

Tax supervision – Made to measure

Flexible when possible, strict where necessary

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Under the editorship of:

Professor Dr L.G.M. Stevens, Chairman (Erasmus University Rotterdam)

Professor Dr M. Pheijffer (Nyenrode Business Universiteit, Leiden University)

J.G.A. van den Broek (Ministry of the Interior and Kingdom Relations)

Th.J. Keijzer (Dorean Global Tax Policy B.V.)

Professor Dr E.C.J.M. van der Hel - van Dijk (Nyenrode Business University, Tax and Customs Administration)

Administrative assistance from:

M.P.L. Adriaansen (Institute for Taxation and Economics Erasmus University Rotterdam)

C.L. Gosen (Ministry of Finance)

S.J. Rozema (Ministry of Finance)

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Preface

The global economy is plunged into one crisis after another. There is continuous concern that the damage to confidence in the monetary system will result in an economic recession. The knack lies in gaining or regaining – or at least, retaining - this confidence. The current generations are, probably more than ever before, aware of the priceless value of confidence – both from a social, societal, economic, financial *and* personal perspective. When confidence is absent, mutual relationships become blocked. However, how *do* we preserve confidence in institutions, companies, governments and people...?

When viewed from this perspective it is certainly special to meet as a committee for many months to consult, study, discuss and, ultimately, submit a report on the importance of government supervision which is based on fundamental confidence and personal responsibility for and within society.

The Tax and Customs Administration introduced 'horizontal monitoring' in 2005, a form of supervision based on the principle that citizens, businesses and institutions should be called to account more for their personal responsibilities – and that the Tax and Customs Administration and taxpayers have a mutual interest in the development of a relationship based on trust that avoids an unnecessarily heavy supervisory burden, complex discussions and retrospective adjustments. This is a pioneering supervisory approach: the Tax and Customs Administration deserves praise for its courage in initiating an operation of this nature, which has an impact on every facet of its supervisory philosophy. The time has now arrived for a review of the advantages and disadvantages that accompanied the introduction of horizontal monitoring and of the opportunities for horizontal monitoring's development.

Following a review of the effectiveness, efficiency and legitimacy of horizontal monitoring, the Committee has come to the conclusion that the introductory process that was primarily based on intuition is now in urgent need of supplementing it with rational management based on valid empirical information. Trust, on its own, is too weak a basis: *justifiable* trust is required, trust which is also retained in completely transparent relationships.

Within this context the Tax and Customs Administration has, in its administrative enthusiasm and fervour, underestimated issues such as the consequences – and, and above all, the complications – of the rollout of horizontal monitoring to include the SME segment. Nor has horizontal monitoring in all segments received the necessary support from information systems which provide for the selection of the appropriate supervisory instruments and for the measurement of the effects and efficiency of the compliance processes. In view of the above, it is debatable whether this approach will result in the achievement of the intended win-win situation.

The Committee is convinced, in part on the basis of developments outside the Netherlands, that the concept of horizontal monitoring is the appropriate approach to be adopted, in particular for the group of (very) large businesses. The Tax and Customs Administration introduced the new supervisory tool with passion and fervour, an approach appropriate to a major change in policy. The time has now arrived – in part in view of the current economic context – for a review or re-review, nuancing and reassessment of horizontal monitoring. The Tax and Customs Administration also appreciates this need. Horizontal monitoring is one of a broad range of supervisory instruments the Tax and Customs Administration employs for what it now refers to as its 'compliance risk management strategy': it is appreciated that horizontal monitoring may not be approached as a standalone operation but should be regarded, alongside vertical supervision, as an element of a balanced enforcement policy – or, in other words, horizontal monitoring is not *the* supervisory instrument but *a* supervisory instrument.

The Committee's findings and comments are based on the observations and experiences currently available. Arriving at the conclusion that a new approach will need to be adopted is always easier when looking back rather than ahead. For this reason the Committee wishes its comprehensive inventory of horizontal monitoring's current bottlenecks and vulnerabilities to be perceived as support for the fulfilment of horizontal monitoring's promise.

The Chairman, on behalf of the Committee,

Leo Stevens

Contents

1	The tasks assigned to the Committee and its approach to the tasks	11
1.1	Introduction	11
1.2	Appointment of the Tax and Customs Administration Horizontal Monitoring Committee	11
1.3	The Committee's approach and procedure	13
1.4	The use of the 'horizontal monitoring' term	14
1.5	Layout of this report	14
2	Social developments that gave cause to the introduction of horizontal monitoring	17
2.1	Introduction	17
2.2	Opinions on government's role in society	17
2.2.1	Introduction	17
2.2.2	Increasing regulatory pressure, heavier supervisory burden	18
2.2.3	The Scientific Council for Government Policy's 'De toekomst van de nationale rechtsstaat' ('Future of the national constitutional state') report	18
2.2.4	Developments in corporate governance	19
2.2.5	Socio-psychological opinions on government supervision	20
2.3	Principles of appropriate supervision	20
2.3.1	Introduction	20
2.3.2	The government frameworks for supervision	20
2.3.3	Six principles of appropriate supervision	21
2.3.4	'Selective' and 'decisive' in relation to 'justifiable trust'	21
2.3.5	The 'autonomous' principle	22
2.4	Horizontal monitoring and the Tax and Customs Administration	23
2.5	Conclusions	24
3	Development of and policy governing horizontal monitoring	27
3.1	Introduction	27
3.2	Reasons for and background to horizontal monitoring	27
3.2.1	The starting shot for horizontal monitoring	27
3.2.2	The business community's criticism of the Tax and Customs Administration's supervisory process	28
3.2.3	Regulatory pressure	28
3.3	History of horizontal monitoring	29
3.3.1	Introduction	29
3.3.2	Very Large Businesses segment	29
3.3.3	Medium-Sized Businesses segment	31
3.3.4	Small and Medium-Sized Enterprises segment	32
3.4	The Tax and Customs Administration's horizontal monitoring policy principles and their implementation	33
3.4.1	Introduction	33
3.4.2	Permanent duties, general policy objective and compliance risk management	34
3.4.3	Segments	36
3.4.4	Compliance agreements	37

	3.4.4.1	Introduction	37
	3.4.4.2	Individual compliance agreements with businesses in the Very Large Businesses and Medium-Sized Businesses segments	37
	3.4.3.3	Compliance agreements with financial service providers and sectoral organisations	39
	3.4.5	Steps in the process and the phase model for the Very Large Businesses/ Medium-Sized Businesses segments	40
	3.4.6	Tax control framework	43
	3.4.7	Onion skin model	44
3.5		The Committee's conclusions on the horizontal monitoring policy	45
3.6		Horizontal monitoring in practice: bottlenecks and vulnerabilities	47
	3.6.1	Introduction	47
	3.6.2	General	47
	3.6.3	Very Large Businesses segment	51
	3.6.4	Medium-Sized Businesses segment	52
	3.6.5	Small and Medium-Sized Enterprises segment	53
3.7		The Committee's conclusions on horizontal monitoring's performance	54
4		Effectiveness and efficiency	57
4.1		Introduction	57
4.2		The Tax and Customs Administration's results measurements	57
	4.2.1	Results measurement, general	58
	4.2.2	Horizontal monitoring result measurements	62
	4.2.3	Adjusted supervision and meta-supervision	63
	4.2.4	Tax Monitor and segment monitoring	65
	4.2.5	Opinions of the Tax and Customs Administration staff (survey conducted by the Tax and Customs Administration)	66
	4.2.6	The Committee's conclusions on the methods the Tax and Customs Administration has implemented to measure effectiveness and efficiency	67
4.3		A more detailed review of effectiveness and efficiency	68
	4.3.1	Introduction	68
	4.3.2	Definitions	69
	4.3.3	The Committee's approach	72
	4.3.4	Has horizontal monitoring gained support (acceptance)?	73
	4.3.5	Has the Tax and Customs Administration provided the expected benefits?	74
	4.3.6	Release of capacity for vertical supervision	76
	4.3.7	Effect on tax revenues	77
	4.3.8	Performance indicators	77
	4.3.9	Opinions of the Tax and Customs Administration's staff	80
4.4		Capacity planning	81
	4.4.1	Introduction	81
	4.4.2	Current Situation	82
	4.4.3	The Tax and Customs Administration's ambition	84
	4.4.4	Savings and investments	86
4.5		The Committee's conclusions	88

5	The legitimacy of horizontal monitoring	91
5.1	Introduction	91
5.2	Legal integration in practice	92
5.3	The Tax and Customs Administration's organisation	93
5.4	General tax law framework	95
5.5	The legitimacy of horizontal monitoring	96
5.5.1	Horizontal monitoring and legal equality	96
5.5.2	Horizontal monitoring and legal certainty	97
5.5.3	Horizontal monitoring and legal protection	98
5.6	The financial service provider's position	99
5.7	Conclusions	100
6	Horizontal monitoring from the international perspective	105
6.1	Introduction	105
6.2	OECD and EU	105
6.2.1	Developments	105
6.2.2	OECD	106
6.2.3	EU	107
6.3	Enhanced relationships in individual countries	108
6.3.1	OECD	108
6.3.2	EU	109
6.4	The business community's practical experience with enhanced relationships	111
6.4.1	Introduction	111
6.4.2	The UK business community's experiences	112
6.4.3	The Swedish business community's experiences	113
6.5	Points for attention revealed by the evaluation of the states consulted in the survey	114
6.6	Conclusions	115
7	Summary, conclusions and recommendations	119
7.1	The tasks assigned to the Committee	119
7.2	Evaluation and assessment of the Tax and Customs Administration's policy change	119
7.3	Bottlenecks and vulnerabilities	126
7.4	Proposals for the further development of horizontal monitoring and effect measurement	131
	Literature	137
	Annex 2 Introduction to the minutes of the round-table discussions	141

Chapter 1 The tasks assigned to the Committee and its approach to the tasks

1.1 Introduction

The Tax and Customs Administration introduced a new form of supervision of taxpayer compliance with tax obligations in 2005: 'horizontal monitoring'. In that same year, the State Secretary of Finance introduced the new supervisory philosophy in a letter to the House of Representatives of the States-General in which he announced a pilot with some twenty Very Large Businesses.¹ On the completion of this pilot horizontal monitoring was rolled out to other members of the Very Large Businesses segment and then to the Medium-Sized Businesses segment. This was followed by the introduction of a variant of horizontal monitoring, via intermediary organisations, in the Small and Medium-Sized Enterprises segment (hereinafter also referred to as the 'SME' segment).

The introduction of horizontal monitoring marks a major cultural change in the manner in which the Tax and Customs Administration gives shape to the performance of its core duties of 'assessing', 'auditing' and 'collecting' taxes. The Tax and Customs Administration concludes agreements with individual businesses in the profit sector, individual organisations in the non-profit sector and financial service providers² in the SME segment, which are based on mutual trust, understanding and transparency and which lay down the required attitude and tax behaviour, as well as the manner in which supervision is conducted and the intensity of the supervision.

The Tax and Customs Administration is of the opinion that the time is ripe for an evaluation of the developments relating to horizontal monitoring and the results that have been achieved. What has horizontal monitoring achieved? What is the effect on the taxpayers' willingness to comply with their obligations? What is the effect on tax revenues? And what are the opportunities for its further development? The House of Representatives of the States-General also submitted a specific request for an evaluation of this nature.³ The State Secretary for Finance appointed an external committee to carry out this evaluation.

1.2 Appointment of the Tax and Customs Administration Horizontal Monitoring Committee

The State Secretary for Finance issued a resolution on 10 November 2011 which appointed the **Tax and Customs Administration Horizontal Monitoring Committee** (hereinafter referred to as the 'Committee').⁴

The members of the Committee are as follows:

- a. Professor Dr L.G.M. Stevens, also Chairman
- b. Professor Dr M. Pheijffer
- c. J.G.A. van den Broek
- d. Th.J. Keijzer
- e. Professor Dr E.C.J.M. van der Hel - van Dijk.

1 The State Secretary for Finance's letter of 8 April 2005 to the House of Representatives of the States-General, *Parliamentary Documents II* 2004/05, 29 643, no. 4.

2 The Tax and Customs Administration employs the concept of 'tax service provider' which, in the Committee's opinion, is less pure: the use of the word 'tax' is a less fortunate choice within the horizontal monitoring context since accountants are involved alongside tax specialists and accountants are not in the first instance tax service providers. For this reason the Committee gives preference to the term 'financial service providers'.

3 General discussions between the Standing Committee for Finance and the State Secretary for Finance, 13 January 2011, *Parliamentary Documents II* 2010/11, 31 066, no. 100.

4 Netherlands Government Gazette, 6 December 2011, no. 21825; the Committee took up its duties on 15 November 2011. The appointment resolution is enclosed in Annex 1 to this report. The annexes are included in a separate section of this report.

The Committee receives administrative assistance from:

- a. M.P.L. Adriaansen (Secretary)
- b. C.L. Gosen (Administrative Secretary)
- b. S.J. Rozema (Administrative Secretary)

The Committee was assigned the following tasks:

- I. to evaluate the horizontal monitoring conducted by the Tax and Customs Administration since 2005, and to submit an opinion on the policy change implemented at the time for the adoption of this new approach,
- II. to identify any bottlenecks in and vulnerabilities of this approach,
- III. to submit proposals for the further development of horizontal monitoring in Very Large Businesses, Medium-Sized Businesses and the Small and Medium-Sized Enterprise (SME) segments, as well as to submit proposals for the effect measurement procedure.

The appointment resolution is enclosed in Annex 1 to this report.

The study was to provide an insight into the question whether horizontal monitoring results in effective and efficient supervision and to arrive at options for the further development of this supervisory instrument. The study then needed to include an inventory of bottlenecks in and vulnerabilities of the adopted approach: it will need to identify points for improvement which, in this context, the Committee understands as the adjustment and enrichment of horizontal monitoring.

The tasks assigned to the Committee have been detailed further in the following questions to be addressed by the study:

Re I. Policy

- Which principles were adopted for the formulation of the policy?
- Were these principles observed on the implementation of the policy? Are these principles still valid?
- How does horizontal monitoring fit in the range of the instruments that the Tax and Customs Administration has at its disposal to promote compliance with tax legislation and combat non-compliance?

Re II. Bottlenecks and vulnerabilities

- How do the various stakeholders (taxpayers, consultants, science and the Tax and Customs Administration) experience the implementation of horizontal monitoring in practice and which bottlenecks (including legal bottlenecks) and vulnerabilities do they perceive?
- What contribution does horizontal monitoring make to the effectiveness and efficiency of supervision? How are the effectiveness and efficiency measured?

Re III. Proposals

- The submission of proposals for the further development of horizontal monitoring, in particular with respect to effect measurements.

1.3 The Committee's approach and procedure

General

The Committee has explored the issue from a broad perspective. During the first phase of the study the Committee consulted the relevant documentation (records of policy objectives and evaluations in business reports) and collected the various opinions of the stakeholders (taxpayers, financial service providers and the Tax and Customs Administration's staff and management) and of academics. Interviews were also held with supervisory authorities. In addition, the Committee made use of Internet consultations and arranged for a survey amongst Tax and Customs Administration staff. The Committee used this information to draw up its findings and formulate its conclusions. The draft report was then submitted to the Tax and Customs Administration for the correction of factual errors and the Committee then made any necessary amendments to the report. The final report (in hardcopy) was submitted to the State Secretary for Finance and published on the Internet at <http://www.rijksoverheid.nl/ministeries/fin>. The Committee's various activities are explained briefly below.

Round-table discussions

Round-table discussions were held with taxpayers (representatives from (Very) Large Businesses, Medium-Sized Businesses and the non-profit sector, financial service providers (umbrella organisations of tax specialists and accounts, and specialists in the governance field), the academic community and the Tax and Customs Administration's staff and management. Meetings were also held with the Tax and Customs Administration's management team, Customs Directorate, representatives from businesses with an in-house customs department and the Director of the Fiscal Information and Investigation Service. The parties invited to take part in the round-table discussions were requested to prepare a position paper in advance of the meeting in which they stated their experiences with horizontal monitoring, the bottlenecks they encounter in practice, potential risks and any suggestions they might have for improvements in the opportunities for the use of horizontal monitoring. All minutes of these meetings were submitted to the participants for approval. The minutes and the participants' position papers are enclosed in Annex 2 to this report. This Annex includes a separate summary drawn up by the Committee, together with a list of findings and issues requiring attention that were intended to serve as a guideline for the Committee when it drew up its report.

Interviews

Interviews were held with the various Dutch supervisory authorities of relevance to the study. Interviews were held with the Inspection Council, Netherlands Competition Authority (NMa), Independent Post and Telecommunications Authority (OPTA), De Nederlandsche Bank (DNB), Social Affairs and Employment Inspectorate SZW, Netherlands Food and Consumer Product Safety Authority (NVWA), the Transport, Public Works and Water Management Inspectorate (IVW), Netherlands Authority for the Financial Markets (AFM) and the Netherlands Court of Audit. The minutes of these interviews were also submitted to the interviewees for approval. The minutes of these interviews are enclosed in Annex 3, together with the Committee's summary, findings and conclusions.

Internet consultations

The Committee also made use of Internet consultations: during the period between 24 January and 24 February 2012 citizens, businesses and institutions were offered an opportunity to state their experiences or opinions of horizontal monitoring. A total of 55 responses were received. Annex 4 contains a summary of the responses together with the Committee's findings and conclusions.

Survey of Tax and Customs Administration staff

The Committee arranged for a survey to be held amongst the Tax and Customs Administration staff active in the Very Large Businesses and Medium-Sized Businesses segments and in the Small and Medium-Sized

Enterprises (SME) segment who are entrusted with horizontal monitoring, supplemented with members of staff drawn from a random sample of other SME segment staff. The survey was held during the period between mid-January and mid-February. The survey encompassed more than potential 3,500 respondents, of whom more than 60% took part in the survey. The staff were requested to state their experiences and opinions of horizontal monitoring. Annex 5 contains the final report from the survey and the Committee's summary, findings and conclusions.

International context

Literature and documents were studied to draw up a review of international developments in supervision and of the horizontal monitoring systems and procedures employed by states other than the Netherlands. All the tax authorities in these states were requested to respond to the contents of this review and were offered an opportunity to submit points for attention to the Committee. Annex 6 contains the associated descriptions of these states. Telephone calls were also made with representatives from large businesses in the UK and Sweden to assess the situation in the international business community.

Literature study

The Committee completed the survey of horizontal monitoring by examining a variety of policy documents and publications. A summary of these is enclosed in Annex 7.

Business plans and management reports

The Tax and Customs Administration's Business Plans and Management Reports contain a certain explanation of the sequential policy steps taken in the implementation of horizontal monitoring. The Committee has included a brief historical summary of this information in Annex 8.

List of agreements

Annex 9 contains a list of the agreements concluded to date. The publication of these agreements increases the insights into the elements of the line of behaviour that, in the opinion of the partners to the agreements, should be prescribed by those agreements. The publication of these agreements also provides an insight into their diversity.

1.4 The use of the 'horizontal monitoring' term

At this early stage it already became clear that many partners to the discussions were of the opinion that the adoption of the 'horizontal monitoring' term was an unfortunate choice as viewed from a legal perspective. This was stated by parties including the supervisory authorities and various participants to the round-table discussions. Since its statutory duty to levy taxes provides the government a power monopoly it does not, as such, operate on a basis of equality with its citizens. Consequently, 'horizontal' does not portray the relationships correctly. 'Monitoring' also needs to be defined in more explicit terms, since the Tax and Customs Administration performs a primarily implementing duty. These issues are discussed in more detail in Chapter 2.

1.5 Layout of this report

Chapter 1, the introductory chapter, reviews the Committee's appointment, the tasks assigned to the Committee and the Committee's approach to these tasks and its procedures.

Chapter 2 reviews general developments in opinions on the relationship between society and government. This Chapter also examines the extent to which the procedures and instruments forming part of the Tax and Customs Administration's 'horizontal monitoring' are compatible with national developments in the field of state supervision.

The first part of Chapter 3 discusses the history of the emergence of the Tax and Customs Administration's horizontal monitoring concept and the policy viewpoint and principles that were derived from this development. The second part assesses horizontal monitoring in practice, with a breakdown by segment.

Chapter 4 reviews the issues relating to horizontal monitoring's effectiveness and efficiency. In the first part of this Chapter the Committee examines the manner in which the Tax and Customs Administration gives shape to effectiveness and efficiency measurements. The second part of the Chapter states the Committee's view of effect measurements and continues with a substantive assessment of the effectiveness and efficiency of the Tax and Customs Administration's horizontal monitoring.

