Cooperation without a covenant is also referred to (in Dutch) as 'convenantachtig werken' (literally, 'covenant-like cooperation'). However, the use of this term is undesirable since it can cause confusion: in practice, the parties can interpret the term differently. For this reason preference is given to the use of (in Dutch) 'convenantconform werken' (equivalent to, 'in analogy with covenant cooperation') in situations of this nature.

⁵³ In practice, this is occasionally the case when the parent company is established outside the Netherlands.

⁵⁴ In view of the need for confidentiality it will be worthwhile to review the possibility of problems before the text of the compliance agreement is prepared. This can be the case when the enumeration includes persons or bodies that are not generally known to be affiliated.

with the Netherlands Tax and Customs Administration. When this is the case the account management team must contact the Ministry's public relations department. The press officer will then consult with the account management team and organisation to review the manner in which publicity is sought and whether the contents are compatible with the Netherlands Tax and Customs Administration's perception.

Working agreements

In practice, some organisations state that they have a need to make specific working agreements after or at the time of the conclusion of the compliance agreement. This request is often based on the wish to obtain an insight into the actions the organisation and the Netherlands Tax and Customs Administration will take in specific cases.

Working agreements of this nature do not specify terms and standards such as 'acceptable return', 'arguable standpoint' or 'material error', since these are specified at a national level. Nor do working agreements relate to periods of time and similar items.

Working agreements may not be laid down in a (standard) contract attached to the compliance agreement. However, a number of themes can be discussed with the organisation (and external specialist) to review the details of the parties' implementation of some elements of horizontal monitoring. The agreements reached during the meeting can be recorded in the minutes. Themes for discussion include:

- contact persons;
- periodic consultations;
- consultations on the improvement of the tax control framework (see also Section 11);
- procedural agreements;
- the settlement of outstanding years.⁵⁵

Termination of the compliance agreement

There is no exhaustive list of circumstances that give cause to the Netherlands Tax and Customs Administration's termination of the compliance agreement. In principle, compliance agreements are terminated solely for serious reasons. Both parties must in any case endeavour to openly discuss potential breaches of trust (see also Section 18). In some instances an incident can lead to (temporary) additional supervision by the Netherlands Tax and Customs Administration. When one of the parties wishes to terminate the compliance agreement then the account management team must always consult with management and the national coordinators.

Concurrence with other covenants

One taxpayer within the MSB and VLB segment may be governed by a number of covenants. Section 16 contains an explanation of the concurrence between an individual compliance agreement, a tax service provider covenant and a sectoral covenant.

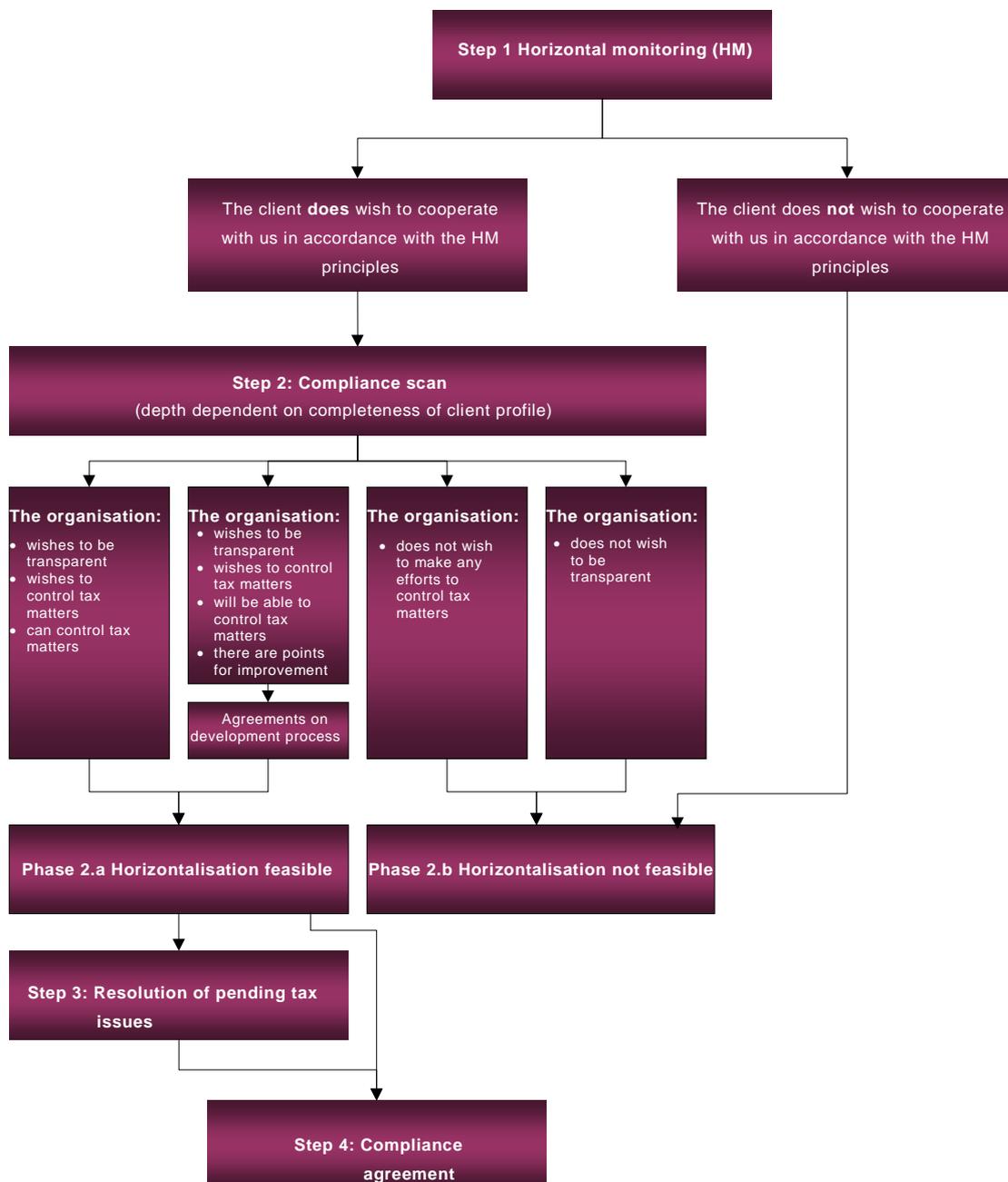
⁵⁵ The agreements on the solution of tax issues are laid down in a separate settlement agreement.

10. ATK+ processing

General

Steps 1 to 4 inclusive of the horizontal monitoring process are part of Phase 2 of the ATK+ client profile. During the horizontal monitoring meeting the Netherlands Tax and Customs Administration and the organisation's management review the options for horizontal monitoring. In some instances the information obtained from the horizontal monitoring meeting gives cause to us to inform the client that horizontal monitoring is not (yet) feasible (Phase 2b, ATK+ client profile).

During the compliance scan the client and the Netherlands Tax and Customs Administration jointly determine whether horizontal monitoring can be implemented and, if so, in which manner. Following the compliance scan we state whether horizontal monitoring is or is not feasible (Phase 2a or Phase 2b, ATK+ client profile). When we conclude that horizontal monitoring is feasible then we and the client focus our efforts on the resolution of pending tax issues (Step 3, see Section 8). Once we have settled these issues or have reached procedural agreements then we conclude a compliance agreement (Step 4, see Section 9). The relationship between steps 1 to 4 inclusive of the horizontal monitoring programme and phases 2a and 2b is shown in the following chart.



ATK+ Compliance Agreement phase

Box 2 of the Compliance Agreement phase (in discussion) is checked once we have discussed the conclusion of a compliance agreement. Box 3 (compliance agreement has been concluded) is checked once the compliance agreement is signed. When horizontal monitoring is feasible and we have made an appointment on this issue with the client but, for substantiated reasons, no compliance agreement is signed then we check Box 4 (not feasible). The account management team states the reason in the explanatory notes, for example because the company is owned by a parent company established outside the Netherlands. When we conclude that horizontal monitoring is not feasible then we do *not* state this in Box 4 of the Compliance agreement phase, since this conclusion has already been recorded in Phase 2b of the client profile.

Output from Phase 2

The output can include the following:

- minutes of the horizontal monitoring meeting (shared with the organisation);
- written report of the kickoff meeting for the compliance scan;
- written report of the compliance scan, with the evaluation, conclusions and agreements;
- when applicable: settlement agreement for pending issues;
- when applicable: assessment procedure for past years;
- compliance agreement;
- an updated client profile and strategic supervision plan in ATK+;
- preliminary consultations.

Phases 3 and 4: administrative organisation and internal control

The client has given us an insight into its design and performance of the internal control of the tax processes of the organisation's business. The client also has an insight into the tax processes which are not yet (adequately) in control at the moment.

The client is responsible for the organisation's internal (tax) control. The client's duty is to design the internal control framework in a manner that is compatible with the nature and size of the organisation. For this reason we do not stipulate any specific requirements for the internal control framework other than those prescribed by tax legislation and regulations.

11. Step 5: analysis and improvement of tax control

Introduction

An adequate control of tax matters is important to organisations, since this provides them an up-to-date insight into the acceptability of the returns they have filed or will file. All organisations make use of tax control instruments, although their choices for the design of their control can differ and their development of tax control can be in one of various stages.

This Section focuses on the improvement of tax control. The organisation bears the primary responsibility for this improvement: the Netherlands Tax and Customs Administration actively encourages and supports the organisation in this process. We share our opinions and discuss our findings with the organisation. We explain how we use the information we have obtained about the organisation to adjust the form and intensity of our supervision to the degree to which the organisation is in control.

The actual design of the organisation's tax control is dependent on its size, complexity and the choices it has made (for example, on the basis of the selected risk profile or budget). Tax control frameworks (TCFs) are customised and specific to each organisation.⁵⁶ However, all tax control frameworks share some common features: these are explained in this Section. We will already have discussed some elements with the organisation during the compliance scan.⁵⁷ The results from these discussions serve as input for the improvement of tax control.

Objectives of tax control

Tax control is an integral element of organisations' control of their business processes, and for this reason the objectives of tax control are in line with the organisations' following general control objectives:⁵⁸

- *Achievement of the strategic objectives*
This can relate, for example, to tax planning issues such as a required effective tax rate.
- *Stimulate effective and efficient operations*
This objective is focused on the primary processes. It will be in the organisation's interest to discuss the tax consequences of issues relating to the primary processes and the relevant (tax) standpoints with the Netherlands Tax and Customs Administration as soon as possible.
- *Enhance the quality of the internal and external (tax) accounts*
These accounts relate to tax returns and to the issue of information to the Netherlands Tax and Customs Administration or third parties.
- *Achieve observance of the relevant (tax) legislation and regulations (compliance)*
This pivots on the organisations' filing of returns that comply with the legislation and regulations and are free of material errors.