Chapter 5 addresses the integration of horizontal monitoring in the tax system's statutory framework. The Committee also examines whether the manner in which horizontal monitoring has been given shape complies with the legitimacy requirements on which the Tax and Customs Administration's procedures need to be based.

Chapter 6 examines developments in horizontal monitoring as viewed from the perspective of international developments in tax supervision. This Chapter also assesses whether the development towards horizontal monitoring taking place within the Tax and Customs Administration is as such compatible with international developments in supervision.

Chapter 7 contains the summary and the Committee's findings and conclusions.

Chapter 2 Social developments that gave cause to the introduction of horizontal monitoring

2.1 Introduction

This Chapter reviews the following question to be addressed by the study:

Was the Tax and Customs Administration's 2005 decision to opt for 'horizontal monitoring' understandable?

A distinction is then made between the following sub-questions:

1. To what extent are the procedures and instruments the Tax and Customs Administration has developed within the 'horizontal monitoring' context since 2005 compatible with the then developments in the relationship between society and government?
2. To what extent are these procedures and instruments compatible with the general state supervision policy?

Before proceeding to the actual evaluation of horizontal monitoring in the following Chapters, the Committee begins by placing the Tax and Customs Administration's horizontal monitoring within a broader social context (Paragraph 2.2). The objective is to assess whether the 2005 decision to proceed to the introduction of 'horizontal monitoring' was understandable. An important part of the aforementioned context is comprised of the national developments in supervision (Paragraph 2.3). Although the Tax and Customs Administration is an implementing organisation and not a (pure) supervisory authority, supervision nevertheless forms a substantial and essential element of its operations. Within this context the principles on which the general state supervision policy is based are of relevance to the evaluation of the Tax and Customs Administration's supervisory policy. Paragraph 2.4 makes this link with the Tax and Customs Administration on the basis of social and national developments. Paragraph 2.5, the last Paragraph, contains conclusions which answer the questions to be addressed by this Chapter of the study.

2.2 Opinions on government's role in society

2.2.1 Introduction

At the beginning of the first decade of this century the Tax and Customs Administration came to appreciate that it would be impossible to continue on the basis of the old working methods. The growth in the number of taxpayers, volume of goods traffic (Customs) and (later) the number of persons entitled to benefits (*note for translation: benefits paid out by tax and customs administration*) was increasingly incompatible with the traditional working methods comprised of solely retrospective inspections of tax returns and business accounts and taking punitive action in the event of established non-compliance with the regulations. The implementation burden imposed on the Tax and Customs Administration increased, as did the administrative burden imposed on taxpayers.

The Tax and Customs Administration was not the sole government authority to be confronted with problems of this nature: they also confronted every government authority, as is illustrated by a series of developments, reports and policy programmes, a number of which are reviewed briefly to the extent that they are of relevance to this study.

2.2.2 Increasing regulatory pressure, heavier supervisory burden

During recent decades a number of social developments have increased the regulatory pressure and, as a result, the supervisory burden. One important factor in these changes was the development of the welfare state and the socially engineered society. Regulations were then regularly employed as a control instrument, which resulted in an increase in the regulatory pressure. Endeavours have been made to reduce this pressure.⁵ These endeavours exhibited – and exhibit – two dimensions, namely a *quantitative* dimension (the reduction of the number of regulations) and a *qualitative* dimension (the improvement of the quality of the regulations).⁶ The tax legislation was also increasingly deployed in an instrumental manner. This resulted in a substantial increase in the number of regulations and an increasingly complex tax system. This complexity increased further in the years since 1992, due to European developments with the associated freedom of persons, goods, services and capital, as well as to the global developments accompanying the intensification of international trade.

In parallel to this, citizens increasingly act as ‘consumers’. The government had already responded to this in the nineteen-eighties by mirroring itself to the business community. The government began to adopt and take ‘customer-oriented’ attitudes and actions, often with the support of automated processes.⁷ In the nineteen-nineties, government’s image began to suffer damage caused by this business approach and neglect of the accountability processes.⁸ More recently, this has been accompanied by criticism that citizenship and constitutionality were fading into the background, a criticism made by persons including Mr Tjeenk Willink, former Vice-President of the Council of State: He emphasised that the government is not a business.⁹ The National Ombudsman regularly stresses that virtually all complaints lodged about the government’s performance originate from disrupted communications caused by the provision of ‘systematic’ and anonymous services.¹⁰

2.2.3 The Scientific Council for Government Policy’s ‘De toekomst van de nationale rechtsstaat’ (‘Future of the national constitutional state’) report

The Scientific Council for Government Policy issued recommendations in its ‘*De toekomst van de nationale rechtsstaat*’ (‘Future of the national constitutional state’) report (2002) on the future of the national constitutional state from the perspective of internationalisation and individualisation. According to this report, it will be necessary to avoid society becoming entrapped in suffocating regulatory pressure. The government’s services will need to be optimised and accommodate a greater degree of self-regulation within society. This will result in a more effective and efficient government. The implementing organisations will then need to receive the necessary additional scope, by means including the application of the principle of equality.

From the Scientific Council for Government Policy’s ‘*De toekomst van de nationale rechtsstaat*’ (‘Future of the national constitutional state’) report:¹¹

5 *Programma Regeldruk Bedrijven 2011-2015, Annex to Parliamentary Documents II 2010/11, 29 515, no. 327.*

6 Stevens Committee, *Regels op maat. Slotaanbevelingen aan het kabinet voor de aanpak van regeldruk*, The Hague: 4 February 2007.

7 D. Osborne & T. Gaebler, *Reinventing government: how the entrepreneurial spirit is transforming the public sector*, New York, 1993. Derived from: I. de Haan, ‘*Parlementaire democratie en maatschappelijke organisatie: de politieke context van de Sociaal-Economische Raad*’, in: B. van Bavel et al. (Ed.), *SER 1950-2010. Zestig jaar denkwerk voor draagvlak, advies voor economie en samenleving*, Amsterdam: Boom 2010, p. 23-48.

8 A.B. Ringeling, *Het imago van de overheid. de beoordeling van prestaties van de publieke sector*, The Hague: VUGA 1993.

9 Council of State, *Jaarverslag 2005*, The Hague: 27 April 2006.

10 National Ombudsman, *De maakbare overheid. Verslag van 19 april 2006 over 2005, aangeboden aan de Tweede Kamer*, The Hague: National Ombudsman’s Office 2006. The National Ombudsman makes comparable observations in his annual report for 2011, *Een vertrouwde overheid. Verslag van de Nationale ombudsman over 2011*, The Hague: 2012.

11 Scientific Council for Government Policy, *De toekomst van de nationale rechtsstaat*, The Hague: Sdu 2002, p. 111.

“When constitutional guarantees are in place which require the government to treat everyone equally it is difficult, for example, to tackle persons who repeatedly perpetrate fraud in a manner other than the approach adopted to persons who always behave properly. In other words, the current application of the principle of equality precludes the adoption of a different approach to individual citizens exhibiting opportunistic or calculating behaviour. However, a less rigid application of the principle of equality that focuses on a differentiated approach as determined by the degree to which the citizen assumes his or her personal responsibility could offer a solution. The government could then adopt a different approach to citizens who do not assume their personal responsibility for the public interest, provided that this approach is not in any conflict whatsoever with the legal protection from the power exercised by the state and other citizens that is provided to citizens on the basis of their fundamental rights and the legislation and regulations.”

The Government’s response makes clear that the then Government agreed with the Scientific Council for Government Policy’s analysis. The Government wished to strive for a government “that exhibits greater reticence deciding to proceed to regulations; that calls more on social forces; which simultaneously provides for assurances for public interests and constitutional rights; that delivers high-quality performances when the representation of public interests cannot be assigned to the market or social institutions.”¹² These are also integrated in the *Aanwijzingen voor de Regelgeving* (‘Instructions for Regulations’).¹³

2.2.4 Developments in corporate governance

In the intervening period incidents in the business community had a great influence on the opinions on corporate governance. The major stock market scandals involving companies including Enron, Worldcom, Ahold and Parmalat developed a ‘fertile’ breeding ground for the adoption of a serious approach to the improvement of corporate governance: it transpired that the internal and external control systems of these companies did not perform adequately, an observation that resulted in the introduction of additional regulations in a large number of states.

One example is the regulations adopted in the USA, which passed the Sarbanes-Oxley Act (SOx) in 2002 that laid down regulations governing the improvement of businesses’ internal control systems. For US companies, this Act entered into force at the beginning of the financial year on or after 1 January 2004. The SOx imposes stringent requirements on the executive boards of companies listed on a US stock exchange. In general, Dutch companies with a listing on a US stock exchange were initially required to comply with the SOx as from mid-2005, although this period was subsequently extended to mid-2006. The objective of the SOx is to restore the public’s confidence in business management and accountancy.

In the Netherlands, the Corporate Governance Code, drawn up by the Tabaksblat Committee, entered into force in 2004. As a result, and in contrast to the past, the tax position of Dutch businesses was now an explicit issue requiring the executive board’s attention.

One of the important provisions of both the SOx and Corporate Governance Code states that the company’s management must issue a statement on the effectiveness of the internal control – the degree to which the business is in control – in an in control statement to be included in the annual report. Businesses may issue an in control statement solely when they have drawn up a Business or Internal Control Framework. The obligation imposed elsewhere offered the Tax and Customs Administration an opportunity: a specific category of (large) businesses was compelled to make investments in control systems, systems that the Tax and Customs Administration could take advantage of in its modification of its supervisory methods. The principle

¹² *Parliamentary Documents* II, 2004/29,643, 31 066, no. 1, p. 3.

¹³ See, in particular, Instruction 7 under c and under d.

requiring businesses of this nature to be in control formed an important cornerstone of the Tax and Customs Administration's supervisory strategy.

2.2.5 Socio-psychological opinions on government supervision

Developments in socio-psychology (for example, Kirchler, Cialdini and Braithwaite) have resulted in a change in opinions on compliance in recent years, together with the introduction of methods for influencing behaviour in government supervisory practice. It transpired that, in general, inspection frequencies and the imposition of sanctions do not exhibit a marked correlation with the degree of compliance.¹⁴

Studies have revealed that compliance is determined by intrinsic motives, extrinsic stimuli and the opportunities available for compliance and non-compliance. The intrinsic motives encompass personal and social standards.¹⁵ *Personal standards* and convictions largely determine whether an individual is or is not inclined to contravene the regulations. It transpires that these standards exert an influence on compliance which is greater than the influence of the probability of being caught and the severity of the sanctions. *Social standards* are also found to exert a great influence on compliance behaviour: individuals are more likely to fulfil their (tax) obligations when they believe that others will also fulfil *their* obligations. This social control is particularly great when those others are members of a relevant group or when the individual at least regards him or herself as a member of that group.¹⁶ It should be noted that Six states that the influence of personal and social standards is not identical for all individuals: she makes a distinction between a variety of categories of individuals which each exhibit a specific response.¹⁷ These developments offer opportunities for government supervision to exert an influence on behaviour, for example by means of powers of conviction and the enhancement of mutual trust.

2.3 Principles of appropriate supervision

2.3.1 Introduction

The developments and opinions outlined in the previous Paragraph have exerted an influence on general state supervision policy. State supervision was based on the principle of *personal responsibility* for the quality of the acts by citizens, businesses and institutions, whereby state supervision constitutes the necessary cornerstone.¹⁸ This Paragraph reviews this in more detail with the objective of assessing the extent that the Tax and Customs Administration has linked up with the developments within state supervision or, conversely, has set an independent course.

2.3.2 The government frameworks for supervision

Two government frameworks for supervision have been published in which different successive Governments laid down their general approach to supervision.¹⁹ The *De Kaderstellende visie op toezicht* ('Government framework for supervision') document published in 2001 places the emphasis on the positioning of state supervisory authorities in the field in which they operate. The second document, published in 2005 – 'Lower burden, more effect' – largely reflects the general opinions reviewed in the previous Paragraph and makes a distinction between various types of supervision. Within the context of the Committee's evaluation the definition of the type of supervision referred to as '*compliance supervision*' is of greatest importance, which is defined as the supervision of citizen and business compliance with the legislation and regulations. This supervision is primarily

14 J. Andreoni, B. Erard, & J. Feinstein, 'Tax compliance', *Journal of Economic Literature* 1998/36, p. 818-860.

15 E. Kirchler, *The Economic psychology of tax behaviour*, Cambridge: Cambridge University Press 2007.

16 M. Wenzel, 'An analysis of norm processes in tax compliance', *Journal of Economic Psychology* 2004/25, p. 213-228.

17 F.E. Six, 'Vertrouwen in toezicht', *Tijdschrift voor Toezicht* 2010/ 4, p. 6-26.

18 Final report of the Supervision II Administrative Committee, *Toezicht: naar naleving voor de samenleving*, The Hague: May 2005, Paragraph 3.5.1.

19 *De Kaderstellende visie op toezicht*, *Parliamentary Documents II* 2000/01, 27 831, no. 1; *Minder last, meer effect zes principes van goed toezicht*, annex to *Parliamentary Documents II* 2005/06, 27 831, no. 15, p. 10.

conducted by state inspectorates and market supervisory authorities.

This second ‘Lower burden, more effect’ government framework for supervision emphasises that the supervisory burden needs to be minimised and that citizens, businesses and institutions also need to bear their personal responsibility in society. The Government wishes to arrive at an adjusted relationship between government and society. “The Government and society need to appreciate, more than in the past, that the government is neither willing nor able to bear all risks. The control of risks and prevention of errors is a joint duty of both government and society.”²⁰

2.3.3 Six principles of appropriate supervision

The ‘Lower burden, more effect’ government framework for supervision formulates six principles of appropriate supervision. In the Government’s opinion supervision needs to be ‘autonomous, professional, transparent, selective, decisive and cooperative’.

The first three principles, *autonomous*, *professional* and *transparent*, focus primarily on the enhancement of the authority and legitimacy of the supervisory authorities: they date from the first government framework for supervision published in 2001. The second government framework for supervision supplements these with three new principles, *selective*, *decisive* and *cooperative*. These three principles relate primarily to the effectiveness and efficiency of supervision. All these six principles are of importance to appropriate supervision.

The potential conflicts between the principles give cause for each supervisory authority to seek an appropriate balance in its operations: for example, *transparency* may not extend to the requirement that all inspections (on-site inspections) be announced in advance since in some situations this can prove ineffective whilst in other situations this can actually be beneficial. In analogy, *selective* may not extend to a situation which results in the semblance of legal inequality, nor may the supervisory authority’s assessment be prompted by political opportunism.

Three of these principles are discussed in more detail below. For some supervisory authorities, two of the principles – *selective* and *decisive* – legitimised their decision to base their supervision on *justifiable trust* (‘horizontal monitoring’). The third principle, *autonomous*, relates to a major difference between (pure) supervisory authorities and implementing organisations of the nature of the Tax and Customs Administration. The other principles (*professional*, *transparent*, and *cooperative*) offer no new insights into the similarities and the differences between pure supervisory authorities and the Tax and Customs Administration.

2.3.4 ‘Selective’ and ‘decisive’ in relation to ‘justifiable trust’

Selective is the principle of greatest relevance to the issue addressed in this report, since the Tax and Customs Administration’s horizontal monitoring is based on the wish to adopt a selective approach to the deployment of the available supervisory capacity. This principle is also associated with the *decisive* principle. *Selective* relates primarily to the choices the supervisory authority makes in setting priorities, whilst *decisive* relates to the manner in which the authority intervenes once an irregularity has been established and is greatly inspired by socio-psychological tenets (Paragraph 2.2.5): “flexible when possible, strict when necessary.”

The selective principle relates primarily to choices made by the supervisory authorities that are based on estimated risks. The supervisory authority will then need to select the appropriate dimensioning for each situation. The resulting supervision shall, first of all, need to be *effective*: the risks must be ‘covered’ to an adequate extent. Secondly, the supervision must be *legitimate* and, above all, must not create a semblance of legal inequality. Thirdly, the supervision must be *efficient*: it must make optimum use of the available capacity

²⁰ *Minder last, meer effect zes principes van goed toezicht*, annex to Parliamentary Documents II 2005/06, 27 831, no. 15, p. 9.

in achieving the specified risk coverage. Consequently, the fulfilment of the *selective* principle gives cause to the need for careful consideration and accounting: for this reason the fulfilment of this principle requires the appropriate fulfilment of another principle of appropriate supervision, i.e. *transparent*.²¹

The crucial issue is then the manner in which the supervisory authority is able to make a correct estimate of the extent to which businesses are ‘bona fide’. The answer to this question is accompanied by the appearance of the ‘trust approach’ concept. This approach is based on the supervisory authority’s reduction of the degree of (vertical) supervision when the authority has justifiable trust in the supervised party’s assumption of the personal responsibility for compliance with the regulations. The supervisory authority then makes use of structurally acquired knowledge of and about the supervised parties: the supervisory activities focused on acquiring this knowledge are referred to as *meta-supervision* or *system supervision*.

Meta-supervision and system supervision

The terminology continues to be employed in an inconsistent manner. We concur with the Netherlands Court of Audit, which makes use of the term ‘meta-supervision’ for “supervision which relies on the supervision results of others.”²²

The government framework for supervision (2001) defines the term ‘meta-supervision’ as “supervision focused on reviewing the performance and quality of horizontal instruments and internal control instruments.”²³ Borghouts defines the term more precisely: “(...) meta-supervision, also referred to as system supervision by others, (...) is the supervision of systems and processes whereby the substance – the product or the result – is no longer the primary objective of the inspection.”²⁴ He is of the opinion that internal quality systems play a major supporting role for meta-supervision.

Helderman & Honigh refer to this form of supervision as ‘system supervision’²⁵, as does the Netherlands Court of Audit: “system-oriented supervision is a form of direct supervision which can be distinguished from data-oriented supervision, in continuation from accountants who conduct system-oriented and/or data-oriented audits.”²⁶

2.3.5 The ‘autonomous’ principle

Supervisory authorities must avoid every semblance of partiality: pursuant to this requirement, they may not show favour to a supervised party above others (legal equality) and must operate largely in autonomy from the minister bearing the due responsibility. For this reason market supervisory authorities have been given the form of independent administrative bodies and state inspectorates are provided organisational and legal assurances for their autonomy.

The government framework for supervision, 2005, states the following about autonomy: “Supervisory authorities operate within the demarcations of ministerial responsibility: their material autonomy is primarily manifested by the manner in which they give shape to their role and their procedures within those demarcations. Society must be able to rely on autonomous assessments by supervisory authorities. It is proper

21 *De Kaderstellende visie op toezicht, Parliamentary Documents II 2000/01, 27 831, no. 1; Minder last, meer effect zes principes van goed toezicht, annex to Parliamentary Documents II 2005/06, 27 831, no. 15, p. 41.*

22 *Netherlands Court of Audit, Systemen van checks and balances bij rechtspersonen met een wettelijke taak. Background study for the study ‘Verantwoording en toezicht bij rechtspersonen met een wettelijke taak, deel 3’, The Hague: Netherlands Court of Audit 2002, p. 5.*

23 *De Kaderstellende visie op toezicht, Parliamentary Documents II 2000/01, 27 831, no. 1.*

24 *H.C.H.L. Borghouts, ‘Perspectieven voor de effectiviteit en geloofwaardigheid’, Bestuurskunde 2002/3, p. 140.*

25 *J.K. Helderman & M.E. Honigh, Systeemtoezicht. Een onderzoek naar de condities en werking van systeemtoezicht in zes sectoren, The Hague: Boom juridische uitgevers 2009, p. 16.*

26 *Netherlands Court of Audit, Systemen van checks and balances bij rechtspersonen met een wettelijke taak. Background study for the study ‘Verantwoording en toezicht bij rechtspersonen met een wettelijke taak, deel 3’, The Hague: Netherlands Court of Audit 2002, p. 5.*

that supervisory authorities can disclose information about abuses to the public. Supervisory authorities can do so only when they can collect information in autonomy and form their assessment on the basis of that information.”²⁷

2.4 Horizontal monitoring and the Tax and Customs Administration

The Tax and Customs Administration defines horizontal monitoring as follows: “horizontal monitoring refers to mutual trust between the taxpayer and the 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.”²⁸

The term ‘horizontal monitoring’ as employed by the Tax and Customs Administration encompasses both the *working relationship* between the Tax and Customs Administration and the taxpayer/financial service provider and the *manner* in which the supervision is given shape. The Tax and Customs Administration reviews the acceptability of a return by making the maximum possible use of the ‘in-house’ supervision (internal control and internal audits) conducted by large businesses and/or financial service providers and the external supervision of this in-house supervision.

Over the course of the years the meaning of ‘horizontal monitoring’ has been stretched further and further. In contrast to the initial years, when the parties to agreements with the Tax and Customs Administration were individual businesses, in later years these agreements were also concluded with financial service providers and sectoral organisations and, ultimately, the Tax and Customs Administration came to regard agreements that were concluded with suppliers of financial software as agreements concluded within the scope of horizontal monitoring. This development is discussed in more detail in Paragraph 3.3.4.

Some authors and participants in the round-table discussions organised by the Committee were of the opinion that ‘horizontal monitoring’ is an odd combination of terms.²⁹ The Netherlands Court of Audit avoids this combination of terms and refers to ‘horizontal accountability’.³⁰

The *Expertise Centrum voor Rechtspleging en Rechtshandhaving* (‘Administration of Justice and Law Enforcement Centre of Expertise’) defines horizontal monitoring as a “form of social control: *non-government* control focused on the improvement of the quality of products and services within specific professional groups or business sectors, such as professional codes of conduct, certification and seals of approval.”³¹ ‘Vertical’ supervisory authorities need to conduct less intensive (vertical) supervision when businesses are engaged in ‘horizontal monitoring’. Businesses submit themselves to this latter form of supervision more-or-less voluntarily: they can, for example, seek certification from a certification body (and pay for the certification) or take part in examinations (audits, inspections) organised by their umbrella organisation.

27 *Minder last, meer effect zes principes van goed toezicht*, annex to Parliamentary Documents II 2005/06, 27 831, no. 15, p. 41.

28 The State Secretary for Finance’s horizontal monitoring letter of 8 April 2005 to the House of Representatives of the States-General, *Parliamentary Documents II 2004/05*, 29 643, no. 4.

29 For example, Van Montfoort regards ‘horizontal monitoring’ as the politically correct term for risk analysis since ‘trust’ actually refers to the low probability of detection. C.J. van Montfoort, ‘Ontwikkelingen in toezicht en verantwoording bij instellingen op afstand. Een terugblik en een blik in de toekomst’, *Tijdschrift voor Toezicht* 2010/1, p. 6-20.

30 Netherlands Court of Audit, *Systemen van checks and balances bij rechtspersonen met een wettelijke taak*. Background study for the study ‘Verantwoording en toezicht bij rechtspersonen met een wettelijke taak, deel 3’, The Hague: Netherlands Court of Audit 2002, p. 5; and, more recently: Netherlands Court of Audit, *Gebruik van horizontale Verantwoordingsinformatie. RWT-verkenningen deel 3*, The Hague: Netherlands Court of Audit 2011, p. 10.

31 Ministry of Justice, *De ‘Tafel van Elf’ een veelzijdig instrument*, The Hague: Expertisecentrum Rechtspleging en Rechtshandhaving 2006.

State supervisory authorities that employ the term ‘horizontal supervision’ usually do so in accordance with the definition formulated by the *Expertise Centrum voor Rechtspleging en Rechtshandhaving*.³² However, the Tax and Customs Administration’s usage is not in agreement with this definition and, consequently, can give cause to confusion. The term the Tax and Customs Administration uses for large businesses and financial service providers comes closest to the term ‘trust approach’ used by the state supervisory authorities.

The Committee has established that the terminology used in this field is not uniform. For pragmatic reasons the Committee has adopted the Tax and Customs Administration’s terminology, although the Committee draws the line at agreements concluded with individual taxpayers and financial service providers. Consequently, the Committee’s report does not regard the relatively recent conclusion of agreements with sectoral organisations and software developers as falling within the scope of horizontal monitoring, because these parties cannot reasonably be called to account for the review of the acceptability of returns filed by the members of their sectoral organisation and/or users of their software or for the performance of supervisory duties.

The tax inspector as an administrative authority

The Tax and Customs Administration is an implementing organisation: the fact that this implementation is accompanied by a substantial supervisory task does not make the Tax and Customs Administration a ‘pure’ supervisory authority, as a result of which at least the *autonomous* principle from the government framework for supervision is given a different shape within the Tax and Customs Administration. Specific assurances are in place for the autonomous operations of the Tax and Customs Administration: for example, the drafting of tax legislation (Directorate-General for Tax & Customs Policy & Legislation) is segregated from the implementation (the Tax and Customs Administration), although this autonomy has not been implemented as consistently as with “pure” supervisory authorities. The determination of the assessment and the inspection to verify that the taxpayer has filed a correct return is entrusted to one administrative authority, the tax inspector. On occasion, this results in discussions about the discretionary scope available to the administrative body (for the tax inspector: the ‘freies Ermessen’) relating to values such as legal equality, legal certainty and legal protection, although these issues can be resolved. This theme is a point for attention in this Chapter. Later in this report (Chapter 5) the Committee shall assess whether the introduction of horizontal monitoring and the involvement of the inspector in horizontal monitoring is in sufficient constitutional balance.

2.5 Conclusions

- The Tax and Customs Administration’s 2005 decision to introduce ‘horizontal monitoring’ is compatible with the opinion of various Governments which held that citizens, businesses and institutions should be called to account more for their personal responsibilities and is, consequently, understandable. Most state supervisory authorities have invested in comparable approaches and, in doing so, have given shape to the principles governing appropriate supervision by the government since the introduction of the second ‘Lower burden, more effect’ government framework for supervision in 2005.
- The Tax and Customs Administration employs the term ‘horizontal monitoring’ whilst various state supervisory authorities refer to ‘trust approaches’ and to ‘system and meta-supervision’. In addition, the Committee has established that the Tax and Customs Administration has stretched the meaning of its ‘horizontal monitoring’ term too far over the course of the years. For pragmatic reasons the Committee has decided to adopt the Tax and Customs Administration’s terminology for this report, although the Committee draws the line at agreements concluded with taxpayers and financial service providers. Consequently, the Committee does not regard the agreements concluded with software developers and sectoral organisations as falling within the scope of horizontal monitoring, because these parties *cannot*

³² Now some Tax and Customs Administration management staff have transferred to state supervisory authorities the Tax and Customs Administration’s terminology would appear to be spreading to other organisations. See also the minutes of the interviews held with officers from various state supervisory authorities.

reasonably be called to account for the acceptability of returns and/or the performance of supervisory duties.

Chapter 3 Development of and policy governing horizontal monitoring

3.1 Introduction

The previous Chapter outlined the social developments that gave cause to a change in opinions on supervision, where horizontal monitoring was placed in the national supervisory context. This Chapter focuses on the Tax and Customs Administration's supervision. Paragraph 3.2 reviews the reasons for and background to the Tax and Customs Administration's decision to supplement its traditional (vertical) supervisory model with a more horizontal monitoring structure. Paragraph 3.3 continues with a brief history of horizontal monitoring, Paragraph 3.4 discusses the principles of the policy and their implementation by the Tax and Customs Administration, Paragraph 3.5 lists the Committee's conclusions on horizontal monitoring *policy*, Paragraph 3.6 examines the opinions and practical experiences the Committee collected from the round-table discussions, consultations with supervisory administrations and Internet consultations and the final paragraph, Paragraph 3.7, lists the Committee's conclusions on horizontal monitoring's *performance*.

This Chapter reviews the following questions to be addressed by the study:

1. Which principles were adopted by the Tax and Customs Administration for the formulation of the horizontal monitoring policy?
2. Were these principles observed in implementing the policy? Are these principles still valid?
3. How does horizontal monitoring fit in with the range of instruments the Tax and Customs Administration has at its disposal to promote compliance with tax legislation and combat non-compliance?
4. How do the various stakeholders (taxpayers, consultants, academics and the Tax and Customs Administration) experience the implementation of horizontal monitoring in practice and which bottlenecks and vulnerabilities do they perceive?

3.2 Reasons for and background to horizontal monitoring

3.2.1 The starting shot for horizontal monitoring

Chapter 2 reviewed a number of coincident developments that took place at the beginning of the first decade of this century that gave cause to the Tax and Customs Administration's appreciation of the need for a fundamental modification of its supervision strategy to respond to the changed and changing circumstances. The Tax and Customs Administration's instruments for enforcement had traditionally been increasing the probability of being caught and the greater threat of penalties. The understanding of the need to give further shape and substance to the personal responsibility borne by citizens and businesses gave cause to a modification of the compliance concept.

The 'horizontal monitoring' term was introduced in the Secretary of State for Finance's letter of 3 June 2001 to the House of Representatives of the States-General which reviewed the approach to domestic tax shelters³³, in which he announced that the Tax and Customs Administration – as a supplement to the traditional form of vertical supervision – would explore the feasibility of horizontal monitoring.³⁴ The Secretary of State had

³³ *Parliamentary Documents II 2003/04*, 29 643, No. 2.

³⁴ This letter was submitted following the consternation about the Tax and Customs Administration's approach adopted to the residents of the 'De Vinkenslag' mobile home park in Maastricht: the Tax and Customs Administration had reached agreement with the residents on the manner in which their profit was to be assessed. Agreements of this nature were qualified as being contrary to the law. The media attention's to the incident resulted in the implementation of more stringent regulations. The law must be applied strictly

expressly opted for a differentiated approach to supervision, later referred to as *compliance risk management*. In addition to implementing more stringent enforcement to combat tax avoidance and evasion, the Tax and Customs Administration is seeking forms of compliance risk management for taxpayers who fulfil all their obligations which are less stringent and do justice to their demonstrated assumption of their personal responsibility. The following excerpt is from Secretary of State's letter of 3 June 2004:³⁵

“The Tax and Customs Administration enforcement policy is based on the selection of risks and their consequences. This, in view of the enormous volume of the Tax and Customs Administration's processes, is the appropriate approach. At the same time, social developments becoming apparent in the enforcement area need to be assigned a place with the policy. The changing spirit of the times is resulting in both the wish that the government focuses more on adequate supervision and more stringent enforcement, without neglecting the quality of the provision of service, and in the need for the provision of more form and substance to the personal responsibility borne by citizens and businesses. (...) Calling on citizens to assume more personal responsibility also gives cause to new forms of compliance risk management based more on horizontal monitoring.”

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

3.2.2 The business community's criticism of the Tax and Customs Administration's supervisory process

Horizontal monitoring was in part introduced in response to the growing level of criticism of the Tax and Customs Administration's then supervisory process. Participants in discussions the Ministry of Finance/Tax and Customs Administration held on 4 June and 8 October 2004, with representatives from large businesses and the Confederation of Netherlands Industry and Employers (VNO-NCW) and the Dutch Association of Tax Advisers (NOB) respectively, stated that the Tax and Customs Administration was 'guilty' of adopting a 'them and us' mentality.³⁶ The business community was of the opinion that the Tax and Customs Administration's operations were excessively based on *distrust*. Moreover, the Tax and Customs Administration's audit process was referred to as long-winded and opaque. The yield from the inspection process was regarded as low, in part because these large organisations have already implemented thorough control procedures that create the sound control and accountability system required by their management and capital providers. This, in the opinion of the representatives from the business community, justified the expectation that irregularities would not normally be discovered in their financial processes. The representatives from large businesses governed by stock exchange supervision cannot permit themselves any dubious behaviour. The Confederation of Netherlands Industry and Employers was of the opinion that the Tax and Customs Administration's reticence in assuming that the reports are reliable results in a great deal of unnecessary duplication. The Tax and Customs Administration's management indicated their sensitivity to this criticism.

3.2.3 Regulatory pressure

As the implementation and supervision costs cannot be viewed separately from the general regulatory

(“Vinkenslagproof”).

³⁵ Parliamentary Documents II 2003/04, 29 643, No. 2, p. 3 and p. 6-7

³⁶ The relevant minutes have not been published.

pressure the search for a more adequate design of the implementation and supervision duties cannot ignore an important cause of the continually increasing regulatory pressure. The belief in the ‘makeable society’, with the associated deployment of taxation as a policy instrument when the implementation of specific measures cannot address a given situation directly has resulted in (highly) specific regulations. These regulations are often at odds with the budgetary function of taxation that is based on the fair distribution of the tax burden in society: this in turn complicates the implementation and associated supervision as compared to a single policy objective. Moreover, by very definition a complicated society results in a complicated tax system – and certainly when society’s trend towards individualisation gives cause to the need for legislators to implement customisation. Furthermore, the regulations are amended at a continually accelerating pace. All in all, these factors complicate the implementation of tax legislation and the supervision of compliance with the provisions. For this reason the government, in its role as legislator, needs to adopt a more critical and reticent attitude when deciding *what* is to be regulated and *how* it is to be regulated. When giving consideration to new regulations attention always needs to be devoted to the feasibility of their implementation and the concomitant costs.

3.3 History of horizontal monitoring

3.3.1 Introduction

The combination of the developments reviewed in Chapter 2 and in Paragraph 3.2 gave cause to the Tax and Customs Administration’s adoption of an open mind to new forms of supervision. This began with the Very Large Businesses segment. This Paragraph of the Committee’s report contains a brief historical outline of the development of horizontal monitoring, whereby a distinction is made between the Very Large Businesses, Medium-Sized Businesses and Small and Medium-Sized Enterprises segments.

3.3.2 Very Large Businesses segment

The Tax and Customs Administration had already begun discussions on the processing methods used for the Very Large Businesses segment some time earlier. A number of businesses in the Very Large Businesses are of a size such that the major (financial) consequences and associated (international) tax issues give cause to the need for account management. At the beginning of 2001, the Tax and Customs Administration decided to implement a reorganisation in which businesses in the Very Large Businesses segment were transferred to a separate division.³⁷

The implementation was based on the principle of proportional enforcement. The level and intensity of the client processing was to be tailored the risks and the financial consequences that characterise businesses in the Very Large Businesses segment. This policy proposal was then detailed in the *Policy Plan for Very Large Businesses 2003-2006* (May 2002). The principles referred to in the Policy Plan were ‘working in real time’, ‘maximum transparency’ and ‘individual customisation within the national statutory framework’.

Excerpt from the Policy Plan for Very Large Businesses 2003-2006 (May 2002):

37 The Amsterdam and Rijnmond Tax districts set up separate Very Large Businesses teams on 1 January 2003 which are jointly responsible for the permanent supervision of between 40 and 50% of the entities classified in the Very Large Businesses segment: the existing (national) target group and ruling teams continue in operation. Seven other Tax districts have set up smaller Very Large Businesses teams. Very Large Businesses teams will not be set up at a further four Tax districts.

“The client processing of very large organisations is carried out in real time. Current information obtained from sources such as business consultations, preliminary consultations and exploratory studies or from external sources (such as quarterly and annual accounts, press releases and the Internet) is reviewed to determine the tax consequences. (...) The quality of the enforcement is determined by two major elements. The first of these elements is the substantive correctness and effectiveness of the Tax and Customs Administration’s acts towards the client, which must comply with both the legislation and regulations and the prevailing policy. These acts can be effective only when they are proportional and in accordance with the principle of equality. This in turn leads to the second major element of quality, namely the uniformity of policy and its implementation. The processing of businesses in the Very Large Businesses segment is based on customisation that must lie within the prevailing national framework to provide assurances for legal equality. This requires maximum transparency in the client processing: moreover, national coordination is essential.”

Practical experience with the new working method was acquired during the following years. The Tax and Customs Administration, in part in response to the aforementioned developments, took the next step in 2005. The Secretary of State for Finance’s letter of 8 April 2005 to the House of Representatives of the States-General informed the House of the initiation of a pilot with 20 very large businesses – the majority of which were listed on the stock exchange – in which the parties would work on the basis of mutual understanding, trust and transparency.³⁸ The objective of the pilot was to conclude a compliance agreement with each business. This letter can be regarded as the kick-off for the introduction of horizontal monitoring and has, as it were, acquired constituting significance.

In the Secretary of State’s words:

“Horizontal monitoring refers to mutual trust between the taxpayer and the Tax and Customs Administration, as well as to the more precise specification of each other’s responsibilities and the options available to enforce the law and comply with the mutual agreements. As a result, the underlying relationships and communications between the citizens and government shift to a more equal situation. 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.”

The Secretary of State explained his plans during the debate with the Standing Committee for Finance in the House of Representatives of the States-General which discussed the Secretary of State’s letter of 8 April 2005. He stated that he intended to end the ‘them and us’ attitude currently governing the relationship between taxpayers and the Tax and Customs Administration. The Secretary of State, in answer to questions from members of the House of Representatives of the States-General, also emphasised that businesses participating in horizontal monitoring would not receive more lenient treatment in terms of the substantive merits of tax legislation. All businesses were to be treated equally.³⁹

During the General Financial Debate at the end of 2005, the Senate – in part urged by academics who had written articles on the issue published in academic journals – requested a copy of a compliance agreement for inspection. The Secretary of State responded to this request in his letter of 9 June 2006, which was accompanied by an anonymised version of a compliance agreement concluded with one of the enterprises.⁴⁰ The Secretary

38 Parliamentary Documents II 2004/05, 29 643, No. 4.

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

40 Parliamentary Documents I 2005/06, 30 306 and 30 307, No. H.

of State made use of this opportunity to inform the Senate that the favourable experience with the pilot had given cause to his decision to expand the project to include 20 additional businesses. The Secretary of State also stated that, pursuant to the principle governing the pilot, compliance agreements are concluded with businesses that have their tax control framework in order, which within this context is understood as businesses which comply with the requirements arising from the IFRS standards and the US Sarbanes-Oxley Act.

The pilot was evaluated in 2007. Questionnaires were submitted to the tax directors of the businesses that had concluded a compliance agreement and members of the Tax and Customs Administration's processing teams assigned these businesses. The Secretary of State for Finance informed the House of Representatives of the States-General about the outcome from the survey in his letter of 12 April 2007.⁴¹ Compliance agreements had now been concluded with almost all the businesses that had been approached to take part in the pilot and experience had been gained in the new method.⁴² The letter referred to the benefits of horizontal monitoring as working with in real time, the Tax and Customs Administration's more rapid determination of standpoints and more openness between the partners. The Secretary of State qualified the results as clearly favourable and concluded that the new method should be continued. The Tax and Customs Administration had also begun to introduce horizontal monitoring in segments other than the Very Large Businesses segment.

3.3.3 Medium-Sized Businesses segment

The Secretary of State's aforementioned letter of 8 April 2005 also devoted attention to the feasibility of introducing horizontal monitoring in the Small and Medium-Sized Enterprises segment. Consideration was being given to a modified variant for the Small and Medium-Sized Enterprises segment in which the sectoral organisations would serve as intermediaries between the enterprises and the Tax and Customs Administration. The Secretary of State was of the opinion that the size of this segment was such that individual compliance agreements would not be desirable. It should be noted that at the time all other taxpaying businesses were classified in the Small and Medium-Sized Enterprises segment: a differentiation had not yet been made between the Medium-Sized Businesses and Small and Medium-Sized Enterprises segments. This changed in 2007.

The *Beleidsplan MGO/OCC 2008-2012 'Samen zichtbaar'* ('Policy Plan for Medium-Sized Businesses segment/OCC 2008-2012 'Visible together') was published in September 2007. This plan stated that businesses in the Medium-Sized Businesses segment and what are referred to as Other Complex Clients (OCC) were also characterised by (financial) consequences and tax issues that justified account management.⁴³ The Medium-Sized Businesses segment, in analogy with the approach adopted to the Very Large Businesses segment, was also assigned to a separate division in the Tax and Customs Administration's organisation.

A pilot was initiated in 2008 to review whether businesses in the Medium-Sized Businesses segment would be willing to conclude compliance agreements. The policy principles formulated for this segment were identical to those for the Very Large Businesses segment. Preliminary consultations are held to obtain a timely insight into the tax consequences of intended acts. Businesses do not wish to – and may not – be confronted *retrospectively* with unexpected Tax and Customs Administration tax rule interpretations. As a result, both sides can achieve efficiency gains. Moreover, this approach results in the majority of the processing being carried out in *real time*.

The Tax districts were requested to select businesses that could come into consideration for horizontal

⁴¹ Letter of 12 April 2007, DGB 2007-1985.

⁴² Agreements have since been concluded with all the businesses that took part in the pilot.