Tax control relates to all types of tax and, as the occasion arises, to customs obligations. The organisation can state the degree to which it is in control on the basis of the work that it carries out in this field.

The Netherlands Tax and Customs Administration's role

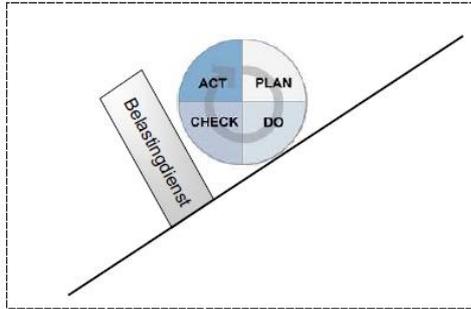
Once the organisation has made an inventory of the manner in which it intends to carry out the analysis and design of the tax control framework⁵⁹ the Netherlands Tax and Customs Administration fulfils an encouraging and supporting role. We then give feedback on our observations. The form and intensity of the supervision is adjusted to the degree to which the organisation is in control. The control process of organisations is shown in the following illustration.

⁵⁶ More information about TCFs is available in the *Tax Control Framework - Van risicogericht naar 'in control': het werk verandert* ('Tax Control Framework – from a focus on risks to being in control: a different approach') document.

⁵⁷ See also Section 7, Step 2: compliance scan.

⁵⁸ The control objectives are cited by COSO, amongst others. COSO's control model is explained in the *Tax Control Framework - Van risicogericht naar 'in control': het werk verandert* ('Tax Control Framework – from a focus on risks to being in control: a different approach') document.

⁵⁹ In practice, most organisations draw up an action plan for this purpose.



The tax control process – the organisation and the Netherlands Tax and Customs Administration

We can give shape to our encouraging and supporting role by:

- making the expectations we have expressed earlier more specific, when necessary, so that the organisation can take account of these in its design of the tax control framework (see also Section 7 and the next paragraph);
- by regularly discussing with the organisation the current situation and progress improving tax control⁶⁰;
- by giving feedback on the information received during our contacts with the organisation (including preliminary consultations). We do not need to know everything about the company, although we can explore some elements in slightly greater depth. In practice, organisations may ask the Netherlands Tax and Customs Administration whether the design of a specific procedure is practicable: which data need to be recorded or are the instructions for an internal review complete, etc. Although we can then share our perception with the organisation we cannot assume the responsibility for these issues from the organisation or the external specialists, where relevant;
- by sharing tax issues with the organisation that we know are frequently encountered in, for example, the sector in which the organisation operates;
- by consulting with the organisation, the independent auditor, other supervisory bodies or external specialists on the design of its monitoring.⁶¹ More information is given in Sections 13 and 14.

In practice, the aforementioned subjects can be discussed during a number of meetings with the organisation. The Netherlands Tax and Customs Administration's encouraging and supporting role should not make excessively great demands on the Administration's time and/or capacity. The members of the account management team jointly decide who will take part in the discussions. The client coordinator directs the work from his or her central position. Officers with the appropriate competences (tax specialists, EDP audit specialists or audit specialists) can be involved in the discussions, depending on the subjects to be addressed.

The Netherlands Tax and Customs Administration's expectations

The Netherlands Tax and Customs Administration needs to obtain an insight into the quality of the organisation's internal control and the degree of compliance so that we can make a justifiable and substantiated adjustment of the form and intensity of our supervision. As stated in Section 1 and the review of the compliance scan, we make a distinction between four aspects of compliance:

1. the (justifiable) registration to pay tax;
2. the (timely) filing of returns;
3. the filing of correct and complete returns;
4. the (timely) payment of the tax stated in returns.

The compliance scan focused on the organisation's attitude and behaviour. This Step pivots on a review of the above four aspects of compliance in terms of the organisation's specific approach to (the improvement of) its compliance. For this purpose we make a distinction between the following areas for attention:⁶²

⁶⁰ These times of contacts can in part coincide with the evaluation moments explained in Section 18.

⁶¹ To ensure that optimum use of the parties' work can be made in Step 6 it will at this early stage provide worthwhile to enter into joint discussions on the content of the control and monitoring work and the feasibility of achieving harmonisation. It is then also possible to discuss the formation of the file and the recording of findings at this point. See also Section 14 of this Guide.

⁶² The various elements are reflected in the tax function. An explanation is enclosed in Annex 3.

- The tax organisation:
 - the organisational structure and tax structure (compliance aspect 1);
 - the duties, powers and responsibilities (compliance aspect 2).
- Communication relating to the tax strategy:
 - the design of the tax strategy communication (compliance aspect 2).
- Tax compliance:
 - the completeness of the records of relevance to tax (compliance aspect 3);
 - the correctness of the tax interpretation (compliance aspect 3);
 - the timeliness of the financial settlement (compliance aspect 4).

The larger accounting firms and tax consultancies can also make use of these areas for attention when advising their clients on the design of a tax control framework. In discussing these areas with the organisation (and, where relevant, the external specialists) the Netherlands Tax and Customs can explain the relevant issues the Administration takes into account when designing its supervision strategy for the organisation.

A number of themes were discussed during the compliance scan. The results from these discussions are used to detail the aforementioned areas for attention: for example, the results from the discussion of the strategic objectives are of importance to the tax strategy communication aspect.

The areas for attention are explained below.

Organisational and tax structure

Organisations can be compliant only when it is known which elements of the organisation are liable to pay which types of tax. The operational structure often differs from the legal structure, which in turn often differs from the tax structure. The organisation needs to have an insight into the question as to whether descriptions are available for all the relevant elements of the organisation for all the relevant types of tax. It will be self-evident that larger organisations or organisations that have frequently undergone changes will devote more attention to the organisational structure.⁶³

Duties, powers and responsibilities

This area for attention relates to arrangements for the tax function within the organisation, i.e. how the organisation assigns duties and powers to the staff on the basis of the organisation's tax strategy (and the tax control derived from the strategy) and supervises the performance of these staff. The organisation also needs to have a clear insight into the officers responsible for the tax processes, the officers who report on the tax processes and the officers who prepare the various types of tax returns.

A particular point for attention is the assignment of the duties, powers and responsibilities in a manner such that the organisation is aware of all developments with consequences for tax matters. This in turn requires the presence of communication structures encompassing all officers with tax responsibilities, such as consultative bodies – in which the officers with tax responsibilities take part – for the discussion of financial, legal and operational developments. The resultant tax risks that are identified can then be assessed and dealt with.⁶⁴

Communication and implementation of the tax strategy

We wish to gain an insight into the communication on the tax strategy and the manner in which this is implemented. Does the organisation devote attention to informing all the officers involved (including the officers within the business processes) and to supervising the officers for compliance with the rules? This element has interfaces with the attention to soft controls (such as integrity).⁶⁵ We need to know whether the perception of the organisation's management as presented during the horizontal monitoring meeting has also been communicated within the organisation. How has the organisation implemented its financial strategy? How does the organisation ensure that all staff are aware of the

⁶³ It is occasionally difficult to retain an insight into all the mergers, takeovers and demergers in international organisations. This is of importance to issues such as the consolidation of the financial statements. The organisation also needs to gain certainty about the tax positions of the various elements of the organisation: in practice we observe, for example, that some non-profit organisations do not have a good insight into the elements liable to pay turnover tax or that some operations are incorrectly deemed to be subject to tax.

⁶⁴ The entirety of these actions within the tax function is also referred to as 'Tax risk management'. See Annex 3.

⁶⁵ When an organisation endeavours to attain a specific effective tax rate then it will need to act in the manner required to achieve its objective (reducing the tax burden). Organisations that attach importance to tax ethics will, for example, ensure that their staff do not prepare false invoices for the organisation's customers.

tone at the top and act accordingly?

Completeness of the records of relevance to tax

The completeness of the records of relevance to tax follows from the general control measures. We ask the organisation to give attention to their procedures that provide assurances for the recording and filing of all transactions.

Almost all organisations have implemented logistics and/or financial information systems to provide support for and control their business processes. Not only are the financial results used to prepare the various types of tax returns, but the (results from) the tax decision-making moments are also usually saved in the information systems.⁶⁶ The complete and correct processing of this data is of essential importance to the ability to file acceptable returns. For this reason we need to establish that the organisation's board of directors endorses the importance of the information systems.

Since many financial processes have been automated, the digital (IT) environment can play an important role in this issue. When you hold discussions on this issue it is wise to call in an EDP audit - specialist to assist you.

Correctness of the tax interpretation

A number of the organisation's staff will be directly or indirectly involved in tax matters. Organisations will, for example, have to review the potential tax consequences of the human resource management department's issue of laptops to the staff. This is also the case for the sales department responsible for inter-company deliveries, the legal department that purchases participating interests and the R&D department that submits an application for a subsidy, etc. We wish to gain an insight into the manner in which the organisation assures that up-to-date tax knowledge is available (either in-house or contracted), that the officers with tax responsibilities are called in to ensure that the tax interpretation of transactions is correct and that situations giving cause to preliminary consultations are identified.

Timeliness of financial settlement

In conclusion, the organisation needs to monitor timely refunds or payments after filing of the (provisional) assessments. We also request attention for fine-tuning of this issue.

Design, existence and operation of the tax control framework

Organisations need a framework to ensure that the organisation's objectives are explicit and that all staff observe the objectives. This framework is referred to as an internal control framework.⁶⁷ The overall design of the framework for tax matters is as follows:

- determination of the tax strategy;
- analysis of the tax risks (depending on the risk assessment and the risk appetite);
- determination of the required control measures;
- implementation of the control measures (procedures, guidelines, audits, etc. relating to the aforementioned areas of attention).

Organisations wishing to comply with their regulations pursuant to the legislation and regulations will regularly review whether the control measures have been implemented in practice and are effective. Consequently, they not only give advance consideration to the design of their control, but also carry out retrospective evaluations of the implementation of the correct control measures. This latter is referred to as 'monitoring'. A number of methods are available for the determination of the existence and operation of internal control (line audits, procedure tests, samples). The organisation determines which method is most compatible to its situation (cf. Article 52 of the State Taxes Act).

The design and monitoring of the internal control is not a static process: it is a continual process that is adjusted in accordance with changed circumstances and/or identified errors.

Internal monitoring

Organisations wishing to proceed with horizontal monitoring have agreed to be transparent on how they ensure that returns do not contain material errors. We can gain an insight into the manner the

⁶⁶ This includes, for example, the statement of VAT on sales invoices (regular, high or low rate, Export or ICL) and the correct payrolling of salary components.

⁶⁷ COSO is a known internal control standard. A comprehensive explanation of COSO is given in the *Tax Control Framework - Van risicogericht naar 'in control': het werk verandert* ('Tax Control Framework – from risk oriented to 'in control': the work changes') document.

organisation has designed this process by proposing that we attend one of the review moments or to examine the findings from the internal auditing department and to discuss them with the organisation. This provides us information for the design of our supervision and enables us to give feedback about the organisation's monitoring process.

The organisation can exercise its discretion in deciding how it will design the internal monitoring function. The Netherlands Tax and Customs Administration gives preference to internal monitoring based on statistical sampling, since this is an efficient, objective and transparent form of internal monitoring. The sample is then part of the internal audit: this enables organisations to review the operation of their (tax) control and identify errors.⁶⁸ The organisation carries out a review of all relevant aspects of the euros that have been collected in the samples. The organisation analyses and rectifies any errors, where relevant, and amends the procedures. This gives shape to the (tax) control learning cycle.

Sampling also offers the Netherlands Tax and Customs Administration an effective, objective and transparent method for use in the performance of our (adjusted) supervision (see Section 14). The organisation, independent auditor and the Netherlands Tax and Customs Administration can also consult on the parameters used for the sampling to bring the internal and external monitoring into line as far as possible.⁶⁹ These parameters include, for example, the materiality that is adopted.⁷⁰ Early in the process all parties can, with due regard for the responsibility borne by each party, discuss who will carry out which work.

When the organisation opts for another tax control method then the Netherlands Tax and Customs Administration can, as the occasion arises, take a sample. The favourable prior information from the alternative tax control method is then used to reduce the size of the sample (more information is enclosed in Section 14).

⁶⁸ COSO states two variants: a continual form of sampling integrated in the processes and periodic samples.

⁶⁹ Seeking harmonisation many enable the organisation to arrive at a single integrated audit, i.e. just one audit that serves a number of purposes (such as the authorisation of expenditure, correctness of quantities and process, the allocation of costs and the tax interpretation of all taxes) and/or one audit for a number of supervisory bodies.

⁷⁰ See Section 14 and Annex 2.

12. ATK+ processing

General

The information about the analysis and the organisation's improvement of the tax control framework is laid down in phases 3 and 4 of the ATK+ client profile. It should be emphasised that the organisation bears the responsibility for the tax control framework in these steps and both phases of ATK+. We expect the organisation to wish to be in control and, consequently, wish to have an insight into its tax control. We may expect that the administrative records, including tax control, are fitting to the nature and the size of the organisation (cf. Article 52 of the State Taxes Act). We attach importance to the organisation's implementation of a learning cycle (including the internal monitoring function) as an element of its tax control framework.

The characteristics of phases 3 and 4 are listed below:

| Phase 3 | Phase 4 |
|--|--|
| <ul style="list-style-type: none"> - Insight for the client - Design and existence - Conversation | <ul style="list-style-type: none"> - Insight for the client and the Netherlands Tax and Customs Administration - Existence and operation - Conversation and the Netherlands Tax and Customs Administration's observations |

In practice, phases 3 and 4 will merge almost seamlessly with each other. We complete Phase 3 once the client informs us in a meeting their view on the design and existence of their tax control. We complete Phase 4 once the client and the Netherlands Tax and Customs Administration have an insight into the existence and operation of tax control. We obtain this insight from conversations with the organisation and our observations.

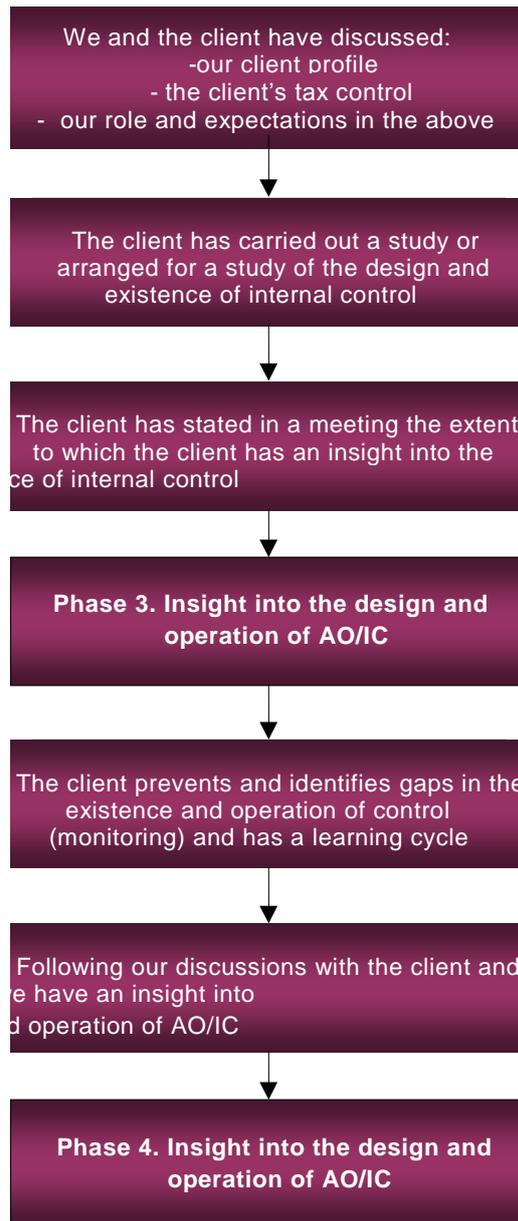
In practice, Phase 3 can sometimes already be completed on the basis of the current client profile, the information from the horizontal monitoring meeting and the compliance scan. However, Phase 4 cannot be completed at this point since we have insufficient information about the existence and operation of the client's internal control. Nevertheless, the information from the process does offer opportunities for the provisional adjustment of the intensity of our supervision. We then come to Phase 4 at a later point in time. However, often we will be in conversation with the client on the client's tax control and then receive information that enables us to complete Phase 3 and Phase 4 at the same time.

The above is shown in the chart on the next page.

Output from phases 3 and 4

The output can include the following:

- minutes of meetings/progress meetings on the improvement of tax control;
- an updated client profile and strategic supervision plan in ATK+;
- reports on information received about:
 - the progress in the improvement of tax control;
 - the process and outcome of the internal monitoring function;
 - the content of the TCF;
 - the outcome of the requests in advance and preliminary consultations.



Phase 5: adjusted supervision

We have an insight into the elements of the tax processes within the business for which the client fulfils his responsibilities and also the elements of tax processes for which the client is (still, or temporarily) unwilling or unable to fulfil his responsibilities.

We also have an insight into the work carried out by external parties (accountants, consultants, etc.).

We have adjusted our supervision based on the manner in which the client provides for acceptable returns. We have determined our supervision strategy in the strategic supervision plan for the short and medium term (five years). We have informed the client with whom we are working on the basis of the horizontal monitoring concept on our strategy (preferably by sharing our strategic supervision plan).

13. Step 6: adjustment of supervision

Introduction

The Netherlands Tax and Customs Administration adjusts the form and intensity of its supervision on the basis of the level of tax control of the organisation. This is included in the compliance agreement. The outcome will be tailored to the specific organisation and entails customisation. This Section explains the effect of horizontal monitoring on a number of elements of individual account management.

Strategic supervision plan

The strategic supervision plan is based on account management of the client. The account management team uses the current client profile to determine the supervision strategy for the organisation based on the improvement and maintenance of compliance by the organisation. Since the organisation's tax attitude, behaviour and internal control can change this will influence our client profile. We continually adjust strategy to the current client profile. The client profile, supervision strategy and client treatment jointly form a cycle. In order for us to be transparent, we would like to be able to share the strategic horizontal monitoring plan with the respective client. Therefore the client profile must always be kept up to date. Each of the ATK+ sections states our approach to the recording of the findings in the horizontal monitoring process.

Preliminary consultations

Requests in advance and preliminary consultations are important to horizontal monitoring. We expect the organisation to submit relevant (tax) standpoints they have adopted or plan to adopt to the Netherlands Tax and Customs Administration as soon as possible. In practice, it can be agreed that the standpoints are known by at least the time at which the returns are filed. The standpoints relate to issues about which the Netherlands Tax and Customs Administration may have a different opinion, such as a difference in the interpretation of facts or the interpretation of legislation. The organisation actively provides the Netherlands Tax and Customs Administration an insight into all the relevant facts and circumstances, the standpoints and the organisation's perception of the resultant legal consequences.

These principles and prior information collected during the process give us our justified expectation that the organisation will adopt a transparent and professional approach to the discussions in advance. The account management team can then adopt an approach to the preliminary consultations which differs from those we have with organisations when we have less prior information about their attitude, behaviour and tax control. For example, we no longer need to review whether the complete set of facts has been outlined. Consequently, the preliminary consultations can be shorter if they solely involve an assessment on whether the organisation has used a correct tax interpretation.

Information reports

Incoming information reports traditionally give cause to the Netherlands Tax and Customs Administration's initiation of an examination of the facts. However, a different approach can be adopted in the presence of a relationship based on horizontal monitoring. A distinction is made between three situations:

- *Pure tax issues*

The information report relates solely to a tax issue, for example as to whether the correct rate of turnover tax has been charged in the sales invoices.

The information report can then be submitted to the organisation with the request to investigate the background of the report. The organisation shares the results from its examination with us: these can give cause to further consultations. If there is a tax inaccuracy then the organisation is responsible for making improvements (see also sections 11 and 19).

- *Atypical information reports*

These information reports can relate to the notification that the organisation may be liable for taxes of a third party (for example, pursuant to the Wages and Salaries Tax and Social Security Contributions [Liability of Subcontractors] Act). The region giving consideration to holding the organisation liable for the tax liability or to initiating an investigation first makes contact with the account management team of the organisation. They jointly assess whether the organisation will be approached and, if so, how. The horizontal monitoring principles remain in force in situations

of this nature.⁷¹

- *Integrity issues*

The information report relates to a situation which impacts the integrity of the organisation or the directors or directors/major shareholders involved. Information reports of this nature must be discussed within the account management team together with the relevant M2 officer. The impressions that are formed must be treated with care and for this reason it is wise to hold an appropriate conversation with the organisation before deciding whether to initiate an examination of the facts (see also Section 18). The outcome of the meeting with the organisation can also reveal the need for a further examination.