⁴³ An OCC (Other Complex Clients) is an entity that does not meet the objective criteria for the Medium-Sized Businesses segment but which nevertheless warrants account management in view of the nature of the tax issues involved. Private individuals with a complex and substantial financial position accompanied by identified shorter or longer-term tax risks can also be classified as an OCC.

monitoring. They submitted proposals for a total of about 100 businesses. The Tax districts' account management teams were originally granted a great deal of discretion in the design of horizontal monitoring for this segment. The interim progress was determined in 2009. This revealed that major benefits could usually be achieved by separating the time of the change in the relationship from the issue as to whether the business was fully in control. The willingness to optimise tax control should, in principle, be sufficient for the conclusion of an agreement – although a more important condition is the presence of (justifiable) trust: justifiable trust is necessary if the Tax and Customs Administration is to be able to decide to rely on the declarations submitted the business and its financial service provider. Tangible consequences need to be attached to justifiable trust. When entrepreneurs declare (where relevant, with their consultant) that specific Chapters of their tax control are in order then the Tax and Customs Administration assumes, in principle, that this is the case and proceeds to the implementation of a modified form of supervision for those Chapters. The first individual compliance agreements were concluded with the Medium-Sized Businesses segment in 2008, all as based on the Tax and Customs Administration report of the interim results in 2009. At the end of 2009, the Tax and Customs Administration decided roll out the concept to the entire Medium-Sized Businesses segment and conclude the pilot phase.⁴⁴ It should be noted that this decision was not based on a separate evaluation.

3.3.4 Small and Medium-Sized Enterprises segment

The Tax and Customs Administration decided to adopt an approach to the Small and Medium-Sized Enterprises segment different from that adopted for the Very Large Businesses/Medium-Sized Businesses segments. The size of the segment gave cause to the decision not to approach the individual businesses but to contact intermediary organisations, initially solely the sectoral organisations⁴⁵, subsequently expanded to include the (umbrella organisations of) financial service providers and software developers.

The Tax and Customs Administration initiated the Horizontal Monitoring for Businesses project in January 2006. This project encompassed the organisation of ten pilots in the Small and Medium-Sized Enterprises segment in which the Tax and Customs Administration and relevant representatives from sectors in the segment reviewed the feasibility of the introduction of horizontal monitoring.

In 2007 the Tax and Customs Administration shifted its attention shifted to financial service providers. The Tax and Customs Administration intends to reach entrepreneurs in the Small and Medium-Sized Enterprises segment via their financial service providers to provide assurances for the quality of the tax returns they file. The Tax and Customs Administration promotes these enterprises' affiliation with agreements concluded with financial service providers.

Before the Tax and Customs Administration launched horizontal monitoring in the market it drew up an inventory of the financial service providers in each Tax district who could come into consideration for horizontal monitoring. The Tax and Customs Administration actively approached the 100 largest offices in the Netherlands and the members of the SRA (*Samenwerkende Registeraccountants en Accountants-administratieconsulenten*, 'Association of chartered accountants and accounting and tax consultants') and NOAB (*Nederlandse Orde van Administratie- en Belastingdeskundigen*, 'Netherlands Association of Accounting and Tax Experts') umbrella organisations.⁴⁶ What were referred to as 'umbrella agreements' were also concluded with Nexia, the *Register*

44 Tax and Customs Administration, *Approach to Monitoring 2010-2014*, The Hague: Tax and Customs Administration, January 2010.

45 'Sectoral organisations' are understood as a variety types of cooperative arrangements which represent entrepreneurs, such as (shop owner) associations, franchise organisations, cooperative groups of self-employed persons without employees and businesses affiliated with the BOVAG motor car industry sectoral association.

46 A list of the 25 largest financial service providers is enclosed in Annex 9. The list also indicates whether the relevant financial service provider has concluded an agreement with the Tax and Customs Administration.

Belastingadviseurs ('Register of Tax Advisors'), KAN and Extendum.⁴⁷ The Tax and Customs Administration decided to adopt this approach on the basis of its expectations that these larger organisations will have implemented adequate quality assurance systems.⁴⁸ In addition, their joint client portfolios would encompass a substantial segment of the Small and Medium-Sized Enterprises market.

The Horizontal Monitoring Small and Medium-Sized Enterprises segment Programme was set up at the beginning of 2011. The objective was to provide for the consistent management of the development and implementation of horizontal monitoring in the Small and Medium-Sized Enterprises segment. The Programme placed the emphasis on cooperation with financial service providers. In addition, the Tax and Customs Administration cooperates with sectoral organisations and with suppliers of financial-administrative software and service providers with the objective of promoting the quality of returns. The Tax and Customs Administration expects that this 'software line of approach' offers great potential for an improvement of the quality of the chain from recording transactions through to filing returns under the motto: '*Automatically Good*'.⁴⁹

Table 1: Number of participants in horizontal monitoring in the Small and Medium-Sized Enterprises segment, situation at 31 December 2011⁵⁰

Participants in horizontal monitoring in the Small and Medium-Sized Enterprises segment	Number of compliance agreements concluded
Sectoral agreements	16
Agreements with financial service provider umbrella organisations	6
Financial service providers participating in horizontal monitoring	161
Entrepreneurs participating in horizontal monitoring via their financial service provider	33,462

3.4 The Tax and Customs Administration's horizontal monitoring policy principles and their implementation

3.4.1 Introduction

During the initial phase the Tax and Customs Administration decided to give shape and content to horizontal monitoring "on the job". The term 'intuitive' was often cited during the discussions the Committee held with a number of key figures at the Tax and Customs Administration in that period, including the then Director General. In the Committee's opinion 'intuitive' is an apt term for the incremental development of the policy at the time. After acquiring a number of years' experience, in 2008 the Tax and Customs Administration published the *Tax Control Framework. Van risicogericht naar "in control": het werk verandert* ('Tax Control Framework. From risk-oriented to in control: the work is changing') document. The Tax and Customs Administration then detailed and published three guidelines for the horizontal monitoring concept for account management in the Very Large Businesses/Medium-Sized Businesses segments (in 2010) and for the Small and Medium-Sized Enterprises segment (in 2011).⁵¹ These guidelines are primarily intended for Tax and Customs Administration staff engaged

47 Tax and Customs Administration, *Programma Horizontaal Toezicht MKB. Jaarverslag 2011 Programma Horizontaal Toezicht MKB* ('Horizontal Monitoring SME Programme. Annual Report 2011 Horizontal Monitoring SME Programme'), The Hague: February 2012, p. 5.

48 Tax and Customs Administration, *Guide to horizontal monitoring within the SME, Tax service providers*, The Hague: February 2011.

49 Tax and Customs Administration, *Horizontaal Toezicht + Software = Automatisch Goed. Een verkenning naar de mogelijkheden om fiscale compliance te integreren in de administratieve keten* ('Horizontal Monitoring + Software = Automatically Good. Exploration of the feasibility of integrating tax compliance in the administrative chain'), The Hague: 2011.

50 Tax and Customs Administration, *Programma Horizontaal Toezicht MKB. Jaarverslag 2011 Programma Horizontaal Toezicht MKB* ('Horizontal Monitoring SME Programme. Annual Report 2011 Horizontal Monitoring SME Programme'), The Hague: February 2012, p. 4.

51 Tax and Customs Administration, *Tax Controle Framework. Van risicogericht naar "in control": het werk verandert* ('Tax Control Framework. From risk-oriented to in control: the work is changing'), The Hague: March 2008; Tax and Customs Administration, *Guide to Horizontal Monitoring within the medium to very large businesses segment*, The Hague: November 2010; Tax and Customs Administration, *Guide to horizontal*

in horizontal monitoring. The guidelines have also been made available to the public.

Paragraph 3.4.2 reviews the permanent duties assigned to and the other frameworks for the Tax and Customs Administration and Paragraph 3.4.3 outlines the Very Large Businesses, Medium-Sized Businesses and Small and Medium-Sized Enterprises segments. The following paragraphs review the cornerstones of horizontal monitoring in more detail, namely the agreement (Paragraph 3.4.4), phase model (Paragraph 3.4.5), tax control framework (Paragraph 3.4.6) and the onion skin model (Paragraph 3.4.7).

3.4.2 Permanent duties, general policy objective and compliance risk management

Before reviewing the Tax and Customs Administration's policy viewpoint and principles governing horizontal monitoring, it is necessary to begin by defining the framework by devoting attention to the broader duty assigned to the Tax and Customs Administration.⁵²

Permanent duties assigned to the Tax and Customs Administration⁵³

The Tax and Customs Administration carries out duties in the following areas:

- levying, auditing and collecting state level taxes;
- supervising the import, export and transit of goods;
- supervising compliance with legislation governing the economic, health, environmental and security fields, economic planning and financial integrity;
- levying and collecting national insurance contributions and employee insurance contributions;
- awarding and auditing income-related benefits;
- conducting investigations in all the above-mentioned areas.

In performing these duties the Tax and Customs Administration complies with the following permanent duty:

"The Tax and Customs Administration implements the legislation and regulations assigned to the Administration as efficiently and effectively as possible. When performing its duties the Tax and Customs Administration endeavours to pursue enforcement in accordance with legal certainty and legal equality. Services to and respect for citizens and businesses are inextricably linked to the performance of these duties."

The Tax and Customs Administration's general policy objective

The Tax and Customs Administration's general policy objective is to maintain and enhance the taxpayers' willingness to fulfil their statutory tax obligations (compliance). Compliance is achieved when citizens and businesses file the relevant facts correctly, fully and in time and pay the correct amount in time.⁵⁴ In addition to adopting a service-oriented and respectful approach, the Tax and Customs Administration also promotes compliance by taking corrective action and, in the most extreme instance, enforcing compliance with prosecution under criminal law. The ability to promote compliance improves with the Tax and Customs Administration's knowledge of taxpayers. Within this context 'knowledge' refers to knowledge of the taxpayers' acts, the (tax) consequences of those acts, the (risk) group of similar taxpayers to which the taxpayer belongs, the temptations to which they are exposed to ignore the regulations and what is required to make sure

Monitoring within the SME segment, tax service providers, The Hague: February 2011; Tax and Customs Administration, *Guide to horizontal monitoring within the SME, sectoral organisations*, The Hague: December 2011.

52 This paragraph is an extract from the Tax and Customs Administration's Business Plan 2007-2011. These permanent duties and the other principles governing the Tax and Customs Administration's work are formulated in a comparable manner in other business plans.

53 Cf. Tax and Customs Administration Business Plan 2007-2011, p. 8.

54 Cf. Tax and Customs Administration Business Plan 2007-2011, p. 9.

that they *do* comply with the regulations.

The Tax and Customs Administration is not able to audit all information – nor is this necessary. It is increasingly necessary to seek an equilibrium between the required level of supervision and (the costs) of the implementation. The Tax and Customs Administration’s supervision focuses on taxpayers who are at risk of failing to comply with the statutory regulations or failing to pay their tax. These risks must be covered. However, since there are different levels of risks the Tax and Customs Administration carries out its audits at an intensity which depends on the level of the risk. In addition to the nature of the actual risk, the Tax and Customs Administration also takes account of the magnitude of the resultant (financial) consequences. The Tax and Customs Administration avoids predictability by supplementing these audits with random audits. The Tax and Customs Administration responds to any discovery of fraud with vigour. Consequently, the Tax and Customs Administration tailors its supervision to the taxpayer’s willingness and ability to comply with the regulations.

Compliance risk management

The Tax and Customs Administration began to make use of the term ‘compliance risk management’ in 2008. Compliance risk management’s objective is to influence the behaviour of citizens and businesses in a manner such that the available staff and resources can be deployed to achieve optimum compliance. The Tax and Customs Administration makes carefully-considered choices of the types of instruments, combinations of instruments and intensity of their use that will be required for a specific situation to achieve improvements in compliance behaviour or to support good behaviour. When trust in the taxpayer is justifiable the Tax and Customs Administration makes the taxpayer’s fulfilment of his or her obligations as simple as possible. However, taxpayers who betray this trust are subjected to more stringent supervision. This philosophy is now determinative for the Tax and Customs Administration’s acts.⁵⁵ The budget statement for 2009 expressed this policy philosophy as follows:⁵⁶

“The Tax and Customs Administration places its trust in the taxpayer. However, in instances in which the Tax and Customs Administration establishes abuse and the improper application of the regulations it will take action in a manner that unequivocally marks the demarcations of the admissible. (...) The Tax and Customs Administration’s compliance strategy is based on these two pillars: trust when possible, repression when necessary.”

Consequently, horizontal monitoring is *one* of the instruments in the Tax and Customs Administration’s range of enforcement instruments. Balanced compliance risk management is essential for the acceptance of horizontal monitoring. In other words: horizontal monitoring is impossible without vertical supervision. This same philosophy has been adopted at OECD level: the OECD has stated that taxpayers who do not participate in what is referred to as an ‘enhanced relationship’ and are not transparent may not expect ‘to prosper at the expense of others’. For this reason all tax administrations need to develop an adequate risk management system to identify this group of taxpayers and also need to have sufficient staff and resources available to ensure that businesses which do not participate in an enhanced relationship also fulfil their obligations.⁵⁷ Horizontal monitoring’s international context is discussed in more detail in Chapter 6.

55 Tax and Customs Administration Business Plan 2010–2011, Memorandum on the Approach towards Monitoring 2010–2014 (January 2010) and budgets IXB 2010, 2011 and 2012.

56 *Parliamentary Documents II* 2008/09, 31 700 Chapter IXB, No. 2, p. 8–9.

57 OECD, *Fourth meeting of the OECD Forum on Tax Administration, Cape Town Communiqué*, OECD 11 January 2008.

3.4.3 Segments

The Tax and Customs Administration has opted for segmentation to enable it to make balanced compliance risk management decisions. This segmentation is based on the classification of all taxpayers into groups with related characteristics such as their financial importance, complexity of their tax issues and their size. The Tax and Customs Administration makes a distinction between four segments, namely Very Large Businesses, Medium-Sized Businesses, Small and Medium-Sized Enterprises and Private Individuals.⁵⁸

The compliance risk management strategy is determined by characteristics of the specific segment. Businesses in the Very Large Businesses segment are characterised by tax issues of a substance and importance such that a 'customised' approach is required. The Tax and Customs Administration refers to this customisation as 'account management'. Account management is also applicable to the Medium-Sized Businesses segment. The approach adopted for the Small and Medium-Sized Enterprises segment is usually more of a group approach, since the Tax and Customs Administration is of the opinion that the importance of and risks associated with enterprises in this segment are such that account management would not be efficient.⁵⁹

Very Large Businesses segment

The Tax and Customs Administration classifies businesses in the Very Large Businesses segment on the basis of following criteria: listed on the Amsterdam Stock Exchange or with a tax size⁶⁰ of more than 25 million euros, or a foreign parent company and a tax size of more than 12.5 million euros, or at least five foreign subsidiaries and a tax size of more than 12.5 million euros. The Very Large Businesses segment is of importance to the continuity of the cash flow (the segment accounts for more than 50% of the State's total tax and contribution revenues) and the Dutch economy. The relevant businesses are important suppliers of data of relevance to tax (such as wage data).⁶¹ In addition to these businesses, the segment also includes non-profit organisations which qualify for Very Large Businesses segment status, such as provinces and municipalities, universities and care institutions. In January 2012, the core of the Very Large Businesses segment consisted of 2,562 entities.⁶²

Medium-Sized Businesses segment

In January 2012, 10,101 businesses were classified in the Medium-Sized Businesses segments. The Tax and Customs Administration's criterion for classification in this segment stipulates a tax size of more than 2 million euros and less than 25 million euros.⁶³ The Medium-Sized Businesses segment contributes about 10% to the Treasury.

Small and Medium-Sized Enterprises segment

The remaining businesses are classified in the Small and Medium-Sized Enterprises segment. This segment contains about 1.5 million entrepreneurs. The Tax and Customs Administration makes a further distinction in the

58 The private individual segment was not included in the Committee's assignment and falls outside the scope of this report.

59 The above passages are excerpts from the Tax and Customs Administration Business Plan 2007-2011.

60 'tax size' is understood as the total amount of corporate income tax, income tax, wage tax and VAT that is due.

61 This relates to the collection of data for third-party taxation (pursuant to Article 53 of the General State Taxes Act).

62 Pursuant to this regulation an 'economic entity' is regarded as a natural person or a body, whether or not directly or indirectly, affiliated with one or more natural persons or bodies in a managerial, financial, administrative or social sense. This definition is included in Chapter 11, second paragraph, of the *Uitvoeringsregeling Belastingdienst 2003* ('Implementation Regulation of the Tax and Customs Administration'), 2003. This definition is detailed in the *Toedelingsbesluit Belastingdienst* ('Decree on the Tax and Customs Administration (Allocation)'), 2003. 1,370 of the total number of 2,562 entities come into consideration for the horizontal monitoring process. The remaining entities are classified in a category referred to as the 'target group remainder'. Although this latter category is included organisationally in the Tax and Customs Administration's Very Large Businesses target group, the size of the businesses is such that they do not qualify for Very Large Businesses or Medium-Sized Businesses status and, consequently, do not qualify for account management. However, they can participate in horizontal monitoring via an agreement with a financial service provider. For organisational reasons the businesses in the target group remainder are processed by a specific Tax district at one national location. This relates to financial institutions (Amsterdam Tax district), energy companies (Rivierenland Tax district) and businesses in the oil and gas sector (Rijnmond Tax district).

63 The Tax districts may exchange a maximum of 20% of the package on the basis of individual assessment with the Small and Medium-Sized Enterprises and Private Individuals segments. These are what are referred to as OCCs.

Small and Medium-Sized Enterprises segment between businesses with employees, including self-employed persons with employees, start-up businesses (businesses for the first three years after their incorporation) and self-employed persons without employees.⁶⁴ The potential target group for horizontal monitoring encompasses the first two of these categories, which jointly contain about 600,000 businesses. The Tax and Customs Administration refers to this sub-segment as the Small and Medium-Sized Enterprises segment plus. Proposals have been drawn up for the elimination of the distinction between the Very Large Businesses segment and Medium-Sized Businesses segment and for the formation of one Large Businesses segment. The two standards that will then be adopted are externally visible criteria (linked to the demarcations of the obligation to carry out audits as laid down in the Civil Code⁶⁵) and, in view of the Tax and Customs Administration's staffing level, a manageable number (in the Tax and Customs Administration's opinion) of about 9,000 entities. Pursuant to these proposals, on which the Tax and Customs Administration's management has yet to reach a decision, 3,667 entities would be transferred from the Very Large Businesses/Medium-Sized Businesses segments to the Small and Medium-Sized Enterprises segment and 2,136 entities would be transferred from the Small and Medium-Sized Enterprises segment to Very Large Businesses/Medium-Sized Businesses segments.

3.4.4 Compliance agreements

3.4.4.1 Introduction

The compliance agreement is the most prominent manifestation of horizontal monitoring. Provisions in the compliance agreement lay down the approach the taxpayer (or the taxpayer's financial service provider) and the Tax and Customs Administration shall adopt towards each other – with mutual trust, openness and transparency – with the objective of arriving at an acceptable return. A distinction can be made between individual compliance agreements that the Tax and Customs Administration concludes directly with businesses in the Very Large Businesses segment and the Medium-Sized Businesses segment and the agreements that the Tax and Customs Administration concludes with financial service providers. Enterprises in the Small and Medium-Sized Enterprises segment joining a compliance agreement concluded with a financial service provider (indirectly) undertake to comply with the provisions laid down in the agreement. A third category of compliance agreements relates to agreements with sectoral organisations in the Small and Medium-Sized Enterprises segment.

3.4.4.2 Individual compliance agreements with businesses in the Very Large Businesses and Medium-Sized Businesses segments

Principles

Individual compliance agreements are governed by a number of principles:

- the Tax and Customs Administration and the taxpayer wish to agree on an effective and efficient method that endeavours to provide a continually up-to-date insight into relevant developments and the rapid determination of standpoints so as to increase legal certainty;
- the parties act towards each other on the basis of mutual understanding, trust and transparency;
- the rights and obligations pursuant to the legislation and regulations remain in full force,⁶⁶

64 This relates to self-employed persons who qualify as entrepreneurs. Cf. SER recommendations 2010/04, SER, *ZZP'ers in beeld. Een integrale visie op zelfstandigen zonder personeel* ('Focus on the self-employed. An integral vision of the self-employed'), The Hague: 15 October 2010.

65 This relates to the criteria laid down in Articles 2:396, 397 and 398 of the Civil Code governing accounting and reporting regulations. The turnover (€ 8,800,000) and number of employees (50) are determinative. The balance sheet total is not taken into account.