Assessment procedure

In principle, in horizontal monitoring all relevant material tax issues are submitted before the return is filed. As a result, in principle the return may not contain any surprises and can be determined immediately. Should there nevertheless be questions about the return then we begin by contacting the organisation to discuss the reason for the failure to notify us of the tax issue (see also Section 18). The underlying reasons can result, for example, in us requesting the organisation to substantiate its standpoint.

Audits

The Netherlands Tax and Customs Administration is responsible for supervision of all returns filed by taxpayers and withholding agents. The strategic supervision choice is laid down in the strategic supervision plan in ATK+. Our design of an audit takes account of all the prior information we have about the organisation: this is not only applicable to determine the work in audits, but also for frequency of our supervision. The additional prior information we obtain with horizontal monitoring justifies a lower audit density than for organisations about which we have no or unfavourable information about their attitude, behaviour and tax control. An explanation about the performance of an audit is enclosed in Section 14.

⁷¹ If necessary, consultations can be held with the regional collection technical coordinators.

14. Step 6: performance of audits

Introduction

This Section discusses supervision in the form of an audit. The adjustment of our supervision (in terms of the frequency and quantity of work) is related to the information we have about the quality of tax control (as reviewed in Section 11) and, consequently, can vary depending on the circumstances at the organisation.

The Netherlands Tax and Customs Administration's design and operation of audits takes account of all the relevant prior information, including the work that has been carried out by or on behalf of the organisation. Consequently, the work that has been carried out provides favourable and up-to-date information that reduces the amount of work carried to be out by the Netherlands Tax and Customs Administration.

The object being monitored

The Netherlands Tax and Customs Administration's supervision always pivots on the acceptability of the returns. In analogy with traditional audits, partial-audits can also be carried out with horizontal monitoring. The audits are not risks-oriented. They, for example, address one or more business processes or one or more types of tax.

Method

The Netherlands Tax and Customs Administration's audits are governed by the principles of responsive regulation and the Audit Approach (the CAB). These concepts can be visualised using the onion skin model as explained in Section 2. Pursuant to the onion skin model, we adjust the nature and scope of our supervision activities to the prior information about the organisation's compliance and its control and audit activities, as well as to the external supervisors involved (including the independent auditor) and other external specialists. Completeness and correctness audits are necessary for an assessment of the acceptability of the return. In principle, these audits will already have been carried out by or on behalf of the organisation. In an ideal situation we will have obtained an amount of prior information that enables us to limit our data-oriented activities to an assessment of the audit work carried out by the organisation, the external supervisors (including the independent auditor) and/or other external specialists.⁷² This can be achieved solely with transparency and cooperation on the part of the organisation, the external supervisors and other external specialists during the performance of our audit.⁷³

Completeness audit

The Netherlands Tax and Customs Administration assesses the design of the organisation's internal control, inclusive of the internal monitoring function. We use this assessment to determine the degree to which we can rely on the general internal control. We can then, depending on the quality of the control, omit the data-oriented completeness audits either in part or in whole. One of the important elements in arriving at our opinion is our discussion with the organisation and the independent auditor (or other external specialist). This discussion pivots on the audits conducted by or on behalf of the organisation, the selection of audit subjects, the findings from the audits and the actions taken on the findings (jointly referred to as the 'learning cycle'). An inspection of the independent auditor's audit file can also yield important information.⁷⁴

Correctness audit

In principle, analyses of the figures and data-oriented detailed audits are carried out to assess whether all the organisation's transactions have been recognised correctly for tax. Our Netherlands Tax and Customs Administration audits make the maximum possible use of statistical sampling, since it is then possible to arrive at a substantiated quantitative assessment of the entire population of data from which the sample was drawn (for example, the outgoing cash flow) without needing to audit all the transactions in the population.

⁷² The independent auditor of organisations plays an important role in auditing the financial statements. For this reason this Section includes several references to the independent auditor.

⁷³ Preference is given to early consultations with these parties to provide for the optimum use of their work.

⁷⁴ See also Section 20.

Our data-oriented audits (such as the statistical (sampling) audit) rely on the work that has already been carried out by the organisation and the independent auditor. When the organisation also takes samples within the context of its internal monitoring function (see also Section 11) then we assess the parameters and the (follow-up of the) findings from the sample. One example of these parameters is the materiality.

On occasion, organisations make arrangements for the internal monitoring of the internal (tax) control that do not include the use of samples. We also use the information obtained in this manner to determine the additional work we will need to carry out to arrive at an assessment of the acceptability of (part of) the return.

The Netherlands Tax and Customs Administration's materiality table is decisive for the design of our correctness audits. When the organisation has adopted the same materiality then we can limit our assessment to the organisation's sample. However, in practice the materiality adopted by the organisation and the independent auditor (or other external specialist with an audit duty) can differ from the materiality adopted by the Netherlands Tax and Customs Administrations. In these situations we begin with an analysis of the differences. As stated earlier in Section 11, it is recommended that consultations are held between the parties at an early stage. It is wise to involve a sampling specialist in these consultations. When it appears that fewer elements have been drawn than necessary on the basis of our parameters then the Netherlands Tax and Customs Administration can decide to carry out additional auditing work. The quality of the audit work that has already been carried out plays an important role in the Netherlands Tax and Customs Administration's review of the amount of additional work that will be required. We assess this quality, for example, by inspecting the records of the findings of the organisation and the independent auditor (or other external specialist with an audit duty). The objective of these data-oriented activities is to gain an insight into the system. It is conceivable that the remaining sampling is reduced to zero when we establish that the organisation adopts a professional approach to the items it has drawn, we have received favourable information during the preliminary consultations, and we have not discovered any errors in the samples drawn by the organisation.

15. ATK+ processing

General

We have gained an increasingly clearer insight into the organisation during phases 1 to 4 inclusive of the ATK+ client profile. We have information about the manner in which the client assumes its tax responsibility. All the information we have received results in an adjustment of our monitoring on the basis of the degree to which and the manner in which the client provides for acceptable returns. This decision is recorded in Phase 5 of the ATK+ client profile.

The following is expected from the account management team for the completion of Phase 5 in the ATK+ client profile:

- an adjustment of the strategic supervision plan which specifies the form of supervision of the client in the short and medium term (5 years);
- the provision of information to the client about the adjustment of our supervision (for example, by sharing the strategic supervision plan). A record of providing this information to the client is made in ATK+. As a result, the client is aware of the design of the Netherlands Tax and Customs Administration's supervision strategy.

Output from Phase 5

The output can include the following:

- an updated client profile and strategic supervision plan in ATK+;
- a report of the adjusted supervision in the form of an audit;
- reports of findings from the periodic evaluations and contacts with the organisation;
- reports of the outcome of the preliminary consultations;
- tax assessments (reports of the process thereof).

Phase 6: covenant with tax service providers

The client has become a signatory to a covenant concluded between the Netherlands Tax and Customs Administration and a tax service provider. We shall now rely heavily on the (meta-monitoring by the) tax service provider.

16. Concurrence individual compliance agreement and other covenants

Introduction

A distinction can be made between a variety of forms of covenants for horizontal monitoring. An organisation can – simultaneously – take part in a sectoral covenant, a tax service provider covenant⁷⁵ and/or an individual compliance agreement. The various forms of covenant exist alongside each other and each give specific shape to the concept in their field.

Sectoral covenant

The forms of cooperation with sectoral organisations are based on mutual trust, understanding and transparency. This cooperation can fulfil a platform function and, linked to this platform, provide for discussions to resolve tax issues in advance. This form of cooperation is referred to as a 'general sectoral covenant'. Organisations can take part in these covenants without an explicit statement of their participation. A horizontal monitoring (sectoral) covenant is also possible, when use is made of the existing covenants for the relevant sector. The substantive agreements are laid down in an annex. The covenant and the annex are published externally on the Netherlands Tax and Customs Administration's website.

Tax service provider covenant

Tax service providers who conclude a tax service provider covenant ensure that the returns of clients they bring under the covenant are acceptable. These returns are referred to as 'covenant returns'. Tax service provider covenants are primarily designed for horizontal monitoring in the SME segment, but can also relate to organisations in the MSB or even the VLB segment. The procedures for the registration and account management of organisations in MSB or VLB segments that fall under the scope of a tax service provider covenant differ from those for organisations in the SME segment. The procedure for organisations in the MSB and VLB segments is explained below.

Principles for registration of organisations in the MSB and VLB segments

- The account management team must give approval for the participation of organisations in the MSB and VLB segments in a tax service provider covenant.
- The requirements governing an acceptable return are identical for tax service provider covenants and individual compliance agreements.
- When organisations take part in a tax service provider covenant then we also endeavour to conclude an individual compliance agreement with the organisations.

Explanation of the principles

The Netherlands Tax and Customs Administration has explicitly opted for individual account management in the MSB and VLB segments, since the Administration's contacts with the organisations are of great importance. For this reason we wish to emphasise the importance of the relationship between the Netherlands Tax and Customs Administration and the organisation in an individual compliance agreement.

Moreover, in practice tax service providers can propose parts of a group entity for inclusion in a tax service provider covenant: the covenant then does not govern all the concern's types of tax and/or taxpayers. This approach may be adopted because the tax service provider does not carry out work for all parts of the organisation or that the organisation (together with the tax service provider) does not yet have full (tax) control throughout the organisation. An individual compliance agreement for the entire organisation is then a logical supplement to the tax service provider covenant.⁷⁶

The standard text of tax service provider covenants includes the following (translated from the original Dutch):

"When a tax service provider submits the name of an entrepreneur that falls under the Netherlands Tax and Customs Administration's individual account management then the Netherlands Tax and Customs Administration, the participating office and the entrepreneur consult on participation in this covenant."

⁷⁵ Within the near future the term 'tax intermediary covenant' will be replaced by the term 'tax service provider covenant'. This Guide has adopted the new name in advance of the change.

⁷⁶ Both covenants link together on the internal control and monitoring aspects.

Application procedure

Pursuant to the standard procedure, the tax service provider completes an application form for clients wishing to participate in the tax service provider covenant and submits the form to a designated central region (the adoption region). The application is processed in the CAS (Covenant administration system)⁷⁷ and sent on to the relevant regional covenant team for the client (this can be a different region from the adoption region).

When the records in the IKB application⁷⁸ reveal that the client is an organisation in the MSB or VLB segment then the application is not sent on to the covenant team but is instead submitted to the relevant account management team.

The account management team then meets with the client and the service provider. The following issues are discussed during this meeting:

- the scope of the tax service provider covenant and the individual compliance agreement;
- the client profile;
- the adjusted supervision.

Scope

During the meeting the account management team consults with the organisation and tax service provider on the companies and types of tax that will be governed by the tax service provider covenant. This makes clear which elements of the group entity will and will not be impacted by the tax service provider covenant.

The completeness aspect can be a point for attention with organisations that fall under horizontal monitoring pursuant to a tax service provider covenant. This is due to the limited size of the organisation and the resultant inherent limitation of internal control.⁷⁹ The Netherlands Tax and Customs Administration expects that the work carried out by the tax service provider which does not relate to an audit will at least be compatible with the work carried out by an accountant within the context of a compilation assignment.⁸⁰ In general, we expect inherent limitations to play less of a role in the MSB and VLB segments.⁸¹

During this meeting we need to explicitly determine that the degree of certainty provided by the tax service provider meets the Netherlands Tax and Customs Administration's requirements.⁸² When this is not the case then we discuss how this certainty can nevertheless be provided by the operation of supplementary work by the organisation, the tax service provider or the Netherlands Tax and Customs Administration. Particular attention will then need to be devoted to the parts of the organisation and types of tax that do not fall under the tax service provider covenant.

Ultimately, equal levels of the work carried out by the organisation and external specialists pursuant to either a tax service provider covenant or an individual compliance agreement will need to result in the same adjustment of our supervision.

Client profile

The Netherlands Tax and Customs Administration's client profile is discussed with the client and the tax service provider. The principle governing the participation of organisations in the MSB and VLB segments in tax service provider covenants is "Yes, unless...".

However, it is possible that the current client profile may give cause to surprise on the receipt of an application for participation in a tax service provider covenant: we may have information about the client the tax service provider does not possess or have interpreted in a different manner, or we may have indications that the organisation's attitude and behaviour are not compatible with the horizontal monitoring principles. The issues giving cause to our surprise are then discussed with the

⁷⁷ The CAS application will be replaced by the CNV application on 1 January 2011.

⁷⁸ The IKB (individual account management information) application is used for the registration of general information about the client, such as the classification into a segment.

⁷⁹ This is not an issue for the correctness aspect since inherent limitations then do not play a role.

⁸⁰ The tax service provider covenant focuses primarily on the SME segment. The size of the organisations in this segment can result in inherent limitations of the administrative organisation/internal control. A number of measures cannot then be implemented in a rational economic manner. In view of the nature of these limitations (the measures are irreplaceable) the accountant or tax service provider cannot provide certainty. It is a plausibility assessment.

⁸¹ This can differ in practice, in particular with respect to private returns and the director/major shareholder's personal holding companies.

⁸² One reason why this issue is important is that the VLB/MSB segments are not included in national actions in the SME segment.

organisation and the tax service provider.

When (it appears that) there are no particulars then we state that we wish to conclude an individual compliance agreement for the entire group entity – even if the entire group entity falls under a tax service provider covenant.⁸³ This is because we attach importance to a permanent individual relationship and wish to continue to work on horizontal monitoring for the entire group entity.⁸⁴ Any such individual compliance agreement we conclude is the culmination of the process as laid down in this Guide. We assume that the tax service provider has already carried out the relevant work for the companies for which an application has been submitted for participation in a tax service provider covenant. Consultations are held on the supplementary work that will be carried out with respect to that part of the group entity (taxpayers and/or types of tax) that falls outside the scope of the tax service provider covenant.

Adjusted supervision

During the meeting with the client and the tax service provider the account management team discusses the consequences of participation in the tax service provider covenant (and the individual compliance agreement) for future individual account management (see the next subsection). When the tax service provider covenant does not govern the entire group entity of an organisation in the MSB or VLB segment and no individual compliance agreement is concluded then the Netherlands Tax and Customs Administration does not adjust its supervision (for the time being). The results from the meeting are laid down in the strategic supervision plan in ATK+.⁸⁵

Account management

The account management team retains the responsibility for the individual account management of organisations in the MSB and VLB segments that participate in a tax service provider covenant. This account management is no different from that of organisations that have concluded an individual compliance agreement (see sections 13 and 14, etc.). Points for attention are then:

- Preliminary consultations
The account management team conducts the consultations on specific issues and requests in advance by the relevant organisation. The tax service provider's office can also request preliminary consultations of a collective nature. These requests are dealt with by the adoption region. The regional covenant teams deal with the preliminary consultations relating to individual SME organisations.
- Contact with the adoption region
The account management team keeps the representative of the adoption region (the relationship manager) of the relevant tax service provider covenant up to date with issues of importance to the relationship with the office. The relationship manager informs the account management team about collective preliminary consultations when the results from those consultations are of relevance to the account management of the organisation in the MSB or VLB segment.
- Adjusted supervision
The form and intensity of the supervision are adjusted based on the efforts made by the organisation and tax service provider. Comparable efforts relating to individual compliance agreements and tax service provider covenants have the same consequences for our supervision.

Pilot projects

We explore whether and, if so, how we can assign the tax service provider covenant a position within the supervision of the MSB and VLB segment, whereby we wish to assure that the account management of organisations under a tax service provider covenant is equal to that of organisations under an individual compliance agreement. For this reason, for the time being the inclusion of organisations in the MSB and VLB segments in a tax service provider covenant takes place on the basis of a pilot project. This method is coordinated, evaluated and harmonised with the MSE HMO (small and medium-sized organisations horizontal monitoring) team. As soon as the account

⁸³ It is also possible that we come to the joint conclusion that the organisation cannot be included in the tax service provider covenant (at present).

⁸⁴ It is also possible that the organisation does not wish to conclude an individual covenant (for the time being). We will then give careful consideration to their arguments to assess whether they are compatible with the values and the principles of the tax service provider covenant. When this is the case then the tax service provider covenant offers added value and we shall review the opportunities for further horizontalisation at a time in the future.

⁸⁵ Adjusted monitoring is given shape in the SME segment, among others, by means of the statistical sampling of companies. MSB and VLB fall outside this sampling.

management team knows or believes that an application for the inclusion of an organisation in the MSB or VLB segments in a tax service provider covenant will be filed the team must contact the MSB (medium sized organisations coordination group) (for an MSB client) or the Chair of the VLB knowledge group (for a VLB client). This enables us to carry out rapid evaluations of experiences.

17. ATK+ processing

General

The account management team completes Phase 6 of the ATK+ client profile after the meeting with the organisation and the consultant. The conclusion that the organisation can participate in the tax service provider covenant is recorded in Phase 6.

Output from Phase 6

The output can include the following:

- minutes of the meeting with the organisation and tax service provider;
- individual compliance agreement;
- an updated client profile and strategic supervision plan in ATK+.

18. Evaluation⁸⁶

Introduction

The organisation and the Netherlands Tax and Customs Administration need to maintain an insight into any changes in the circumstances of either party, since these can be of influence on the initial horizontal monitoring agreements. In addition, we and the organisation need to discuss each other's experiences: this is compatible with this form of cooperation and is included in the agreements laid down in the covenant. We wish to periodically determine whether the trust in each other is still justified and that we devote attention to the experiences and developments that can have an influence on trust. This Section explains the evaluation of horizontal monitoring agreements.

Changed circumstances

The prevailing circumstances at the time of the horizontal monitoring meeting, compliance scan and the conclusion of the compliance agreement can subsequently change.

Changes can occur at the Netherlands Tax and Customs Administration such as:

- changes in policy;
- changes in the members of the account management team.

These changed circumstances can be of importance to the organisation and can have consequences for the mutual trust. For this reason it is beneficial to confirm this trust when any such changes occur.

Changes can occur at the organisation such as:

- changes in the market conditions;
- changes in the strategy;
- management or shareholder changes;
- changes in the administrative organisation or legal organisation (the relocation of company divisions, mergers, takeovers and demergers);
- changes in the tax department or at the tax consultant;
- changes in the external accountant or other external specialists.

These changes can have an influence on the organisation's attitude, behaviour and/or tax control and, consequently, on our client strategy.

Experiences

Favourable experiences confirm trust in the other party, and for this reason it is beneficial to state these experiences explicitly. When experiences give cause to doubts then it is important, from the perspective of repressive enforcement, to begin by sharing these doubts with the organisation and jointly determining the factual situation.

When for, example, we have doubts about the transparency then we and the organisation will need to jointly determine whether the organisation has not been (sufficiently) transparent and the reasons. Mistakes can be made for many reasons: for example, the organisation was not in control (and, consequently, was also unaware of the potential point of dispute), the organisation assumed that the issue did not need to be discussed with the Netherlands Tax and Customs Administration or, in an extreme situation, the organisation deliberately decided not to be transparent. We do not proceed immediately to more regulations and increased auditing, but delay our assessment until after the analysis of the situation. Appropriate action will be decided on the basis of the circumstances.

When we conclude that the organisation's intention was and still is good then the relationship of trust can be restored by Netherlands Tax and Customs Administration's exhibition of understanding and, as the occasion arises, the organisation's implementation of appropriate measures.

When it appears that the organisation deliberately committed a breach of trust then we work through what is referred to as an 'intervention pyramid' or 'escalation ladder'. Our intervention is responsive and is based on the intention, the circumstances, the severity and the frequency of the breach of trust. The intervention can be comprised, in ascending sequence, of the following:

- explaining or refining the agreements on attitude and behaviour (such as a renewed review of the principles of horizontal monitoring);

⁸⁶ This Section is based on the *Vertrouwen geven en in control zijn; gaat dat samen?* ('Giving trust and remaining in control: is this compatible?') brochure published by the Ministry of Finance.

- temporary additional supervision;
- corrective action (with a penalty, where relevant);
- terminating the agreement (the covenant).

Every intervention needs to be followed by an analysis to determine whether the behaviour has been improved and the client strategy can be adjusted favourably for the client.

Periodic evaluation of the covenant

In addition to the special reasons stated above, all covenants always include arrangements for periodic evaluations. Although no fixed periods of times are specified for these evaluations, it is important that they take place. The design of the evaluation depends in part on the frequency of the contacts with the organisation. It can be practical to combine the evaluation with a company meeting/visit to assess the current situation. A written report is made of the evaluation.

It is recommended to involve the officers who played a role in the conclusion of the covenant (including the organisation's management board and the Netherlands Tax and Customs Administration) in the evaluation. During the evaluation we ask the organisation for feedback. How have they experienced horizontal monitoring? Are their experiences what they had expected? Do they have any points for improvement for us?