66 The Secretary of State for Finance has repeatedly stated that the tax processing of enterprises that have concluded a compliance agreement shall take place within the framework of the relevant legislation and regulations and, consequently, the processing can never be more or less favourable than that of taxpayers who have not concluded an agreement. See also the Secretary of State for Finance's letter of 26 October 2009, No. DB2009/624M. The Netherlands' interpretation of horizontal monitoring does not result in the loss of tax revenues as compared to other forms of supervision. See also the Secretary of State for Finance's letter of 7 June 2011, No. IFZ2011/359U.

- an agreement relates to the Dutch levy of all state taxes and their collection.

The 'Guide to Horizontal Monitoring within the medium to very large businesses segment' stipulates that variances from the standard texts are not permitted so as to protect legal equality, effectiveness and neutrality (the level playing field). Variances are permitted solely in very exceptional circumstances and then solely in consultation with the processing team, the management and the national coordinators.⁶⁷ The text of an individual compliance agreement (model agreement) is available from the Tax and Customs Administration's website.⁶⁸

Pursuant to the text of the model agreement the taxpayer and the Tax and Customs Administration enter into the following obligations:

- the taxpayer shall provide for an internal control system, internal audits and external audits designed to provide for the preparation and filing of acceptable returns;⁶⁹
- relevant (tax) standpoints adopted or to be adopted about which a difference of opinion could arise shall be submitted to the Tax and Customs Administration as soon as possible;
- following the receipt of a standpoint that has been or is to be adopted the Tax and Customs Administration shall consult with the taxpayer on its viewpoint of the legal consequences for as far as possible and state its opinion on the legal consequences as soon as possible;
- the information requested by the Tax and Customs Administration shall be submitted as quickly as possible and shall be both explicit and complete;
- when stating its opinion on the legal consequences the Tax and Customs Administration shall pay due regard to the relevant periods for the issue of the opinions;⁷⁰
- the inspector shall determine the assessments as soon as possible after the returns have been filed and in consultation with the taxpayer whenever possible.

Working agreements

The Guide appreciates businesses' need to lay down specific working agreements after or in combination with the conclusion of the compliance agreement. Pursuant to the Guide, working agreements of this nature may not relate to the substance of terms and standards such as an acceptable return, arguable standpoints and material errors. Nor may the working arrangements lay down periods and similar. Working agreements may not be laid down in a (model) agreement attached to the compliance agreement. The Guide states that the partners to the compliance agreement may discuss the manner in which they will give substance to specific elements of horizontal monitoring on the basis of a number of themes. The agreements reached during these discussions may be laid down in the minutes of the meeting. Themes addressed during these discussions can include contact persons, periodic consultations, consultations on the enhancement of tax control, procedural agreements and the settlement of outstanding years.⁷¹

Resolution of pending issues

Individual compliance agreements can also include agreements on the resolution of 'pending issues'. 'Pending issues' are understood as tax issues or collection issues are already known to the business and/or the Tax and Customs Administration that need to be settled. These issues may relate to current audits, outstanding

67 See Tax and Customs Administration, *Guide to Horizontal Monitoring within the medium to very large businesses segment*, The Hague: November 2010, p. 31.

68 http://download.belastingdienst.nl/belastingdienst/docs/standaardtekst_individueel_convenant_dv411z4ed.pdf.

69 An acceptable return is a return which complies with the legislation and regulations and is free of material errors.

70 The agreement does not lay down explicit filing or response times: see Tax and Customs Administration, *Guide to Horizontal Monitoring within the medium to very large businesses segment*, The Hague: November 2010, p. 31.

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

returns and current objection and appeal procedures. The processing team is granted a certain degree of discretion in the search for a solution for the tax issue. This discretion relates to the interpretation of facts and the assessment and termination of uncertainties within the scope of the correct application of legislation, the regulations and case law.⁷²

Termination of compliance agreements

Differences in opinion on the interpretation of tax issues may conceivably ultimately result in the loss of trust. The termination of the compliance agreement is then a logical consequence.⁷³ Within this context the Minister of Finance's statement in answer to questions raised by members of the House of Representatives of the States-General on the uncertainty relating to the avoidance of VAT payments by ING and DSB is also of importance. The Minister answered the question whether a compliance agreement with the Tax and Customs Administration can be continued when the taxpayer deliberately follows a route with the objective of avoiding tax as follows:⁷⁴

“Compliance agreements are not terminated when taxpayers are fully transparent and submit issues of relevance to tax to the inspector in advance. Nor are compliance agreements terminated in the event that taxpayers and inspectors are unable to reach agreement on the tax consequences of a specific body of facts: any such dispute can ultimately be submitted to the court. However, the basis for a compliance agreement falls away when a taxpayer employs aggressive tax structures and is not (fully) transparent in their use. Taxpayers who have concluded a compliance agreement are expected to refrain from continually seeking the limits of the relevant tax legislation.”

The future will reveal whether – and if so, how often – individual compliance agreements are actually terminated or amended. The Committee notes that this is a matter between an individual taxpayer and the Tax and Customs Administration that will be unlikely to be published, since tax inspectors are bound by their obligation of confidentiality.⁷⁵

3.4.4.3 Compliance agreements with financial service providers and sectoral organisations

The Tax and Customs Administration is endeavouring to introduce horizontal monitoring in the Small and Medium-Sized Enterprises segment in cooperation with the (umbrella organisations of) financial service providers and with sectoral organisations.

Agreements with financial service providers

The relationship of trust with taxpayers in the Small and Medium-Sized Enterprises segment is not directly with the taxpayers, but rather with their financial service providers. The Tax and Customs Administration intends to reach entrepreneurs in the Small and Medium-Sized Enterprises segment via their financial service providers and to ensure that the quality of the returns they file is acceptable. In adopting this approach the Tax and Customs Administration can reduce the supervisory burden for entrepreneurs who file acceptable tax returns and, at the same time, devote more attention to higher-risk returns.⁷⁶ In essence, horizontal monitoring with financial service providers is based on the Tax and Customs Administration's ability to rely on the work financial service providers carry out for their clients (the entrepreneurs).

Agreements with sectoral organisations

72 Tax and Customs Administration, *Guide to Horizontal Monitoring within the SME segment, Tax service providers*, The Hague: February 2011, p. 29.

73 *Parliamentary Documents I* 2006/07, 30 322, No. D.

74 Letter from the Minister of Finance of 1 July 2010, No. DGB2010/2996U (in reply to parliamentary question 8), p. 3.

75 Cf. Chapter 67 of the General State Taxes Act.

76 Tax and Customs Administration, *Guide to Horizontal Monitoring within the SME segment, Tax service providers*, The Hague: February 2011, p. 5.

A distinction is made between two categories of agreements: I) pure sectoral agreements in which the cooperation is focused on the resolution, prior to the implementation, of various issues of relevance to tax that are shared by many businesses, such as standards for the valuation of stock and II) horizontal monitoring sectoral agreements which also contain provisions governing adjusted supervision.

Horizontal monitoring sectoral agreements (Re. II) can be concluded only when the relevant sector has implemented some form of (self-)control, for example behavioural codes and professional codes or codes of conduct. In some instances these are accompanied by procedures for disciplinary measures for the specific sector and/or certification procedures and seals of approval. This internal supervision is required for the conclusion of a horizontal monitoring sectoral agreement. Since many sectors have not implemented some form of internal control the Tax and Customs Administration is unable to rely on this control in its supervision of these sectors. Two of the 16 sectoral agreements that have been concluded contain a (limited) control clause.⁷⁷

The large majority of the agreements do not contain a control clause. These agreements provide for cooperation between the parties and for the feasibility of reaching mutual agreement on the procedure to be followed in resolving any current tax bottlenecks or uncertainties that may occur in practice. These working agreements are then included in an annex to the agreement at periodic intervals and published. These agreements do not contain any provisions for the control of the members of the sectoral associations' compliance with the working agreements included in the annex: the membership of a sectoral association is, in the first instance, focused on the general representation of the members' interests and the provision of service. There is no financial-administrative relationship between the sectoral organisations and their members that provides for the reliable control of the members' tax compliance. The Committee has already concluded (in Chapter 2) that it cannot regard these agreements with sectoral organisations as falling within the scope of horizontal monitoring.

3.4.5 Steps in the process and the phase model for the Very Large Businesses/Medium-Sized Businesses segments

Steps in the process

The 'Guide for horizontal monitoring within the medium to very large business segment' summarises the steps the Tax and Customs Administration and the taxpayer work through in the horizontal monitoring process:

Table 2: Steps in the process

Steps in the process	
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 tax control framework
step 6	adjustment of supervision

These steps are explained briefly below.

Step 0: up-to-date client profile

Either the Tax and Customs Administration's processing team or the taxpayer (or the taxpayer's financial service

⁷⁷ Sectoral agreements containing a control clause have been concluded with the daily newspaper distribution sectoral association (part 3 of the agreement) and with the BOVAG motor car industry sectoral association (part 2 of the agreement).

provider) can take the initiative to explore the opportunities available for horizontal monitoring. This initiative can be taken at any time.

Step 1: horizontal monitoring meeting

The objective of the horizontal monitoring meeting is to enable both parties to explore the feasibility of implementing horizontal monitoring for the taxpayer. This exploration reviews the principles, responsibilities and expectations, the tone at the top and the experiences with the current contacts.

Step 2: compliance scan

The objective of the compliance scan is to carry out an assessment, in cooperation with the taxpayer, of the feasibility of horizontal monitoring. For this reason the Tax and Customs Administration wishes to gain insight into the tax attitude and the behaviour of the taxpayer (and the other parties involved), i.e. *willingness*. The Tax and Customs Administration also holds discussions with the taxpayer to review how the taxpayer will assume his or her responsibility for filing acceptable returns. The Tax and Customs Administration and the taxpayer jointly determine whether the preconditions are met for the adequate control of tax matters, i.e. *ability*.

Step 3: resolution of pending tax issues

Resolving pending tax issues clears the way for working in real time. In principle, as many of the pending issues as possible are settled prior to the conclusion of the agreement.

Step 4: compliance agreement

The compliance agreement contains provisions governing the manner in which the taxpayer and the Tax and Customs Administration will cooperate in the future.

Step 5: analysis and improvement of the tax control framework

The taxpayer bears the primary responsibility for the improvement of the taxpayer's tax control. The design of the tax control depends on the taxpayer's size and the complexity. The Guideline outlines the risk caused by the Tax and Customs Administration's adoption of an overly-active role in the analysis and improvement, namely that the organisation adopts a passive attitude in waiting for the Tax and Customs Administration to give notification of points of attention and allows its personal responsibility to be determined accordingly.

Step 6: adjustment of supervision

The Tax and Customs Administration's form and intensity of supervision is tailored to the extent to which the taxpayer is in control of tax matters and to the work carried out by external specialists. The supervision is tailored to the specific organisation and, consequently, involves customisation. The Tax and Customs Administration works on the basis of trust in and understanding for the position of the taxpayer, although the Guide warns the Tax and Customs Administration's staff not to lose their ability to form objective opinions. This risk is referred to as the 'risk of attachment'.⁷⁸

Phase model

The Tax and Customs Administration keeps records (for internal use) of the progress in the relevant businesses' horizontal monitoring process in an electronic file.⁷⁹ A distinction is made between six phases in this development process:

Table 3: Client profile phase model

Client profile phase model	
phase 1	client profile
phase 2	horizontal monitoring is/is not feasible

78 Tax and Customs Administration, *Guide to Horizontal Monitoring within the medium to very large businesses segment*, The Hague: November 2010, p. 13.

79 This is carried out in ATK+ (transparent individual account management application).

phase 3	insight into the design and implementation of the administrative organisation/internal control
phase 4	insight into the implementation and performance of the administrative organisation/internal control
phase 5	adjustment of form and intensity of supervision
phase 6	agreement with financial service provider

The following table, from the Tax and Customs Administration, lists the situation at 31 March 2012.

Table 4: Horizontal monitoring within the Very Large Businesses/Medium-Sized Businesses segments (at 31 March 2012)

Phase in client profile	Medium-Sized Businesses segment		Very Large Businesses segment (excl. target group remainder)	
	Number	Percentage	Number	Percentage*
1: client profile	8168	82,4%	1191	94,5%
2a: horizontal monitoring feasible	2497	25,2%	768	61,0%
2b: horizontal monitoring not feasible	1939	19,6%	214	17,0%
3: insight into the design and implementation of the administrative organisation/internal control	1100	11,1%	484	38,4%
4: insight into the implementation and performance of the administrative organisation/internal control	479	4,8%	238	18,9%
5: adjustment of form and intensity of supervision	349	3,5%	190	15,1%
6: agreement with financial service provider	87	0,9%	5	0,4%
Unknown	1541	15,5%	59	4,7%
Total number of businesses	10127		1271	
Status of agreement	Medium-Sized Businesses segment		Very Large Businesses segment (excl. target group remainder)	
1: no consultations	4915	48,7%	519	37,9%
2: consultations	1829	18,1%	403	29,4%
3: agreement concluded	954	9,4%	177	12,9%
4: agreement not feasible	620	6,1%	150	10,9%
Unknown	1786	17,7%	121	8,8%
Total	10101	100%	1370	100%

*The phases are not mutually exclusive and, consequently, the numbers and percentages do not add up to 100%

3.4.6 Tax control framework

Very Large Businesses segment

The memorandum *Tax Control Framework. Van risicogericht naar "in control": het werk verandert* ('Tax Control

Framework. From risk-oriented to in control: the work is changing’) document was published in March 2008.⁸⁰ This document is intended for all technical staff and managers engaged in the Very Large Businesses segment. This document also devotes attention to what is referred to as the ‘onion skin model’.

A tax control framework is an internal control instrument focused specifically on the business’ tax function. The tax function plays a role in (virtually) all business processes. The tax control framework’s objective is to gain total control of all tax matters: timely and correct payments also fall within the scope of a tax control framework. The Tax and Customs Administration has stated that it does not intend to formulate generic minimum requirements or templates for tax control frameworks.⁸¹ Nor will the Tax and Customs Administration take any initiatives for certification. A tax control framework is not an independent audit object for the Tax and Customs Administration, but rather a means to review the acceptability of a return.

The statement that the Tax and Customs Administration intends to conclude compliance agreements with businesses that have their tax control framework in order has resulted in the business’ tax position becoming a point requiring the express attention of the executive board. The attitude of the senior management – the tone at the top – is regarded as having a great influence on the (tax) integrity of the entire business and its officers. Although the tax control framework does not need to be in order at the time of the conclusion of the compliance agreement, the taxpayer does need to be working towards this objective.

The tax control framework is an integral element of the taxpayer’s business or internal control framework. The design of an internal control framework – and, consequently, of a tax control framework – requires customisation and is dependent on numerous factors (including the size, complexity and organisation of the business). An important stipulation laid down in both the Sarbanes-Oxley Act and the Corporate Governance Code (the Tabaksblat Code) prescribes that the business’ management shall issue a statement on the effectiveness of the internal control, i.e. the extent to which the business is in control. This statement is issued in the form of an in control statement that is included in the annual report. Businesses can issue an in control statement solely when they have implemented a business or internal control framework. In practice, the internal control integrated framework developed on COSO’s request has now become more or less standard.⁸²

The IFRS also compels businesses to provide information sufficient for the recognition of any tax risks, where relevant. Moreover, the majority of these businesses have an in-house tax department and an internal audit department, which should provide sufficient guarantees for the reliability of the tax control framework, notification of any shortcomings of material relevance to tax administrations and the implementation of any measures required to resolve those shortcomings.

Medium-Sized Businesses segment

The ‘Guide for Horizontal Monitoring within the medium to very large businesses segment’ reveals that the standards for the Medium-Sized Businesses segment and Very Large Businesses segment are, in principle, identical: a system of internal control, internal audits and external audits that ultimately results in an acceptable return.

The Medium-Sized Businesses policy plan (September 2007) also devotes attention to the role of the external consultant/auditor. In the Very Large Businesses segment the Tax and Customs Administration will usually focus

80 Tax and Customs Administration, *Tax Control Framework. Van risicogericht naar “in control”: het werk verandert* (‘Tax Control Framework. From risk-oriented to in control: the work is changing’), The Hague: March 2008.

81 Tax and Customs Administration, *Tax Controle Framework. Van risicogericht naar “in control”: het werk verandert* (‘Tax Control Framework. From risk-oriented to in control: the work is changing’), The Hague: March 2008, p. 4.

82 Committee of Sponsoring Organisations of the Treadway Commission. COSO is a voluntary private organisation which is dedicated to the improvement of the quality of financial reporting by means of business ethics, effective internal controls and corporate governance. www.coso.org.

on the design, implementation and performance of the administrative organisation/internal control (the tax control framework), but in the Medium-Sized Businesses segment the Tax and Customs Administration will need to devote the majority of its attention to the agreements on the design, implementation and reporting of tax audits carried out by the external consultant/auditor for the specific business.

Small and Medium-Sized Enterprises segment

The Tax and Customs Administration has expressly adopted a different approach to the Small and Medium-Sized Enterprises segment. The size of these enterprises is such that the preparation of a tax control framework is not an appropriate instrument for these taxpayers. The horizontal monitoring of businesses in the Small and Medium-Sized Enterprises segment is based on reliance on the financial service provider's work for their client. The basis for the supervision is then shifted to the financial service provider's internal quality system, in particular the acceptance policy governing the admission of clients and the work processes.⁸³

The Tax and Customs Administration expects the financial service providers to verify the identity of the entrepreneurs participating in horizontal monitoring and to assess their integrity. Entrepreneurs wishing to participate in horizontal monitoring are also required to sign a statement together with the financial service provider, a *statement of affiliation*. The financial service provider is also required to set up a tax affairs department which ensures that issues which qualify for preliminary consultations are recognised by the financial service provider and are actually submitted for discussion. The umbrella organisations of the financial service providers that have concluded umbrella compliance agreements with the Tax and Customs Administration also play a role in quality assurance. The umbrella organisation assesses whether an associated financial service provider can and may participate in horizontal monitoring and reviews the quality of the financial service provider's organisation. The umbrella organisation subjects agreement returns filed by the financial service provider to periodic reviews.

The differences between the various subgroups within the financial service provider sector need to be recognised before preparing a precise description of the manner in which substance is given to horizontal monitoring in the Small and Medium-Sized Enterprises segment. The quality assurance systems of accountancy firms which conduct statutory audits are supervised by the Netherlands Authority for the Financial Markets (AFM). Moreover, these accountancy firms require a licence issued by the AFM to perform their duties. The group of accountancy firms affiliated with the *Samenwerkende Registeraccountants en Accountants-administratieconsulenten*, ('Association of chartered accountants and accounting and tax consultants') (SRA) are also governed by requirements (imposed by the association) for their quality assurance systems and are subject to supervision. This is also the case for accountancy firms affiliated with other accountants' organisations. However, there is also a large group of accountancy firms which conduct their practice without a licence. They are not then governed by specific requirements and, as a result, are not subject to explicit supervision (although assurances are provided by the disciplinary measures that govern their work as accountants). Tax consultants are not required to possess a licence and are not subject to supervision of a form comparable with the supervision conducted by the AFM. However, they may have implemented in-house regulations that provide assurances for a high level of reliability, such as the SRA rules.

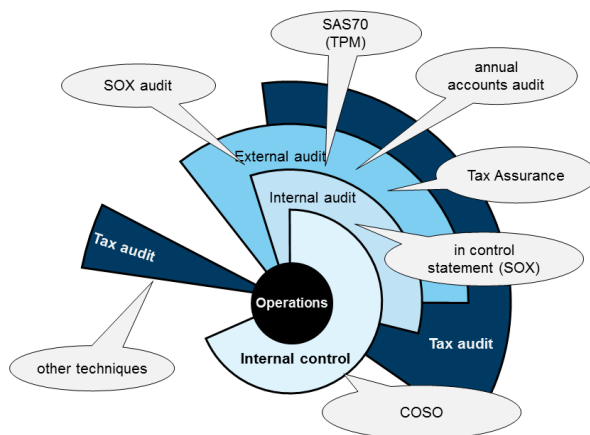
3.4.7 Onion skin model

The Tax and Customs Administration, pursuant to one of the important principles formulated in the Tax and Customs Administration's Audit Approach and the guides, does not duplicate work carried out by others. What is referred to as the 'onion skin model' has been defined to avoid any such duplication.⁸⁴ The following

⁸³ See also Tax and Customs Administration, *Guide to horizontal monitoring within the SME, Tax service providers*, The Hague: February 2011, Annex IV.

⁸⁴ H.H.W. Kloosterman, 'Schillenmodel', *De Accountant* 1991/7, p. 403-406. The onion skin model is also described in the Tax and Customs Administration's Audit Approach.

diagram details the onion skin model used for the Very Large Businesses segment. The onion skin model is also applicable to the Medium-Sized Businesses and Small and Medium-Sized Enterprises segments.