19. Adjustments and penalties

Introduction

At various times during the horizontal monitoring process it can become clear that returns which have been filed contain errors. This issue can arise during the compliance scan (Section 7), the resolution of pending tax issues (Section 8), as a result of the findings of the organisation or the Netherlands Tax and Customs Administration during the improvement of tax control (Sections 11) or during an audit we have conducted (Section 14).⁸⁷

Adjustments

The following questions play a role with respect to the possible adjustment of errors:

- Are adjustments always necessary?
- What is the cause of the errors?
- Who makes the adjustment?
- Do other periods also need to be examined?
- Which penalty is appropriate and applicable?

Are adjustments always necessary?

Horizontal monitoring assumes that organisations want to file adequate returns. This objective is achieved by agreeing in the covenant that the organisation will provide for a system of internal control, internal audits and external audits. This system is designed to prevent errors and, in the event that errors do occur, to identify and correct the errors. All known errors must be rectified. When the organisation discovers errors then the organisation reviews whether modifications to the internal control are required to prevent their recurrence: this completes the learning cycle. When a known error is a material error which, consequently, has an influence on the overall returns then this should not normally result in discussions: the organisation and the Netherlands Tax Customs Administration will usually both be of the opinion that the errors must be rectified. Known errors that are not (in their totality) material errors must also be rectified. This is the generally prevailing adjustment policy, which is also compatible with the horizontal monitoring principles.

What is the cause of the errors?

We assume that errors are made unintentionally. For this reason we always adopt an open attitude, even when errors have been discovered. We begin by meeting with the organisation to discuss how the errors were caused, whether the organisation was aware of the errors and which actions the organisation has taken as a result of the errors. The next steps and the imposition of a penalty, where relevant, are determined by the responsive regulation principles.

Who makes the adjustment?

We expect the organisation to rectify the errors the organisation has made. The organisation gains an insight into errors by means of the existence of an internal monitoring function (see Section 11). The Netherlands Tax and Customs Administration expects that the organisation will respond to any errors by filing supplementary returns (such as for turnover tax) or supplements to filed returns (such as for corporation tax).

Do other periods also need to be examined?

When an error is discovered the question is then whether the organisation needs to take action in order to identify and rectify any errors in the past. Material errors are determinative for the answer to this question, whereby both the qualitative aspect (which includes the culpability of the error) and the quantitative aspect of materiality are of importance.⁸⁸ When an error in the current period is material then we expect the organisation to assess whether it is probable that the error also occurred in earlier returns. When this is not probable then the organisation is not under the obligation to expand its investigation to those returns. However, when it *is* probable that the error has occurred in earlier returns then we expect the organisation to expand its investigation to those returns. In the latter instance a reasonable estimate of the amount of the error is made. The work we expect the organisation to carry out increases with the importance of the identified error. The Netherlands Tax

⁸⁷ This Guide bases the levy of taxes on the national legislation and regulations. Netherlands Customs is governed by specific regulations within the context of European legislation and regulations that in some instances require settlement by a criminal court.

⁸⁸ See Annex 2 for a further explanation of qualitative and quantitative materiality.

and Customs Administration and the organisation can also reach joint agreement on the extrapolation of findings in a specific period to earlier periods.

It is, from a practical perspective, conceivable that we agree on the adjustment of errors of a limited magnitude in past years, pursuant to Article 64 of the State Taxes Act (efficiency provision), in a recent period. In this situation it will be necessary to provide compensation for the interest, where relevant, on unpaid tax.

Note

A meeting to discuss possible adjustments can test the relationship, certainly when these relate to earlier periods. For this reason it is necessary to pay due regard to the horizontal monitoring principles and, if so required, explain them again to the organisation.

Penalties⁸⁹

Which penalty is appropriate and applicable?

When rectifications are made it is also necessary to review the need for the imposition of a penalty. The above explained that the account management team offers the organisation an opportunity to determine the magnitude of the error(s) and to rectify the error(s). This requires open and constructive cooperation between the Netherlands Tax and Customs Administration and the organisation.

The Administrative Fines (Tax and Customs Administration) Decree (BBBB) is applicable to the determination of the penalty. A distinction needs to be made between two steps with respect to the BBBB which also extends to the communications with the organisation:

1. the determination of the degree of fault at the time of filing the (adjustment to) the return;
2. the circumstances giving cause to a more severe or more lenient penalty.

When determining the degree of fault the Netherlands Tax and Customs Administration and the organisation always discuss the cause of the error and the reason why the organisation was unable to prevent the error: the design, existence and operation of the tax control framework will then play a role since, for example, the error may have been due to inadequate instructions, failure to comply with the instructions or insufficient supervision of compliance with the instructions.

Pursuant to the penalty policy, the established degree of fault determines the standard penalty percentage or standard penalty amount (for default penalties). The BBBB (paragraph 6) includes an explicit provision stating that variances from the standard penalties are permitted. Consequently, when determining the ultimate penalty the inspector is not bound by fixed amounts or percentages. These deliberations must always result in a penalty that is appropriate for the specific situation, whereby the account management team takes account of all special circumstances. The taxpayer's current behaviour also plays a role in these deliberations: has the organisation, for example, implemented measures to prevent a recurrence? Or has the organisation let things drift? The BBBB states that the determination of the individual punishment takes account of the organisation's constructive attitude following the discovery of the error. The individual penalty imposed on taxpayers who do not accept culpability, and decide to contest the adjustment and the proposed penalty differs from the individual penalty imposed on taxpayers who personally discover the error, accept the (evident) culpability, make every effort to prevent the recurrence of the error and personally carry out an investigation of past returns to determine the magnitude of the error. It should be noted that this is applicable both to horizontal monitoring and the 'traditional' account management.

When adjustments exceed the ceiling stipulated by the notification, transaction and prosecution (ATV) directive then it is always necessary to contact the penalty specialist and/or penalty fraud coordinator. Consultations are held to decide whether a penalty is to be imposed and, if so, the amount of the penalty. The account management team and the penalty specialist give consideration to all the relevant facts and circumstances and, ultimately, determine the individual penalty. If so required, the account management team and the penalty specialist can also consult with the regional procedural law technical coordinator.

⁸⁹ This Section relates solely to administrative penalties. Pursuant to specific regulations Netherlands Customs and other supervisory bodies will usually need to require settlement by a criminal court.

20. External specialists

Introduction

Virtually all organisations in the MSB and VLB segments call in external specialists for the performance of work directly or indirectly relating to tax matters, such as an external auditor who conducts a (statutory) audit and a tax consultant who gives advice or prepares a return. Many organisations seek assistance from external specialists for the horizontal monitoring process: their work can contribute to the organisation's ability to file acceptable returns. This Section reviews cooperation with external specialists.

External specialists and horizontal monitoring

External specialists are active in many areas that impact horizontal monitoring: their working field is extremely varied and developing rapidly. A number of parties are active in several fields,⁹⁰ whilst other areas are the exclusive domain of a specific party.⁹¹

A number of accountants and consultancy organisations have formed multidisciplinary groups in which external specialists in different fields work together, such as what is referred to as the 'audit of tax' in which the auditor obtains clarity about the tax position in the annual accounts (the tax section) by arranging for an audit to be conducted by a specialised team of accountants and tax specialists to gain an insight into any tax risks and their potential consequences for the financial statements.

Cooperation with external specialists

External specialists carry out a great deal of work that is of relevance to the horizontal monitoring process. Our attitude always focuses on seeking cooperation with organisations and the external experts they call in for assistance. This results, for example, in our paying attention to the work external specialists have carried out or will carry out and discussing where and to which extent we can rely on their work. We endeavour, at an early stage, to reach agreement on the maximum coordination of the work carried out by the organisation, external specialists and account management team. A transparent relationship with the external specialists is then of importance. This positive attitude is intended to develop the most efficient possible design of the process for all the parties involved.

Some examples

We always, in all the steps of this Guide, examine opportunities for us to rely on the work carried out by external specialists. A number of examples are enclosed below to illustrate this.⁹²

Step 1: horizontal monitoring meeting

The organisation can opt to invite external specialists to the horizontal monitoring meeting. When this is the case then we then discuss how we can make use of the work carried out by the organisation and the external audits.

Step 2: compliance scan

We hold discussions with the organisation and the external specialists to review whether they have carried out work which we can rely on during the compliance scan. The external specialists may, for example, have already made an inventory of the manner in which the organisation has designed the organisation's tax function. A previous assignment to an external specialist in which they were requested to carry out an analysis of the organisation's control indicates that the organisation has also devoted attention to control issues in the past. The external specialists' experiences with the organisation's attitude towards recommendations for improvements in control and the resultant actions taken by the organisation are also of relevance.

Information of this nature may result in the decision to limit the scope of the compliance scan. In addition, the nature of the work organisations wish to carry out with the assistance of external specialists is also of relevance. It will be worthwhile to hold a meeting with external specialists who are closely involved in the relevant organisation to discuss their work for the organisation.

We rely as much as possible on the work that has already been carried out by the organisation and

⁹⁰ For example, the provision of advice on the design of (Tax) Control Frameworks.

⁹¹ For example, the performance of statutory audits.

⁹² The role played by external specialists is also frequently referred to in the various sections of this Guide.

their external specialists. The Netherlands Tax and Customs Administration and the organisation jointly conclude whether horizontal monitoring is feasible.

Step 5: improvement of tax control

Organisations wishing to gain tax control can request external specialists for support. The division of their roles will usually be specified in a action plan. Any analyses of tax control carried out by external specialists are of relevance in this phase.⁹³ These analyses will be incorporated in the steps the organisation takes to optimise its tax control.

To ensure that optimum use of the parties' work can be made in Step 6 it will provide worthwhile to discuss, at an as early as possible, the content of the control and monitoring work and to discuss possibilities for working together.⁹⁴ This can relate, for example, to the design of the monitoring function.

Step 6: adjusted supervision

The Netherlands Tax and Customs Administration's supervision is always based on responsive regulation and the Audit Approach (CAB) principles, whereby we make the maximum possible use of the work that has already been carried out during the internal and external audits. It can also be appropriate for us to request the inspection of parts of the auditor's audit file or other relevant files.⁹⁵ We request an inspection solely of the parts of the auditor's audit file or other relevant files that can be of importance to our assessment of the need for any supplementary work or our opinion of the acceptability of the return.⁹⁶

⁹³ In practice, base-point and quick scans, for example, may have been carried out.

⁹⁴ This includes, for example, the method adopted for the formation of files and recording of findings. More information is enclosed in Section 11 of this Guide.

⁹⁵ The Accountants-Netherlands Tax and Customs Administration Code of Behaviour was withdrawn on 1 January 2010. Our work continues to encompass inspections of audit files even though this code of behaviour has been withdrawn. Accountants affiliated with the NIVRA or NOvAA endorse the importance of our inspection of their files. They have agreed to make every effort to encourage their clients to agree to these inspections and to the issue of an explanation. See also '*praktijkhandreiking 1113*', published by the Koninklijk NIVRA en NOvAA on 20 October 2010.

⁹⁶ In principle, the Netherlands Tax and Customs Administration does not have access to tax consultants' advice files or tax reports. When tax consultants are active in the field of independent auditors then the regulations governing independent auditors also govern tax consultants. The regional audit/monitoring or procedural law technical consultants can be contacted about any questions, comments or problems relating to the inspection of auditor's files or other relevant files.

21. Cooperation between the Customs Administration of the Netherlands and Netherlands Tax and Customs Administration in the field of horizontal monitoring

Introduction

This Section briefly reviews Netherlands Customs' core duties, as well as the opportunities available for cooperation in horizontal monitoring. A distinction is made between the situation in which the initiative for horizontal monitoring and cooperation is taken by 'blue' and the situation in which the initiative for horizontal monitoring and cooperation is taken by 'green'.

Netherlands Customs' core duties

Netherlands Customs' has three core duties, namely:

- *Stop task*
Netherlands Customs makes sure that goods not permitted to enter the country are stopped at the border. Some goods are not allowed free entry into the Netherlands or European market. Netherlands Customs therefore takes measures, such as supervising goods movements with scanning equipment or detection gates, whereby Netherlands Customs pays particular attention to narcotics, weapons, animals suffering from an infectious disease and counterfeit goods. Netherlands Customs also 'stops' the export of certain goods, such as weapons and ammunition. These goods may not be exported, for example, to war zones or to countries subject to international sanctions.
- *Control task*
Netherlands Customs controls the correct application of European and national customs legislation. Goods from countries outside the European Union for which import duties have yet to be paid may be transported, processed and stored in the Netherlands. These are subject to regulations that ensure that the taxes are paid.
- *Levying and collecting*
In conclusion, the Netherlands Customs levies and collects taxes, namely import taxes, excise duties and consumer taxes.

The stop task and control task influence the Netherlands Custom's approach to horizontal monitoring. Netherlands Customs' horizontal monitoring has, in consultation with the business community, been formulated as follows (translated from the original Dutch):

Inspections of cross-border goods traffic carried out by the Netherlands Customs and other government bodies are based on the proprietary control mechanisms, certification, quality and safety systems within companies, groups of companies, sectors and chains, as a result of which the goods of safe and honourable companies can cross the border without impediments.

Netherlands Customs' core duties are also reflected in the form of the cooperation between the Netherlands Tax and Customs Administration and Customs Administration of the Netherlands.

Opportunities for cooperation

The opportunities available for cooperation and the form and the intensity of any such opportunities for cooperation in the horizontal monitoring process depend on a number of factors, such as:

- the client's need for a joint 'blue-green' process (the focus is on the client's needs);
- the feasibility for Netherlands Customs to reach agreements at concern level rather than at operating company level;
- the opportunities for the realisation of 'green' chains;
- the 'blue' segmentation (MSB/VLB).

The Netherlands Tax and Customs Administration and Customs Administration of the Netherlands determine the form and intensity of their cooperation on the basis of these factors. This cooperation can range from solely the use of each other's knowledge of the client and the active provision of information about each other's activities relating to the client right through to working together on the entire horizontal monitoring process.⁹⁷

⁹⁷ The ultimate form of cooperation – the complete integration of the account management teams, as is the case with the Rijnmond Oil and Gas Team and the Amsterdam Trade team – falls outside the scope of this Guide.

Initiative taken by 'blue'

Phase 1: client profile

An insight into Netherlands Customs' knowledge of the client is important when developing the client's profile and preparing the up-to-date client profile (step 0), and for this reason the account management team discusses the information about the client with Netherlands Customs. The two parties carry out a joint analysis of any variances between the two profiles. The account management team also makes an inventory of the group entity's operating companies in which Netherlands Customs play a role. When customs obligations are an issue for a number of working companies then a discussion about potentially more intensive cooperation in the horizontal monitoring process is desirable.

Phase 2: is horizontal monitoring feasible?

When cooperation would appear to be useful from the perspective of both the Netherlands Tax and Customs Administration and Customs Administration of the Netherlands then the horizontal monitoring meeting with the organisation also discusses the need for a joint 'blue/green' process. This discussion is governed by the following principles:

- the focus is on the client's needs and wishes;
- when it is decided that the process will be carried out jointly and that a covenant will be concluded then the 'blue/green' version of the compliance agreement is used;
- the organisation's lack of AEO status⁹⁸ does not constitute an impediment to the cooperation or to the conclusion of a joint compliance agreement;
- the client is completely transparent. The client's achievement of control can be carried out in phases, both for 'blue' and for 'green'. The Netherlands Tax and Customs Administration and Customs Administration of the Netherlands have understanding for the relationship and for the resultant work that will need to be carried out by the client;
- when it is decided that the cooperation will be limited to mutual exchanges of information then the 'blue' horizontal process is followed and the 'blue' compliance agreement is concluded.

Initiative taken by 'green'

Phase 1: client profile

In contrast to the 'blue' process (which, in principle, encompasses the entire group entity and all types of tax), Netherlands Customs primary focus is placed on applications for and the award of AEO status. This status is awarded at the level of the individual operating companies. When processing an operating company's application for AEO status Netherlands Customs needs to determine whether the operating company is a member of a 'blue' group entity in the MSB/VLB segment and, if so, the operating company's position in the 'blue' group entity. This information is required for the appropriate assessment of the need to recommend that the group entity submits an application for all (relevant) operating companies.

When the operating company is a member of an MSB/VLB group entity then the Netherlands Customs officer processing the AEO application contacts the Netherlands Tax and Customs Administration's client coordinator to inform the coordinator of the application and request the sharing of the two parties' client profiles.

Phase 2: is horizontal monitoring feasible?

Netherlands Customs' award of the AEO status is a suitable time for an assessment of the feasibility of further horizontalisation to encompass all types of customs tax and duty or other parts of the group entity. An initial exploration of the scope of cooperation with 'blue' took place in Phase 1. When cooperation would appear to be useful from the perspective of both the Netherlands Tax and Customs Administration and Customs Administration of the Netherlands then the horizontal monitoring meeting with the organisation also discusses the need for a joint 'blue/green' process. This discussion is governed by the following principles:

- the award of AEO status is an important indicator for 'blue' and is always entered in the client profile;
- the focus is on the client's needs and wishes;
- when the operating company is a member of a 'blue' group entity that is processed in the

⁹⁸ More information about AEO is available at www.douane.nl.

MSB/VLB segment then it is preferable not to continue with a separate further ('green') development of horizontal processing. When it is decided that the process will be carried out jointly and that a covenant will be concluded then the 'blue/green' version of the covenant is used;

- the client is completely transparent. The client's achievement of control can be carried out in phases, both for 'blue' and for 'green'. The Netherlands Tax and Customs Administration and Customs Administration of the Netherlands have understanding for the relationship and for the resultant work that will need to be carried out by the client;
- when it is decided that the cooperation will be limited to mutual exchanges of information and that solely the 'green' horizontal monitoring process will be followed then no compliance agreement will be concluded. In situations of this nature Netherlands Customs can reach agreement on a supervision scheme;
- when 'blue' processes the operating company in the SME segment then an individual horizontal monitoring process for 'blue' is not feasible. The client's attention can be drawn to the feasibility of participating in a tax service provider covenant.

Cooperation after the conclusion of an individual compliance agreement

The Netherlands Tax and Customs Administration and Customs Administration of the Netherlands each retain their supervisory responsibilities for their types of tax and duty and processes. This is also applicable to the manner in which the supervision is adjusted to the quality of the client's internal control. The two account management teams jointly endeavour to harmonise the form and intensity of their supervision to the maximum possible extent. The planning of supervision activities are determined (when possible) in consultation. The progress and evaluation meetings are held jointly whenever possible.

Annex 1: Glossary of terms and abbreviations

| Term | Explanation |
|---|--|
| ACC | Administrative/assistant client coordinator. Assists the client coordinator in the account management team. |
| Acceptable return | Within the context of supervision an acceptable return is defined as a return that complies with the legislation and regulations and is free of material errors. |
| ATK+ | Individual account management application, used as the permanent file for each of our clients in the MSB and VLB segments. |
| Authorised Economic Operator (AEO) | Enterprises involved in international trade may apply to Netherlands Customs for the AEO status. This status offers them a number of benefits in international trade. The AEO status and criteria for its award are based on European legislation and regulations. |
| Client coordinator | The client coordinator is the member of the account management team who organises, directs and evaluates the individual account management. The client coordinator maintains the relationship with the client. |
| Client profile | The profile of the client the account management team builds up in ATK+ and including the organisation's activities, degree of internal control and the level of compliance. |
| Compliance | The maintenance and improvement of the taxpayers' willingness to fulfil their statutory tax obligations. |
| Compliance scan | A joint scan carried out with the client to explore the feasibility of horizontal monitoring. This is based on interviews, inspections of documents and discussions about the findings. |
| Enforcement tools | The entirety of the instruments used by the Netherlands Tax and Customs Administration in the performance of the Administration's supervision duties/enforcement duties. |
| External specialist | All parties involved in the provision of services (ranging from recommendations for and the analysis and improvement of the TCF) and the monitoring of the organisation. Consequently, the term also encompasses tax consultants and the independent auditor. |
| Formation of file | Digital or hardcopy collection of relevant documents filed and supplemented with context in a manner that enables a colleague to take over the account management, if necessary, without further explanation. |
| Horizontal meeting | The first acquaintance with an organisation, including an exploration of the feasibility of horizontal monitoring. |
| Horizontal monitoring | A form of supervision based on understanding, transparency and trust and which is founded on each party's assumption of their own responsibilities. |
| Horizontal monitoring phases | Subdivision of the horizontal monitoring process into six phases in ATK+. The objective is to provide an immediate insight into the organisation's current phase in the horizontal monitoring process and the Netherlands Tax and Customs Administration's information about the organisation. Registration is also of importance with respect to the administrative management information. |
| IKB | The MSB and VLB segments are jointly referred to with the term IKB, the abbreviation of the Netherlands for individual account management. The IKB (individual account processing information) application is used for the registration of general information about the client. |
| Internal monitoring | The audit the organisation has carried out into the design, existence and operation of the organisation's internal controls and the implementation of the learning cycle. |
| Justified trust | 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 has been collected. |
| Meta-supervision/ monitoring | The Netherlands Tax and Customs Administration's supervision of the monitoring carried out by others (including the supervision of other supervisory bodies and supervision of the quality systems of the tax service providers with whom a covenant has been concluded). |
| MSB segment | The Netherlands Tax and Administration's medium-sized organisations. |
| Netherlands Tax and Customs Administration's Audit Approach (CAB) | The Netherlands Tax and Customs Administration's overall approach to supervision, focused on determining that returns are acceptable. We then make the maximum possible use of the work that has already been carried out by the organisation and the relevant external specialists. |
| Responsive regulation | The adjustment of the method of enforcement to the motives and (absence of) willingness to comply with the regulations. |