Pursuant to the Tax and Customs Administration's onion skin model the Administration makes use of: (1) the taxpayer's internal control, (2) internal audits (internal accountancy department, the tax department) and (3) external audits (external auditor).

It is important to determine whether the business has called in accountancy (and tax) expertise and, if so, to what extent. The Tax and Customs Administration may then request an inspection of parts of the auditor's audit dossier or other relevant dossiers. The Tax and Customs Administration does not, in principle, have access to the consultancy dossier or tax reports submitted by the financial intermediary. The Tax and Customs Administration requests an inspection solely of the parts of the auditor's audit dossier or other relevant dossiers that can be of importance to the assessment of the need for any supplementary work or to the formation of an opinion of the acceptability of the return.

3.5 The Committee's conclusions on the horizontal monitoring policy

The previous paragraphs reviewed the Tax and Customs Administration's horizontal monitoring policy principles as based on information from various sources. This Paragraph of the report contains the Committee's answers to the following questions about (the development of) *the horizontal monitoring policy* prior to provision of the overall answer to the first task assigned to the Committee (in Chapter 7):

1. Which principles were adopted by the Tax and Customs Administration in the formulation of the horizontal monitoring policy?

- Horizontal monitoring is based on the principle that compliance with the tax regulations is promoted by (voluntary) cooperation between taxpayers participating in horizontal monitoring (initially taxpayers in the Very Large Businesses segment) and the Tax and Customs Administration in a *relationship* based on trust, understanding and transparency. The taxpayers assume their personal responsibility for compliance with the tax regulations and the Tax and Customs Administration places its trust in them.
- The Tax and Customs Administration in turn adjusts its *supervision* in accordance with the degree to which the taxpayer is *in control* (and, consequently, the degree to which the trust is justifiable). The Tax and Customs Administration then relies on the control measures the taxpayer has implemented (the tax control

framework) to be *in control* of tax matters and on the internal and external audits conducted to verify control.

The combination of these elements should result in more effective supervision (in terms of the taxpayer's improved compliance with the regulations) and more efficient supervision (in terms of the taxpayer's reduced supervisory burden). This issue is reviewed in Chapter 4.

2. Were these principles observed on the implementation of the policy? Are these principles still valid?

The total taxpayer population is of a size and diversity that compels the Tax and Customs Administration to implement *segmentation* to provide for the manageability and efficiency of the performance of its duties. This segmentation is implemented by classifying the total taxpayer population into categories on the basis of shared characteristics such as the financial consequences, complexity of the tax issues and size of the taxpayer, etc. The Tax and Customs Administration makes a distinction between three categories, namely the Very Large Businesses segment, Medium-Sized Businesses segment and Small and Medium-Sized Enterprises segment.

Very Large Businesses segment

The development of horizontal monitoring began in the Very Large Businesses segment, a segment in which account management is customary. Both of the aforementioned horizontal monitoring principles remain valid and are observed in the practical implementation of the concept. However, the Committee notes that there is scope for improvement in the optimum use of the results from external audits, in particular in terms of the assessment of internal control measures when making an assessment of the tax control framework.

Medium-Sized Businesses segment

Account management is also employed in the Medium-Sized Businesses segment and the Tax and Customs Administration also concludes individual compliance agreements within the scope of horizontal monitoring. The principles formulated within the scope of the Very Large Businesses segment can also be adopted, with some reserves, to the Medium-Sized Businesses segment. The first principle is valid and is observed in the practical implementation. However, the observation of the second principle is much more complex since the corporate governance legislation and regulations governing businesses in the Medium-Sized Businesses segment are less compelling than those governing businesses in the Very Large Businesses segment. The Tax and Customs Administration cannot rely on the tax control measures implemented by businesses in the Medium-Sized Businesses segment to the same extent as in the Very Large Businesses segment. The size of the Medium-Sized Businesses segment also complicates the situation for the Tax and Customs Administration: the capacity of the Tax and Customs Administration is insufficient to implement account management for the entire segment.

Small and Medium-Sized Enterprises segment

The number and diversity of the enterprises in the Small and Medium-Sized Enterprises segment – for which the Tax and Customs Administration adopts a group-oriented approach – are such that the Tax and Customs Administration is unable to implement the horizontal monitoring principles formulated for the Very Large Businesses segment (with account management) for enterprises in the Small and Medium-Sized Enterprises segment.

The relationship of trust with enterprises in the Small and Medium-Sized Enterprises segment is not, in contrast to the Very Large Businesses segment, developed directly with taxpayers but rather with their financial service providers. The Tax and Customs Administration intends to reach enterprises in the Small and Medium-Sized Enterprises segment via their financial service providers to provide assurances for the quality of the returns they

file.

For this reason the Tax and Customs Administration is compelled to abandon the principle of relying on the individual business' tax control. The Tax and Customs Administration has replaced this with meta-monitoring which makes use of information that include the results from the financial service provider's quality assurance system.

3. How does horizontal monitoring fit in with the range of instruments that the Tax and Customs Administration has at its disposal to promote compliance with tax legislation and combat non-compliance?

In 2004, the Secretary of State positioned horizontal monitoring as an element of a *differentiated approach to compliance*. The Committee concludes that the Tax and Customs Administration's management has expressly positioned horizontal monitoring – both internally and externally – as a change in culture. This Committee is of the opinion that this was understandable in view of the major change in attitude required for the implementation of horizontal monitoring.

However, as a result many of the Tax and Customs Administration staff and external interested parties gained the impression that there would ultimately be no alternative to horizontal monitoring. In 2008, horizontal monitoring was explicitly positioned within the Tax and Customs Administration's overall compliance risk management. As a result, horizontal monitoring has now become *one* instrument and not *the* instrument in compliance risk management.

3.6 Horizontal monitoring in practice: bottlenecks and vulnerabilities

3.6.1 Introduction

The previous part of the Committee's report outlined the developments in the Tax and Customs Administration's horizontal monitoring on the basis of the available policy plans, letters to the Senate and House of Representatives of the States-General, various horizontal monitoring guides and other relevant information.

This Paragraph reviews the various aspects of horizontal monitoring against the opinions and experiences submitted during the round-table discussions, consultations with the supervisory administrations and the Internet consultations. The Committee makes a distinction between the various segments when this is of relevance. The Committee wishes to note, in advance, that it has adopted a critical tone – a tone which is logical in view of the Committee's assignment to focus on bottlenecks and vulnerabilities. The Committee's comments and conclusions need to be viewed from this perspective. However, this is without prejudice to the Committee's opinion that opting for horizontal monitoring has added a valuable instrument to the range of supervisory instruments.

3.6.2 General

Paradigm change

The Tax and Customs Administration has qualified the horizontalisation of supervision as the adoption of a fundamentally new approach. The term 'paradigm change' was often heard during the discussions the Committee held with various levels of Tax and Customs Administration staff, although the Secretary of State for Finance has referred to a 'differentiated approach'. The Committee has established that the Tax and Customs Administration appreciated that opting for a new form of supervision implied a fundamental change in culture

for both the entire organisation and for the individual members of staff. The discussions resulted in the Committee's conclusion that the implementation of the concept was an intuitive process.

The discussions held by the Committee revealed that in the taxpayers' experience some Tax and Customs Administration staff are in favour of horizontal monitoring, whilst others exhibit a greater or lesser degree of resistance to the concept. The business community is still often confronted with tax inspectors and auditors of the old school who are focused primarily on finding errors. During the round-table discussions, the business community and the non-profit sector stated that they have the impression that the Tax and Customs Administration is not completely ready for horizontal monitoring.

The Committee's conclusions

The Committee understands that it was necessary to position horizontal monitoring as paradigm change to achieve the fundamental shift from working on the basis of distrust to working on the basis of trust.

The Committee has established that this has resulted in a substantial group of staff exhibiting resistance to the concept – resistance which still persists.

The Committee concludes that work still needs to be done in guiding the staff in the total compliance concept, one element of which is horizontal monitoring.

Horizontal monitoring's rollout

The Committee has already referred to the intuitive approach that was adopted to the introduction of the entire horizontal monitoring process. The Committee can understand this approach in view of the experimental character and the limited scope of horizontal monitoring at the time, in 2005 and 2006, and can even qualify the Tax and Customs Administration's step as courageous: in taking this step it played a pioneering role. However, the Committee is also of the opinion that it would have been logical that a rationalisation proves would have followed an experimental phase of this nature. Nevertheless, this rationalisation was not implemented, as is revealed by the manner in which the decision was taken to roll out horizontal monitoring to taxpayers other than those classified in the Very Large Businesses segment. The Committee has taken cognisance of the results from the evaluation submitted to the House of Representatives of the States-General at the time. The Committee is of the opinion that these results are not sufficiently convincing to justify the conclusion that the rollout of horizontal monitoring to other segments was feasible – and certainly in view of the significant differences in the applicable (international) legislation and regulations and presence of external stakeholders that are exhibited between the Very Large Businesses segment and the other segments.

The Committee's conclusion

The Committee concludes that the rollout to taxpayers other than those classified in the Very Large Businesses segment was implemented without further substantiation or a study of the differences between the segments, and without a study of the potential effects these differences could have on the concept and the implementation of horizontal monitoring. Moreover, the compensatory measures required as a consequence of these differences were not made clear.

Compliance risk management

The Tax and Customs Administration introduced the ‘compliance risk management’ term in 2008. The objective of compliance risk management is to deploy the available staff and resources in a manner that achieves an optimum effect on compliance. The Tax and Customs Administration states that justifiable trust is an element of this strategy: taxpayers who justify the trust placed in them are facilitated in the fulfilment of their obligations, whilst taxpayers who betray this trust are subject to more stringent supervision. The Committee is of the opinion that explicitly positioning horizontal monitoring in the Tax and Customs Administration’s overall supervisory approach was worthwhile: this emphasised that horizontal monitoring is just one of the many instruments available to the Tax and Customs Administration in performing its statutory duties. This positioning was of importance to the correction of the ‘totalitarian’ impression of horizontal monitoring that had been gained by taxpayers, Tax and Customs Administration staff and other players. Some Tax and Customs Administration staff and external parties have the impression that the Tax and Customs Administration focuses solely on horizontal monitoring and devotes insufficient attention to taxpayers who do not participate in horizontal monitoring. However, the Tax and Customs Administration’s time allocated to supervision reveals that this is not the case (see Chapter 4). Nevertheless, the Committee has established that horizontal monitoring’s positioning as an element of the range of compliance instruments has yet to become rooted throughout the organisation.

The Committee’s conclusions

Compliance risk management is a valuable approach to positioning the various supervisory instruments in the range of instruments available to perform the statutory duties.

Pursuant to its compliance risk management strategy the Tax and Customs Administration adopts a structured approach to its review of the behaviour of all taxpayers and deploys – on the basis of the effects that that are to be achieved – the various supervisory instruments (including horizontal monitoring) in the differentiated manner required to achieve those effects.

In other words, horizontal monitoring is not the supervisory instrument, but a supervisory instrument.

Relationship based on mutual understanding, trust and transparency

Some participants in the round-table discussions warned that horizontal monitoring should not evolve into a dogma. Too many taxpayers and financial service providers still have this impression. According to one of the participants in the discussions, ‘behaviour which should be regarded as self-explanatory in everyday life and work suddenly needs to be laid down in an agreement’. Notwithstanding these (critical) comments, the Committee has observed an improvement in the manner in which (large) businesses and the Tax and Customs Administration approach each other and has observed an improvement in mutual understanding resulting from the introduction of horizontal monitoring. The round-table discussions and Internet consultations revealed that taxpayers appreciate the horizontal monitoring concept, in particular the change in the Tax and Customs Administration’s attitude and the resultant improved relationship between taxpayers and the Tax and Customs Administration. Mutual understanding has increased, the parties have become more transparent and the beginnings of (justifiable) trust are becoming apparent. The Tax and Customs Administration’s contacts with taxpayers increase its insight into tax risks *and* its understanding of the taxpayers’ operations. Conversely, taxpayers and their financial service providers gain an increased insight into the Tax and Customs

Administration's processing strategy.

The Committee's conclusions

Participation in horizontal monitoring has resulted in increased mutual understanding between taxpayers/financial service providers and the Tax and Customs Administration.

Taxpayers participating in horizontal monitoring and the Tax and Customs Administration have gained an increased insight into each other's acts as a result of the increased transparency and greater understanding of each other's interests.

Model compliance agreements

In contrast to the initial horizontal monitoring phase, when compliance agreements were usually customised and taxpayers were able to make a contribution to the agreements, the Committee has observed that model compliance agreements have now become customary. The 'Guide to Horizontal Monitoring within the medium to very large businesses segment' stipulates that variances from the standard texts are not permitted in view of the need to protect legal equality, efficiency and neutrality (the level playing field). Variances are permissible solely in very exceptional circumstances and then solely in consultation with the processing team, the management and the national coordinators. The Committee is of the opinion that model agreements of this nature are of value in promoting transparency and legal equality. However, the Committee also notes that the taxpayers' contribution to their compliance agreements has now been reduced to zero or virtually nothing.

The Committee's conclusions

The Committee is of the opinion that the policy prescribing the use of model compliance agreements has reduced the degree of customisation.

Although the use of model agreements is beneficial to transparency and legal equality, taxpayers can now make at most a very limited contribution to the agreement.

Resolution of pending issues

Agreements not only lay down provisions governing the future, but also lay down provisions for the settlement of any pending issues of relevance to tax. The round-table discussions and Internet consultations revealed that the Tax and Customs Administration 'would be prepared to incur a loss' on the settlement of past tax years when this resulted in the conclusion of an agreement. This could be indicative of preferential treatment in recruiting participation in horizontal monitoring which is in conflict with the law and/or the principle of equality. Although the Committee has included this comment within the limits of the scope of its study, the Committee's discussions and the other information it received have not revealed any solid evidence to substantiate the conclusion that preferential treatment has been an issue.⁸⁵ However, it is also impossible to arrive at the converse conclusion. The Committee's considerations took account of the fact that reaching a compromise is not unusual in the settlement of lengthy, drawn-out and complex issues. Moreover, it is not unusual for parties to reach a compromise in the regular (court) settlement of disputes relating to complicated differences of opinion and lengthy, drawn-out conflicts in interpretation when so instigated by the court. In some instances

⁸⁵ Any such investigation would need to be based on an analysis of specific cases. The Committee is of the opinion that this does not fall within the scope of its assignment for the evaluation. Moreover, in view of the obligation to maintain confidentiality prescribed in Article 67 of the General State Taxes Act an exemption would be required for an investigation of this nature.

this form of settlement is even anticipated by reaching a compromise solution to avoid legal action. It would have been desirable, in view of the uncertainty on the settlement of disputes, to have drawn up an explicit procedure for the settlement of past tax issues at the time of horizontal monitoring's implementation that would have provided for a broader verifiable consideration of interests. This could be achieved by increasing the transparency of the Tax and Customs Administration's existing procedure.

The Committee's conclusion

The Committee observes that account management and the associated statutory obligation to maintain confidentiality result in a lack of transparency in the settlement of past tax issues. For this reason the Committee cannot reach a conclusion on the settlement of past tax issues.

Risk of attachment

The Tax and Customs Administration has stated that it performs its duties on the basis of trust in and understanding for the position of the individual taxpayer. The 'Guide to Horizontal Monitoring within the medium to very large businesses segment' warns the Tax and Customs Administration's staff of the risk of losing their ability to form objective opinions, a risk which is referred to as the 'risk of attachment'. The Committee is of the opinion that the Tax and Customs Administration needs to remain continually alert to the risk of attachment. Non-professional relationships increase the risk of corruption. The Committee advocates an adequate accommodating policy, for example the rotation of staff, reviews of the quality of dossiers, or the separation of duties. The Committee leaves the further formulation of this accommodating policy to the Tax and Customs Administration.

The Committee's conclusion

Account management is accompanied by the risk of attachment. An accommodating policy is required for situations of this nature. A policy of this nature is not currently visible or explicit.

3.6.3 Very Large Businesses segment

Tax control framework

Businesses are expected to be in control and have their internal control focused specifically on tax matters in order (by means of a tax control framework). This responsibility is, in principle, borne by the entrepreneur: the entrepreneur develops a tax control framework and indicates whether – and, if so, the extent to which – he or she is in control. The discussions revealed that in practice both taxpayers and the Tax and Customs Administration staff are in need of a specification of the uniform minimum requirements governing tax control frameworks. This is also applicable to the requirements governing a correct tone at the top. Various participants in the discussions, including Tax and Customs Administration staff, informed the Committee that the Tax and Customs Administration staff experience difficulty in assessing the stage of the development of a tax control framework and that the business community is also in need of more guidance. Some Tax and Customs Administration staff would appear to exhibit a passive attitude to the assessment of tax control frameworks (the question is: when is 'good' good enough?). The Committee is of the opinion that uncertainties of this nature are undesirable with such a fundamental element of horizontal monitoring within the Very Large Businesses segment. Moreover, uniform assessments are necessary: the Tax and Customs Administration

staff need to form identical opinions on the level of the development of tax control frameworks when the circumstances are identical.

The Committee's conclusion

The information made available to the Committee results in the Committee's conclusion that there have been and still are too many uncertainties about the design and assessment of tax control frameworks.

Onion skin model

What is referred to as the 'onion skin model' is employed for horizontal monitoring in the Very Large Businesses segment (and the Medium-Sized Businesses segment). Pursuant to this model the Tax and Customs Administration relies on the work carried out by the external auditor. This work relates not so much to the auditor's actual, material audit, but rather to the external auditor's work and findings relating to the administrative organisation, the internal control measures and the tax control framework. The discussions held by the Committee revealed that the Tax and Customs Administration does not rely sufficiently on the results from the auditor's work in these areas. For this reason the Committee cannot exclude the possibility that the Tax and Customs Administration and taxpayer duplicate work as a result of the insufficient use of the onion skin model.

The Committee's conclusion

The information made available to the Committee results in the Committee's conclusion that the Tax and Customs Administration does not make structural use of the onion skin model in the manner intended in its theoretical design.

3.6.4 Medium-Sized Businesses segment

Tax control in Medium-Sized Businesses segment

The Committee observes that the Tax and Customs Administration's tax control standard for the Medium-Sized Businesses segment – a system of internal control measures that results in an acceptable return – is identical to the standard for the Very Large Businesses segment. However, the Medium-Sized Businesses segment is not governed by the (formal) obligation to comply with the wide range of regulations that governs the Very Large Businesses segment. As a result, businesses in the Medium-Sized Businesses segment will usually incur additional compliance costs in implementing an equivalent to the tax control framework. The Tax and Customs Administration is able to rely much less on the internal administrative organisation and internal control measures implemented by businesses in the Medium-Sized Businesses segment. For this reason other assurances will be required: the Tax and Customs Administration shall need to rely more on the work carried out by external consultants and auditors. The Committee has yet to be convinced that the development of internal control by businesses in the Medium-Sized Businesses segments, the insight into the conditions and the reliance on the work of others, in particular of the auditor, have crystallised to the full extent. The number of businesses at which the Tax and Customs Administration has an insight into the design and implementation and/or performance of the tax control system falls short of the target for the Medium-Sized Businesses segment. The Tax and Customs Administration is of the opinion that this is due to the businesses' insufficient investments in tax control. The Committee is of the opinion that this is also due to the Medium-Sized Businesses segment's need for more tax control guidelines (see Chapter 4).

The Committee's conclusions

The Committee has established that reliance on the internal administrative organisation and internal control measures of businesses in the Medium-Sized Businesses segment is far from as self-explanatory as in the Very Large Businesses segment. The Committee has not been able to confirm that the Tax and Customs Administration has implemented the necessary compensatory measures.

The Committee concludes that the differences between the internal control systems and external audit systems of businesses in the Very Large Businesses segment and Medium-Sized Businesses segment have not been recognised to an adequate extent.

3.6.5 Small and Medium-Sized Enterprises segment***Horizontal monitoring in the Small and Medium-Sized Enterprises segment***

Various parties have expressed serious doubts to the Committee about the feasibility and desirability of the rollout of horizontal monitoring in the Small and Medium-Sized Enterprises segment. A number of issues play a role in this issue. Financial service providers, who support the concept and have 'gone horizontal', experience pressure imposed on them to supply clients for horizontal monitoring. These participants in the discussions have the impression that the Tax and Customs Administration's implementation of horizontal monitoring focuses more on quantity than quality. This, irrespective of any suggestions of eagerness, could result in concessions being made on the quality of the horizontal monitoring system process and the inclusion of organisations and businesses in horizontal monitoring which are not yet ready for the concept.