| | |
|---------------------------|--|
| SME segment | The Netherlands Tax and Administration's small and medium-sized organisation segment. |
| Tax function | The combination of the strategy, staffing and procedures within an organisation that jointly determine the organisation's (degree of) tax control. |
| Tax service provider | External party with whom the Netherlands Tax and Customs Administration has concluded a tax service provider covenant (formerly a tax intermediary covenant). |
| TCF | The Tax Control Framework, the part of the internal control system relevant to tax processes. |
| Tone at the top | The strategy (values), activities, communication and behaviour of the management of the organisation and the Netherlands Tax and Customs Administration. |
| Transparency | The willingness and ability to be open about (relevant) tax affairs both on the part of the organisation and the Netherlands Tax and Customs Administration. |
| Understanding | The wish to understand the other and act accordingly. |
| Up-to-date client profile | The internal preparations for a horizontal monitoring process in which the account management team analyses the current client profile and explores horizontal monitoring. |
| VLB segment | The Netherlands Tax and Customs Administration's very large businesses segment. |

Annex 2: Materiality

Introduction

This Section reviews the generally prevailing materiality as imposed by the Netherlands Tax and Customs Administration as a requirement to be met by acceptable returns. The adoption of a requirement of this nature is in line with accountancy's customary practice for the auditing of financial statements.⁹⁹

The Section begins with an explanation of the relationship between the terms 'materiality' and 'acceptable return', whereby a distinction is made between 'quantitative materiality' and 'qualitative materiality', and then presents and explains the generally prevailing materiality table adopted for quantitative materiality.

Quantitative materiality in relation to acceptable returns

The term 'acceptable return' plays an important role in the Netherlands Tax and Customs Administration's supervision. The term 'acceptable return' does *not* imply that taxpayers may refrain from correcting known errors in the return below a specific amount, since the return plays an important role: its primary role is to serve as the basis for the inspector's adoption of the appropriate assessment (assessment tax) and as a payment statement for payments based on returns (self-assessment tax). For this reason the return must comply with the requirements imposed by the tax legislation and, in principle, be free of errors (or, in other words, complete and correct). Consequently, the Netherlands Tax and Customs Administration assumes that taxpayers design the processes for the preparation of tax returns in a manner that gives due regard to a tolerance of zero.

The term 'acceptable return' relates to the requirements the Netherlands Tax and Customs Administration imposes on the reliability and accuracy of returns *on the basis of the Administration's supervision*. These requirements are incorporated in the Netherlands Tax and Customs Administration's Audit Approach (CAB) and the materiality table enclosed in this Annex.

In practice, errors in financial accounting can occur even when the internal control organisation has been designed in the appropriate manner. This is also applicable to tax returns. However, pursuant to economic reality not all the errors in tax returns can or will be discovered. However, it is important that the total amount of the (potential) errors in returns does not exceed the materiality limit. A return that meets this condition is referred to as an 'acceptable return'

Consequently, materiality serves as an approval limit and acquires its significance from monitoring. The monitoring activities are designed in a manner that ensures that reasonable certainty is obtained that the presence of errors will at least be detected when the maximum expected amount of the error transgresses the materiality approval limit.

Materiality is *not* a limit below which adjustments are unnecessary. All errors that are discovered, irrespective of their financial importance, must be corrected.

Quantitative materiality can be expressed as a monetary amount. The Netherlands Tax and Customs Administration has adopted a table for this monetary amount which is enclosed and explained below.

Qualitative materiality in relation to acceptable returns

In addition to quantitative materiality in relation to acceptable returns, 'qualitative materiality' also plays an important role. This relates not so much to the monetary amount above which errors may not remain undiscovered but rather, and largely, to the significance of an error that has already been discovered.

Qualitative materiality relates to the nature of the error, in particular to the degree of culpability – such as a situation in which errors have been made intentionally, i.e. with intent or even with fraudulent intention. It is also possible that the design or existence of the administrative organisation or internal control exhibits serious shortcomings, for example because the organisation has neglected to

⁹⁹ For example, the *Handleiding Regelgeving Accountancy* ('Accountancy regulations guide', HRA) states that the standards that serve as the basis for the auditor's opinion require a reasonable degree of certainty that the financial statements in their entirety do not contain any material misstatements resulting from fraud or error (*Nadere voorschriften controle- en overige standaarden, 200 Algemene doelstellingen van de onafhankelijke accountant, alsmede het uitvoeren van een controle overeenkomstig de Standaarden*).

implement control measures for crucial points, or because the internal control has been breached with intent, as a result of which the risk of errors has been taken deliberately. The discovery of errors made with serious culpability will as such preclude the approval of returns even when the financial impact is relatively minor.

Table for generally prevailing materiality

The Netherlands Tax and Customs Administrations determines the monetary amount of materiality within the aforementioned context using the table shown below (amounts in €):

| Size of the organisation | | materiality |
|--------------------------|---------------|---------------|
| - | 300,000 | Turnover x 5% |
| 300,000 | - 500,000 | 15,000 |
| 500,000 | - 1,000,000 | 30,000 |
| 1,000,000 | - 2,200,000 | 60,000 |
| 2,200,000 | - 4,400,000 | 120,000 |
| 4,400,000 | - 8,800,000 | 180,000 |
| 8,800,000 | - 17,500,000 | 300,000 |
| 17,500,000 | - 35,000,000 | 600,000 |
| 35,000,000 | - 70,000,000 | 900,000 |
| 70,000,000 | - 140,000,000 | 1,500,000 |
| 140,000,000 | - | 3,000,000 |

Notes to the content of the table

The “size of the organisation” of a profit organisation can be based on the Netherlands turnover. The “size of the organisation” of a non-profit organisation can be based on the amount of the (operational) budget rather than the turnover. When the supervision relates to part of an group entity (for example, one company) then the “size of the organisation” is, in principle, the size of the relevant part.

The monetary amounts in the “Materiality” column are expressed in terms of expenditure (i.e., where applicable, inclusive of VAT). Consequently, the monetary amounts are explicitly *not* expressed in terms of amounts of tax. When the supervision relates to the actual tax (such as the input tax) then the materiality is determined by converting the amount of expenditure into the amount of tax. This conversion is carried out using the highest rate that can be applicable to the relevant type of tax and is rounded up to the nearest thousand euros.¹⁰⁰

Use of the table

The following is applicable to the use of the table:

- The generally prevailing materiality table as enclosed in this Annex is applicable to audits conducted by the Netherlands Tax and Customs Administration and can also be used within the context of horizontal monitoring.
- Departures from the generally prevailing materiality table are permitted solely in the following situations:
 - When the Netherlands Tax and Customs Administration carries out supervision with a greater accuracy (also referred to as ‘zooming in’) within the context of a national action: in this situation the size of the organisation, in derogation of the above, is determined on the basis of the size of the object being audited.
 - When the Netherlands Tax and Customs Administration Technical Knowledge Group has issued a special materiality table for the supervision.
 - When the supervision relates solely to Netherlands Customs duties and excise duties: in this situation the size of the organisation, in derogation from the main rule, is determined on the basis of the value of the incoming goods flow.
 - When the supervision relates solely to wage tax: in this situation the size of the organisation, in derogation from the main rule, is determined on the basis of the total amount of the payroll.
- The table for the generally prevailing materiality is also applicable to the (very) large concerns

¹⁰⁰ For example: for a profit organisation with turnover of between € 300,000 and € 500,000 the materiality expressed in VAT euros amounts to $19/119$ of € 15,000 = (rounded up to the nearest thousand euros) € 3,000.

that have their (tax) affairs in order. The prevailing materiality does not have a relation to the quality of the internal organisation.

However, the presence of an appropriate internal control organisation for the (tax) processes can result in a reduction of our supervision work. Nevertheless, this is subject to the condition that the quality of the prior information that is used must be validated.

- In addition to the aforementioned materiality, the Netherlands Tax and Customs Administration also bases the design of its supervision on the following principles:
 - a statistical reliability of 95%;
 - a tolerance that varies between 60% and 100% of the materiality and which is not allocated;
 - an expectation of zero errors, which on the basis of the Poisson distribution is equivalent to a reliability factor (R) of 3.

Annex 3: Tax function

Tax control, also referred to as the tax function, is comprised of a number of sub-processes. The sub-processes distinguished in practice are listed in the following table, together with the associated areas for attention. Not all of the sub-processes listed below are of equal relevance to the compliance aspects recognised by the Netherlands Tax and Customs Administration: for example, although the tax accounting sub-process is of relevance to the financial statements, this is of relevance to the Netherlands Tax and Customs Administration solely within the context of the preliminary consultations.

| Sub-process | Areas for attention |
|---------------------|--|
| Tax organisation | <ul style="list-style-type: none"> - Relationship between the tax objectives and organisational objectives - Duties, powers and responsibilities - Organisational and tax structure - Staffing level and training - Integration in the organisation |
| Tax accounting | <ul style="list-style-type: none"> - Tax positions in the financial statements - Tax provisions in the financial statements - Reconciliation with the financial accounts - Consolidation |
| Reports | <ul style="list-style-type: none"> - Tax section in the financial statements |
| Tax compliance | <ul style="list-style-type: none"> - Timely filing of complete and correct tax returns - Supervision and follow-up of audits - Contacts with the Netherlands Tax and Customs Administration - Documentation on adopted tax standpoints |
| Tax risk Management | <ul style="list-style-type: none"> - Organisation of tax awareness - Identification of tax risks - Settlement of tax risks |
| Planning | <ul style="list-style-type: none"> - Recognition of tax opportunities and their implementation |
| Communication | <ul style="list-style-type: none"> - Promotion of tax awareness within the organisation |
| Internal monitoring | <ul style="list-style-type: none"> - The organisation's monitoring of the tax function |
| IT | <ul style="list-style-type: none"> - Support provided by IT for the achievement of the tax objectives |