Questions have also been raised about the division of interests and responsibilities between the Tax and Customs Administration, financial service provider and taxpayers, as well as about the advantages (and disadvantages) attached to participation in horizontal monitoring, in particular from the perspective of the Small and Medium-Sized Enterprises segment. Pursuant to the Tax and Customs Administration's segmentation, taxpayers classified in the Small and Medium-Sized Enterprises segment do not come into consideration for an individual agreement: they are obliged to make use of the services of a financial service provider who has concluded an agreement. As a result, an enterprise in the Small and Medium-Sized Enterprises segment that complies with all the requirements (such as a tax control framework) to be met by businesses in the Very Large Businesses/Medium-Sized Businesses segments will still be unable to conclude an individual agreement. Moreover, a taxpayer wishing to participate in an agreement relationship who has a financial service provider that does not participate in horizontal monitoring may be 'compelled' to opt for another financial service provider.

The Committee's conclusions

The Committee has serious doubts about the manner in which horizontal monitoring has been implemented in the Small and Medium-Sized Enterprises segment. It is a moot point whether sufficient consideration was given to the specific characteristics of this segment at the time of the decision to proceed to a somewhat forced rollout.

The Committee also concludes that questions relating to the horizontal monitoring in the Small and Medium-Sized Enterprises segment – questions in part raised by the ‘triangular relationship’ between enterprises in the Small and Medium-Sized Enterprises segment, the financial service provider and the Tax and Customs Administration, as well as by the Tax and Customs Administration’s segmentation – have not been addressed to an adequate extent and are still in need of an adequate answer.

3.7. The Committee's conclusions on horizontal monitoring's performance

The previous Paragraph reviewed horizontal monitoring's performance against the opinions and practical experiences submitted during the round-table discussions, the consultations with supervisory administrations and the Internet consultations. This information has resulted in the Committee reaching the following conclusion.

4. How do the various stakeholders (taxpayers, consultants, science and the Tax and Customs Administration) experience the implementation of horizontal monitoring in practice and which bottlenecks and vulnerabilities do they perceive?

The Committee concludes that most of the businesses and financial service providers that already participate in the horizontal monitoring have a favourable opinion of the *horizontal monitoring concept*. The Tax and Customs Administration's fundamental shift from working on the basis of ‘distrust’ to working on the basis of ‘trust’, working in real time, the preliminary consultations and obtaining rapid certainty about tax issues were all referred to as benefits offered by horizontal monitoring. On its part the Tax and Customs Administration benefits from an improved information position and the provision of advance assurance of the quality of the return – both of which are major benefits in comparison with the past ‘retrospective’ audit of returns.

The parties involved also stated that they experience bottlenecks and vulnerabilities in *horizontal monitoring's performance*. The Committee focused on this aspect in this Chapter (in Paragraph 3.6). The bottlenecks and vulnerabilities are as follows:

- the resistance exhibited by staff due to the change in culture;
- the absence of guidelines for the design on the tax control framework (experienced, in particular, by the Medium-Sized Businesses segment) and for the assessment of the tax control framework (experienced, in particular, by Tax and Customs Administration staff);
- the rollout of horizontal monitoring in the Small and Medium-Sized Enterprises segment, which raises questions including the design of the meta-monitoring, the role of the financial service provider, the restrictions in the selection of a financial service provider (in effect, a ‘truck system’) and the benefits for enterprises in the Small and Medium-Sized Enterprises segment;
- the risk of ‘attachment’ on entering a relationship of trust between businesses and the Tax and Customs

Administration;

- the lack of transparency in the settlement of past tax issues;
- the lack of clarity about the contents of agreements.

The Committee formulates recommendations for the further development of horizontal monitoring in Chapter 7. These recommendations take account of the above bottlenecks and vulnerabilities.

Chapter 4 Effectiveness and efficiency

4.1 Introduction

The Committee needed to assess the contribution horizontal monitoring makes to the effectiveness and efficiency of the Tax and Customs Administration's supervision and submit proposals for the methods used to measure the effects.

This Chapter reviews the following key questions to be addressed by the study:

1. Which methods has the Tax and Customs Administration implemented to measure horizontal monitoring's effects (and efficiency)?
2. Is it possible to give a substantive assessment of the effectiveness and efficiency of the Tax and Customs Administration's horizontal monitoring and, if so, what is the assessment?

The measurement of *effects* encompasses both qualitative and quantitative elements. The Tax and Customs Administration is seeking relationships based on mutual trust, transparency and openness to achieve an improvement in compliance. Taxpayers are 'enticed' to participate in horizontal monitoring by offering them a number of benefits including the provision of rapid certainty in preliminary consultations, rapid certainty about assessments and reduced supervision. The Committee and various interested parties (taxpayers, financial consultants and the Tax and Customs Administration) reviewed questions including the following:

- What is the relationship between voluntary taxpayer participation in horizontal monitoring and the Tax and Customs Administration's quantitative performance indicators, namely the number of businesses in the Very Large Businesses/Medium-Sized Businesses segments in the various phases of the phase model and the number of enterprises in the Small and Medium-Sized Enterprises segment governed by a compliance agreement concluded with a financial service provider?
- Can the Tax and Customs Administration fulfil the commitments it has laid down in compliance agreements, such as the provision of rapid certainty in preliminary consultations, rapid certainty about assessments and reduced supervision? This is important, since the fulfilment of these commitments is a constituting element of the relationship of trust which the Tax and Customs Administration intends to develop and enhance to promote taxpayer willingness to comply with the tax regulations.
- Does horizontal monitoring contribute to the improved allocation of staff and resources required both to provide an appropriate level of horizontal monitoring service and to address a sufficient number of "high-risk" items which fall outside the scope of horizontal monitoring?

This Chapter continues with a review of the Tax and Customs Administration's current methods for the measurement of the results of its acts (Paragraph 4.2), followed by a number of the Committee's findings on the methods (Paragraph 4.3). The second part of the Chapter discusses the Committee's perception of the concepts of "effectiveness" and "efficiency" in relation to horizontal monitoring, how they could be measured, and concludes with an examination of the feasibility of arriving at a substantive assessment of horizontal monitoring's current effectiveness and efficiency (Paragraph 4.4). The final Paragraph (Paragraph 4.5) lists the Committee's conclusions.

4.2 The Tax and Customs Administration's results measurements

The Tax and Customs Administration has implemented a number of methods for the measurement of the results of its efforts. Firstly, the budget specifies a set of quantitative indicators that give direction to the

Tax and Customs Administration's acts. Targets are specified for each of these indicators each year. Periodic measurements of the progress in the achievement of these targets are carried out for management and accountability purposes. These measurements are reviewed in Paragraphs 4.2.1 to 4.2.3 inclusive.

The Tax and Customs Administration also intends to achieve a further – more qualitative – effect with horizontal monitoring, namely an improvement in its relationship with taxpayers. Horizontal monitoring implies the adoption of a new approach that will have consequences for taxpayers and financial service providers, as well as for the Tax and Customs Administration's staff. These developments are measured by conducting interviews with the relevant taxpayers (the Tax Monitor) and the specific monitoring of businesses in the Very Large Businesses and Medium-Sized Businesses segments (a Small and Medium-Sized Enterprises segment Monitor is being developed) and conducting surveys among Tax and Customs Administration staff. These interviews and surveys are reviewed in Paragraphs 4.2.4 and 4.2.5.

4.2.1 Results measurement, general

Chapter IXB of the Ministry of Finance's National Budget specifies four operational objectives for the Tax and Customs Administration:

1. The provision of services to taxpayers, contribution payers and parties entitled to benefits in the manner appropriate to their situation.
2. The Tax and Customs Administration's performance of supervision and investigations to promote the fulfilment of the statutory obligations of taxpayers, contribution payers and parties entitled to benefits.
3. The provision of a contribution to the protection of society from unwanted goods.
4. The efficient and smooth performance of the mass processes.

The second objective is of particular relevance to this study. The Tax and Customs Administration has implemented a variety of instruments to achieve this objective which include tax audits, desk audits, company and current-status visits, compliance agreements within the scope of horizontal monitoring, theme-based campaigns and investigations. Performance indicators and the associated targets specified in the budget serve for management purposes and for the Tax and Customs Administration's subsequent accounting for its performance. These indicators are specified in the budget and in the annual agreements concluded between the Tax and Customs Administration's management and the Tax district managements (in the form of a management contract).

The Tax and Customs Administration, in line with the government's endeavours to make the effects of its policy visible, intends to replace and/or supplement the traditional input and output indicators specified in the budget with outcome (or effect) indicators whenever this is feasible. However, the indicators specified in the Ministry of Finance's budgets to 2010 were restricted virtually solely to output indicators. These indicators did not, as such, indicate whether – and if so, to what extent – the supervisory approach contributed to the improvement in compliance. The following table from the 2010 Budget reproduced below provides an insight into to the performance indicators the Tax and Customs Administration had adopted at the time.⁸⁶

⁸⁶ The Committee has not assessed the table on its merits.

Table 5: Measurable information from the Ministry of Finance's 2010 Budget⁸⁷

Performance Indicator	Actual 2007	Actual 2008	Target 2009	Target 2010
Number of current-status visits, of which:	31,400	43,200	51,900-62,500	52,800-63,400
SME			50,000-60,000	50,000-60,000
MSB			1,500-2,000	2,500-3,000
VLB			400-500	400-500
Number of tax audits, of which:	60,300	52,300	36,400-44,200	37,600-45,700
SME			35,000-42,000	35,000-42,000
MSB			1,200-1,700	2,200-3,200
VLB			200-500	400-500
Number of hours (acts)		378,000	250,000-300,000	400,000-450,000
Number of SME enterprises governed by a horizontal monitoring agreement	N/A	N/A	N/A	60,000-120,000
Number of processed income tax returns of private individuals	1,026,000	709,600	500,000-700,000	500,000-700,000
Number of processed income tax returns of businesses, of which:				
SME	303,500	269,100	140,000-160,000	140,000-160,000
MSB	7,600	7,900	6,200-6,700	4,400-5,400
VLB	3,200	3,000	1,800-2,000	1,800-2,000
Number of processed corporate income tax returns, of which:				
SME	35,000	30,800	22,000-26,000	22,000-26,000
MSB	9,100	9,400	5,500-6,000	4,500-5,500
VLB	4,500	5,800	3,200-3,400	3,500-4,500
Collection status (in %)	2,5	2,2	2,5-3,0	2,5-3,0

SME = Small and Medium-Sized Enterprises segment; MSB = Medium-Sized Businesses segment; VLB = Very Large Businesses segment

87 Parliamentary Documents II 2010/11, 32 500 IXB, No. 2. The collection status is defined as the amount of the payment arrears (the outstanding receivables of which the payment term has expired and against which notices of objections have not been lodged) expressed as a percentage of the total tax and national insurance contribution receipts: it serves as a key indicator of the (relative) size of the balance of the Tax and Customs Administration's accounts receivable.

The 2011 Budget took a step towards outcome measurement, when the *compliance risk management strategy* concept (see Chapter 3, Paragraph 3.4.2) also made its appearance. The Tax and Customs Administration selects the instruments from the range it has at its disposal which make the largest contribution to compliance. The objective is to influence the behaviour of citizens and businesses in a manner such that the available staff and resources can be deployed to achieve optimum compliance. The Budget also gave a definition of *compliant behaviour*:

- (justifiably) registering for taxpayer status (i.e. all taxpayers are known and are registered correctly);
- filing returns in time;
- filing correct and complete returns;
- paying the tax stated in the return or assessment in time.

This Budget introduced *filing returns in time* and *paying in time* as outcome indicators. A number of traditional output indicators were dropped from the 2011 Budget: these included the number of tax audits and the number of processed tax returns.⁸⁸ Table 2 lists the numbers of tax audits conducted during the period between 2008 and 2011.⁸⁹

Table 6: Tax audits conducted by the Tax districts by segment⁹⁰

	2008	2009	2010	2011
Total	1,201,200	1,049,200	691,000	558,600
Desk audits (processed tax returns)	1,105,700	933,000	587,000	462,500
Income tax returns, private individuals	790,600	728,600	427,500	361,500
Income tax returns, Small and Medium-Sized Enterprises	258,200	148,300	113,700	68,400
Income tax returns, Medium-Sized and Very Large Businesses	10,900	14,600	8,100	1,100
Corporate income tax returns, Small and Medium-Sized Enterprises	30,800	26,400	25,300	21,900
Corporate income tax returns, Medium-Sized and Very Large Businesses	15,200	14,900	12,300	9,700
Tax audits	52,300	44,400	43,000	36,700
Tax audits, Small and Medium-Sized Enterprises	47,300	41,500	40,500	34,400

88 However, these indicators are still being updated and the information is published in the Tax and Customs Administration's annual Management Report.

89 These figures gave the Committee the impression that the number of desk and tax audits (output) fell sharply during the period between 2008 and 2011. The Tax and Customs Administration's Management Report 2011 stated the following about this situation: "The Tax and Customs Administration continued its endeavours to further horizontal monitoring in 2011. The approach has shifted towards a more service-oriented and preventive approach (working in real time) that is designed to prevent mistakes. In contrast to a number of years ago, when the supervision focused on tax audits and desk audits, other instruments such as enforcement communications and horizontal monitoring are now deployed. Tax audits have been deployed increasingly specifically in recent years."

90 Tax and Customs Administration Management Report 2011, Annex 1, Production Tables

Tax audits, Medium-Sized Businesses	3,900	2,300	2,000	1,800
Tax audits, Very Large Businesses	1,100	500	400	500
On-site inspections and inspections of the present situation	43,200	71,800	61,000	59,400
On-site inspections and inspections of the present situation, Small and Medium-Sized Enterprises	N/A	68,700	57,400	56,400
On-site inspections and inspections of the present situation, Medium-Sized Businesses	N/A	2,500	3,100	2,700
On-site inspections and inspections of the present situation, Very Large Businesses	N/A	500	300	200

Tax gap

The Ministry of Finance's same IXB 2011 Budget also introduced the *tax gap* concept. The Tax and Customs Administration intends to minimise the tax gap that arises when citizens and companies do not observe the four aforementioned elements of compliance. The State Secretary for Finance's recent letter to the Senate of the States-General explained the tax gap as follows.⁹¹

1. The Tax and Customs Administration estimates the theoretical 'loss' in tax revenue from registered taxpayers in the Private Individual and Small and Medium-Sized Enterprises segments. The Tax and Customs Administration estimates the magnitude of the tax gap in these segments to generate knowledge about taxpayer compliance behaviour. This information is obtained by collecting a statistical sample from the tax returns filed by the Private Individuals and Small and Medium-Sized Enterprises segments, subjecting the random sample of tax returns to a thorough audit and then extrapolating the results from the audits to obtain an insight into the actual return behaviour of the entire population of registered taxpayers in the Private Individual and Small and Medium-Sized Enterprises segments respectively. The results from these samples serve as the basis for the selection for the compliance risk management strategy in the relevant segments.
2. The Tax and Customs Administration does not estimate the theoretical loss in tax revenue from businesses in the Medium-Sized Businesses and Very Large Businesses segments as account management has been implemented in these segments.
3. Nor does the Tax and Customs Administration estimate the theoretical loss in tax revenue caused by fraud and unknown taxpayers. However, the Tax and Customs Administration's compliance risk management strategy activities extend to investigations of any such fraud and unknown taxpayers.

The results from the timeliness of tax returns, correctness and completeness of tax returns and timeliness of payment tax gap measurements are published in the 2011 budget onwards. The Tax and Customs Administration intends to use the resultant insight into the tax gaps (for example, the types of mistakes, the types of tax, the types of taxpayers and the types of economic sectors) to make more precise decisions in its compliance risk management strategy and deployment of its available capacity. The table from the 2012 Budget is enclosed below (solely for indicative purposes).

⁹¹ Letter from the State Secretary for Finance to the Senate of the States-General of 4 January 2012, DGB/2011/7006U.

Table 7: Tax gap timeliness, correctness and completeness of returns and timeliness of payment⁹²

	2009 Measurement Results	2010 Measurement Results
Percentage of VAT returns received in time	94,9%	95,0%
Percentage of wage tax returns received in time	97,5%	97,9%
Filing correct and complete tax returns; percentage of lost tax revenue based on the sample of Private Individuals (expressed as a percentage of the total tax revenue for this segment)	1,5%	1,5%*
Filing correct and complete tax returns; percentage of lost tax revenue on the basis of the Small and Medium-Sized Enterprises sample (expressed as a percentage of the total tax revenue for this segment)	6,2%-9,2%	6,1%
Percentage of tax returns/assessments paid in time	88%	86%

* New measurements were not available at the time the Committee completed this report.

4.2.2 Horizontal monitoring result measurements

Horizontal monitoring has received attention in the budgets from 2007. The explanatory note to the 2007 Budget introduced the statement – with a reference to the letter of 8 April 2005 (see Chapter 3) – “concluding compliance agreements within the scope of horizontal *monitoring*”. One year later, the Budget emphatically announced that “the Tax and Customs Administration shall increase its investments in reaching prior agreements (horizontal monitoring) in the coming years”. The Budget then noted that “this implies the need for the division of the total supervisory capacity between horizontal monitoring and vertical supervision. For this reason the number of tax audits will decrease slightly from the number in 2007.”

The 2009 Budget explained the policy change in more detail, and emphatically stated that the Tax and Customs Administration assumes that it can trust taxpayers. The compliance strategy was described as “*trust when possible, repression when necessary*”. The Budget also stated the intention (and necessity) of adopting the principle of working in real time. The Budget referred to this as follows: “*For compliant taxpayers, this implies working on the basis of trust and prior agreements, with fewer retrospective audits. (...) For 2009, it has been decided to place more emphasis on preventive forms of compliance and less emphasis on traditional instruments such as tax audits. Although the number of contacts with businesses will not be reduced, the nature of the client contacts will change. (...) Visits to businesses/starting businesses and advance assessments will play a prominent role in the new supervisory approach.*” However, the budgets did not as yet lay down specific performance indicators for this new supervisory form.

This changed with the 2010 Budget, which specified the following performance indicator: *number of enterprises in the Small and Medium-Sized Enterprises segment governed by a horizontal monitoring agreement*. One year later, the 2011 Budget introduced the following indicators for the Very Large Businesses and Medium-Sized Businesses segments: *insight into the quality of the business’ tax control*. This is in line with the phase model which the Tax and Customs Administration has implemented for this segment (see Chapter 3). Tables 8 and 9 list the actuals and

⁹² Ministry of Finance’s IXB 2012 Budget, *Parliamentary Documents II* 2011/12, 33 000 IXB, No. 2, p. 18.

the targets for 2011, as enclosed in Chapter IXB of the Ministry of Finance's 2011 Annual Report.⁹³

Table 8: Performance indicator for horizontal monitoring in the Very Large Businesses/Medium-Sized Businesses segments

	2011 Target	2011 Actual
Organisations at which the feasibility of horizontal monitoring has been assessed (as a percentage of the number of organisations in the segment):		
Medium-Sized Businesses segment	35-45%	43%
Very Large Businesses segment	70-80%	77%
Organisations at which the Tax and Customs Administration has an insight into the quality of the design and implementation of the tax control (as a percentage of the number of organisations in the segment):		
Medium-Sized Businesses segment	20-25%	10%
Very Large Businesses segment	40-50%	38%
Organisations at which the Tax and Customs Administration has an insight into the performance of the tax control (as a percentage of the number of organisations in the segment):		
Medium-Sized Businesses segment	10-15%	4%
Very Large Businesses segment	20-30%	18%

Table 8 reveals that the actuals fell short of the targets, in particular in the Medium-Sized Businesses segment. The Tax and Customs Administration's explanatory note states the reason for the failure to achieve the target as follows: "The Tax and Customs Administration is largely dependent on the efforts businesses make to achieve appropriate internal tax control. These efforts have not yet resulted, in particular in the Medium-Sized Businesses segment, in a situation in which the Tax and Customs Administration can rely on the organisation's internal control."

Table 9: Performance indicator for horizontal monitoring in the Small and Medium-Sized Enterprises segment

	2010	2011 Target	2011 Actual
Number of enterprises in the Small and Medium-Sized Enterprises segment which are governed by a horizontal monitoring agreement	6,000	15,000-30,000	33,000

The target for 2011 was achieved by an ample margin.

4.2.3 Adjusted supervision and meta-supervision

Horizontal monitoring is based on the principle that the Tax and Customs Administration will adjust its supervision when taxpayers and/or their service provider are in control. The Tax and Customs Administration will then refrain from tax audits or desk audits of the tax returns filed by the taxpayers. However, periodic *reality checks* shall need to be carried out to assess the performance of the agreements on tax control reached with the business or service provider in practice: this is a standard procedure for all supervisory authorities. The results

93 Parliamentary Documents II 2011/12, 33 240 IXB, No. 1.

from these *reality checks* also provide information on the achievement of horizontal monitoring's effect.

Very Large Businesses/Medium-Sized Businesses segments

The Tax and Customs Administration refers to *adjusted supervision* in the Very Large Businesses/Medium-Sized Businesses segments. The Tax and Customs Administration gains an insight into the degree of internal control from the business' monitoring and the Tax and Customs Administration's observations. Since the Tax and Customs Administration has implemented account management in the Very Large Businesses and Medium-Sized Businesses segments it refers to 'customisation' in these segments. The "Guide to Horizontal Monitoring within the medium to very large businesses segment" contains the following explanation of this adjusted supervision: "*The Tax and Customs Administration adjusts the form and intensity of its monitoring to the degree to which the organisation is in (tax) control. (...) The detailing, tailored to the specific organisation, entails customisation. (...) The adjustment of the monitoring (in terms of the frequency and quantity of work) is related to the information we have about the quality of the tax control and, consequently, can vary depending on the circumstances at the organisation.*"⁹⁴

The Tax and Customs Administration was requested to submit information on the specific implementation of adjusted supervision in the Very Large Businesses and Medium-Sized Businesses segments. However, the Tax and Customs Administration was unable to provide this information. The specific activities are laid down in the individual dossiers of the relevant businesses. No structural policy information is available.

Small and Medium-Sized Enterprises segment

The Tax and Customs Administration refers to *meta-monitoring* in the Small and Medium-Sized Enterprises segment. Meta-monitoring needs to provide information on the quality of the work processes of the financial service providers and the quality of the filed compliance agreement returns. Meta-monitoring includes random audits of tax returns: this sample serves as a *reality check* that needs to answer to the question: Does the combination of measures result in an acceptable tax return? This audit focuses, in addition to the assessment of the correctness of the contents of the tax returns, on the underlying processes of the financial service provider. When the audit reveals errors in the compliance agreement return then the Tax and Customs Administration and the service provider consult on the need for any modifications of the underlying processes, where relevant.

The first compliance agreement returns were subjected to a random audit within the scope of this meta-monitoring of the Small and Medium-Sized Enterprises segment in 2011. This random sample formed part of the annual sample of the total number of returns filed by enterprises in the Small and Medium-Sized Enterprises segment (*2010 Businesses Sample*). At the end of 2010, approximately 5,000 enterprises had filed a return within the scope of a compliance agreement: the sample encompassed 1% of these enterprises. As the number of items was very small (45 audits were ultimately completed) it is not possible to draw any firm statistical conclusions. The Tax and Customs Administration gained a favourable impression of the perceived quality of the audited compliance agreement returns as compared to the audited non-compliance agreement returns. The returns of 38 of 45 of the enterprises were qualified as acceptable (85%), a percentage which is significantly lower for non-compliance agreement returns. Adjustments were made for three enterprises, primarily in connection with income tax profit returns. Penalties were imposed in two cases. No cases were identified in which preliminary consultations had unjustifiably not been held or in which the results from the preliminary consultations that had been held were not incorporated in the return.

The Tax and Customs Administration shall audit 36 entities with 105 tax reference numbers in 2012: 25 financial service providers are involved in these 36 entities. In addition, meetings will be held with financial service providers to discuss and assess the financial service provider's processes and activities on the basis of the filed

94 Tax and Customs Administration, *Guide to Horizontal Monitoring within the medium to very large businesses segment*, The Hague: November 2010, p. 49 and 51.

returns. In 2012, this will relate to 24 financial service providers and 144 tax returns.

4.2.4 Tax Monitor and segment monitoring

The Tax and Customs Administration traditionally measures the attitude of citizens and businesses to the fulfilment of their tax obligations and the degree of client satisfaction by means of a set of survey questions included in the *Tax Monitor*. This survey measures (developments in) compliance in terms of the taxpayers' *attitude* towards paying taxes: it does not examine the respondents' actual behaviour. The respondents are asked questions including whether they consider tax evasion to be unacceptable, whether they endorse the proposition that they would never evade tax and whether they are of the opinion that in paying taxes they make a contribution. The results are published in the Tax and Customs Administration's annual Management Report. The relevant table from the Management Report 2011 is reproduced below.⁹⁵

Table 10: Attitude of taxpayers towards taxes (%)⁹⁶

	2009	2010	2011
	Benchmark survey		
Tax evasion is unacceptable	92	93	93
The taxpayer would in no instance evade tax	87	90	88
Paying tax is making a contribution	31	35	34

As the Tax Monitor does not ask specific questions about the taxpayers' attitude to and behaviour relating to horizontal monitoring the Tax and Customs Administration began supplementary studies several years ago which are designed to obtain this additional information. In-depth interviews conducted in 2009 and 2011 examined the Medium-Sized Businesses segment's *awareness and appreciation of and experience* with horizontal monitoring. In 2011, these interviews were also conducted in the Very Large Businesses segment. In addition, in 2010 the Tax and Customs Administration carried out a qualitative study of the Small and Medium-Sized Enterprises segment which encompassed in-depth interviews with representatives from the umbrella organisations of financial service providers, financial service providers and sectoral associations. This study also focused on their awareness and appreciation of horizontal monitoring and their experiences to date. A separate Small and Medium-Sized Enterprises Monitor is under development.

The most important conclusions from the aforementioned studies can be summarised as follows.⁹⁷ Hard figures about the Very Large Businesses segment's awareness of horizontal monitoring were not available until 2011, although a small-scale qualitative study did indicate that the large majority of the businesses in the Very Large Businesses segment were aware of horizontal monitoring. The 2011 monitor revealed that the level of awareness was virtually 100%. Approximately 60% of the businesses in the Medium-Sized Businesses segment had heard of horizontal monitoring by the end of 2009, a percentage which had increased to 87% in 2011. Although financial service providers were thoroughly familiar with the development of horizontal monitoring, businesses in the Small and Medium-Sized Enterprises segment were less aware of horizontal monitoring at that time: approximately 20% of the businesses in the Small and Medium-Sized Enterprises segment were aware of horizontal monitoring in 2009. The large majority of businesses in the Very Large Businesses and Medium-Sized Businesses segments

⁹⁵ *Parliamentary Documents II* 2011/12, 33 000 IXB, No. 24.

⁹⁶ Tax and Customs Administration 2011 Management Report, Table 1, p. 8.

⁹⁷ Tax and Customs Administration, *Horizontal Monitoring Monitor*, The Hague: May 2011. This aggregated the results from the various studies.

endorsed the horizontal monitoring concept. Approximately 60% of the respondents in the Medium-Sized Businesses segment had a favourable perception of horizontal monitoring; 20% had a highly favourable perception. These businesses expected that horizontal monitoring would result in (their ability to conduct) (more) constructive consultations with the Tax and Customs Administration which would in turn result in smoother processes and would eliminate the wastage of energy in conflicts about past issues. The financial service providers also had a favourable perception of horizontal monitoring, although they exhibited more reservations than the Very Large Businesses and Medium-Sized Businesses segments. Financial service providers are of the opinion that the most important benefits horizontal monitoring offers them relate to improved communications and cooperation with the Tax and Customs Administration, whilst businesses will benefit from more rapid certainty. Their doubts relate to a potential increase in the administrative burden imposed on small businesses and the availability and motivation of Tax and Customs Administration staff required to ensure that horizontal monitoring achieves the appropriate performance.

4.2.5 Opinions of the Tax and Customs Administration staff (survey conducted by the Tax and Customs Administration)

In 2010, the Tax and Customs Administration asked representative groups of staff from ten Tax districts about *their experiences with and appreciation of horizontal monitoring*.⁹⁸

This survey did not ask specific questions about effectiveness and efficiency, although the respondents were asked for their opinion of the changes in implementation. The respondents were presented seven new elements in the Tax and Customs Administration's implementation of horizontal monitoring and were requested to state the extent to which they regarded each element of the changes in the Tax and Customs Administration's implementation as favourable or unfavourable. The elements and the results from the survey are listed in the following table.

Table 11: Changes in the implementation

	(Very) unfavourable	Neutral	(Very) favourable	Average for element
Approaching taxpayers on the basis of trust	14.3%	17.7%	68.0%	4.99
More horizontal monitoring	19.5%	25.2%	55.3%	4.59
Improved services	1.9%	9.9%	88.3%	5.68
More visible supervision	3.5%	14.5%	82.0%	5.46
More frequent adoption of a project-based approach	15.4%	27.5%	57.1%	4.73
Management on the basis of a compliance risk management strategy	11.2%	34.1%	54.6%	4.71
Endeavour to achieve compliance	4.7%	16.0%	79.3%	5.46

More than half of the staff had a favourable or very favourable perception of all the elements in the changes. Improved services were ranked highest, followed by more visible supervision and the endeavour

⁹⁸ This is the sole survey conducted amongst staff assigned to the various segments to date. A separate survey of staff assigned to the Medium-Sized Businesses segment conducted towards the end of last year also raised a number of the above questions. The report of this survey has yet to be published.

to achieve compliance. The results appear to indicate that some staff have yet to endorse approaching taxpayers on the basis of trust: approximately one-third has an unfavourable or neutral perception of this element.

Although the staff assigned to the Small and Medium-Sized Enterprises segment are also generally in favour of all the new elements of the Tax and Customs Administration's implementation, they have a markedly less favourable perception of several elements as compared to the staff assigned to the Medium-Sized Businesses segment and, in particular, the Very Large Businesses segment. They have a less favourable perception of approaching taxpayers on the basis of trust, the endeavour to achieve compliance and more horizontal monitoring. However, they have a slightly more favourable perception of operating on the basis of a compliance risk management strategy and the adoption of a project-based approach than the staff assigned to the Very Large Businesses and Medium-Sized Businesses segments. Many of the Tax and Customs Administration staff assigned to the Small and Medium-Sized Enterprises segment have yet to be convinced that the course set for the implementation of horizontal monitoring is the appropriate course.

The management group of staff had the most favourable perception of all the new elements of the implementation. The management is more convinced than the other groups that horizontal monitoring will achieve the required results.

4.2.6 The Committee's conclusions on the methods the Tax and Customs Administration has implemented to measure effectiveness and efficiency

1. No business case – with specific benchmarks, performance indicators and a calculation of the required capacity – had been drawn up at the time horizontal monitoring was introduced in the Very Large Businesses segment (2005), Medium-Sized Businesses segment (2008) and Small and Medium-Sized Enterprises segment (2007).
2. No benchmark survey was carried out to determine the degree of compliance at the time of the introduction of horizontal monitoring.
3. The Tax and Customs Administration has not as yet devoted sufficient attention to the *measurement of the effects* of horizontal monitoring. An indicator for horizontal monitoring was introduced in the 2010 budget, namely *the number of enterprises in the Small and Medium-Sized Enterprises segment governed by a horizontal monitoring agreement*. An indicator for the Very Large Businesses/Medium-Sized Businesses segments was introduced one year later, i.e. six years after the introduction of horizontal monitoring. These are output indicators which do not provide any information about the *effect* of horizontal monitoring. No effect indicators have been specified to date. The Tax and Customs Administration focuses exclusively on input and output management.
4. The manner in which *reality checks* are carried out within the scope of adjusted supervision of the Very Large Businesses/Medium-Sized Businesses segments is not clear and there is no insight into the results from these reality checks. For this reason the Committee cannot assess the extent to which the quality systems (the tax control framework, etc.) provide assurances for the quality of the returns.
5. The Tax and Customs Administration needs to appreciate that different requirements are imposed on the quality assurance systems of the various groups of financial service providers. The Tax and Customs Administration has not adequately demonstrated that it takes account of these differences, for example by making a distinction between the number of *reality checks* and/or compensatory measures.
6. The Tax and Customs Administration has carried out – or arranged for the performance of – a qualitative study of the awareness and appreciation of horizontal monitoring in the Very Large Businesses and Medium-Sized Business segments (monitoring of the Very Large Businesses and Medium-Sized Businesses segments). A similar study was also carried out in the Small and Medium-Sized Enterprises segment. This

- study is of a fairly recent date (the study of the Very Large Businesses segment dates from 2011).
7. In 2010, the Tax and Customs Administration carried out – or arranged for the performance of – a study relating to the changes in supervision. This survey is also of a fairly recent date.
 8. The overall impression is that the traditional, output-oriented performance indicators have been adjusted downwards over the course of time and, in some instances, even disappeared from the budget whilst virtually no indicators have been introduced to replace them.
 9. The findings in this Paragraph give cause to the conclusion that the Tax and Customs Administration would appear to be navigating without a clear compass.

4.3 A more detailed review of effectiveness and efficiency

4.3.1 Introduction

The Committee gave consideration to the extent to which it can reach conclusions on horizontal monitoring's effectiveness and efficiency. In the first instance the Committee has established that the Tax and Customs Administration has failed to take sufficient account of the importance of the later performance of effect measurements since the time at which horizontal monitoring was introduced in the Very Large Businesses segment in 2005. The Committee reached this conclusion on the basis of facts including the lack of a business case or benchmark survey. This conclusion is also applicable to the introduction of horizontal monitoring in the Medium-Sized Businesses and Small and Medium-Sized Enterprises segments. The discussions the Committee held with the Tax and Customs Administration's management and staff revealed that the Tax and Customs Administration is struggling with the measurement of effectiveness and efficiency. It can provide virtually no indication of the Tax and Customs Administration's costs and benefits accompanying either the traditional or the new approach to supervision.⁹⁹

It is also necessary to make the following note. It is difficult – if not impossible – to establish a causal relationship between the deployment of instruments (and the associated costs) and their effect on the degree of compliance. This is due to the fact that compliance is determined by a combination of intrinsic motives (tax ethics), extrinsic stimuli (the probability of being caught and the severity of the sanctions) and the opportunities available for compliance (the complexity of the regulations and the costs incurred in complying with the regulations). A (theoretical) assessment of the effectiveness of the instruments that are deployed can be carried out only once two other sets of data are available. Firstly, it is necessary to determine the extent to which citizens and companies provide correct, timely and complete information and pay the amount of tax due, together with the extent to which they would have done so if the instruments had not been deployed (behaviour). Secondly, it is necessary to determine the extent to which citizens are prepared to fulfil their statutory obligations, together with the extent to which they would have been prepared to fulfil those obligations if the instruments had not been deployed (attitude). These comparisons should then provide an insight into the effectiveness.

In 2010, the Tax and Customs Administration requested a study of the objective of compliance. The report on this study, which was also submitted to the House of Representatives of the States-General, concluded that the comparisons required for a determination of the effectiveness in the aforementioned manner cannot be carried out in full.¹⁰⁰ Although indicators for both the behavioural and attitudinal components of the degree of

99 It should be noted that although the discussions about the measurement of the effects of supervision began in 2005, a number of government organisations have initiated systematic work on their introduction only in the past few years. This was, for example, revealed during the recent review of the effect measurement guide within the context of the long-term *Effecten van Toezicht* ('Effects of Supervision') programme, *Inspectieraad & Centrum voor Criminaliteitspreventie en Veiligheid, Effecten van toezicht en handhaving meten. Een handreiking* ('Inspection Council & Centre for Crime Prevention and Public Safety, *Measuring the effects of supervision and compliance. A Guide*') Utrecht: Centre Centrum voor Criminaliteitspreventie en Veiligheid, 2011.

100 *Parliamentary Documents II 2010/11*, 31 066, No. 98.

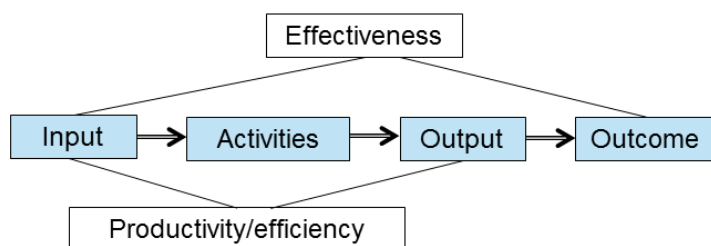
compliance are available, these are not complete and it is not possible to determine the extent to which they are indicative of the actual degree of compliance. Moreover, it is not possible to determine the extent to which the degree of compliance that was achieved was due to the Tax and Customs Administration's activities and its deployment of the selected instruments (the causal relationship) or was due to other factors such as economic developments or amendments of the regulations. For these reasons it is not, as such, possible to determine the effects of the deployment of instruments on the behaviour of taxpayers and, consequently, on tax revenues. This note is also applicable to the deployment of horizontal monitoring. However, this without prejudice to the fact that a government agency which is responsible for a large portion of the state revenue may be expected to have the best possible insight into the factors that need to form the basis for the policy that governs the management of its operations.

4.3.2 Definitions

This Paragraph reviews the Committee's perception of the *effectiveness* and *efficiency* concepts and explains how, in its opinion, these concepts can be defined in more specific terms.

Strategic policy objective

Effectiveness and efficiency refer to policy objectives. In the Committee's opinion the *effectiveness* of horizontal monitoring relates to the *intended* effects of the Tax and Customs Administration's efforts on compliance with tax legislation and regulations and on the underlying social problems (the loss of tax revenue).¹⁰¹ In addition, the Tax and Customs Administration's efforts need to be carried out as purposefully as possible (*efficiency*). The following diagram shows the relationship between the *effectiveness* and *efficiency* concepts:



Explanatory note:

This relates to the relationship between the available capacity and financial resources (input), the activities carried out within the scope of horizontal monitoring (preliminary consultations, compliance surveys and *reality checks*, etc.), the results of those activities (the number of compliance agreements and number of preliminary consultations, etc.), the effects (outcome) on the attitude and behaviour of taxpayers (the improvement in compliance with the regulations) and the impact (final outcome) on society (in terms of tax ethics and tax revenues).

Improvement in compliance

Consequently, the deployment of horizontal monitoring should make a contribution to compliance (behaviour relating to compliance with the tax regulations) and should result in a larger number of acceptable returns and fewer mistakes. This *improvement in compliance* can be interpreted in terms of four elements of compliant behaviour:

- (justifiably) registering for taxpayer status (i.e. all taxpayers are known and are registered correctly);

¹⁰¹ The Tax and Customs Administration's acts can have a wide range of effects. *Effectiveness* links up with the Tax and Customs Administration's objectives and, for this reason, relates to *intended* effects. The deployment of an instrument can also have (favourable and unfavourable) side-effects, i.e. effects caused by the instrument that were not intended.

- filing returns in time;
- filing correct and complete returns;
- paying the tax stated in the return or assessment in time.

The demonstration of the causality between the Tax and Customs Administration's activities within the scope of horizontal monitoring and the degree of the improvement in compliance by those businesses governed by horizontal monitoring requires at least a comparison with a previous situation (prior to the introduction of horizontal monitoring) and/or a control group. However, this is not always feasible in practice.

When a benchmark measurement has not been carried out then one option could be to measure the effect – on the assumption that attitude and behaviour change slowly rather than overnight – by making comparisons over the course of time.

When no control group is available then the effect could be measured by carrying out a supplementary study comprised of interviews with the relevant businesses or financial service providers to determine the plausibility of the influence which horizontal monitoring has on improved compliance with the regulations.

Policy sub-objectives

The goals specified by the strategic policy objectives can, with due regard for the (potential) methodological limitations of effect measurement, be supplemented with *sub-objectives* that link measurable terms to the deployment of horizontal monitoring. An adequate implementation of horizontal monitoring implies, for example, *an improvement in the working relationship* with businesses and financial service providers, the creation of *a better information position* for the Tax and Customs Administration, and *adjusted supervision*. In achieving these results horizontal monitoring makes a contribution to an improvement in compliance with the regulations and to an improved allocation of staff and resources that provides for both the implementation of horizontal monitoring *and* the inclusion of an adequate number of other supervisory items.

1. Improvement in the working relationship

The Tax and Customs Administration assumes that a relationship with taxpayers and financial service providers which is based on trust, mutual understanding and transparency will result in improved compliance with the tax regulations.

When viewed from the horizontal monitoring perspectives of the improved relationship and (mutual) trust then an important criterion is the Tax and Customs Administration's ability to fulfil its commitments. The guides for the staff assigned to the Very Large Businesses and Medium-Sized Business segments and the Small and Medium-Sized Enterprises segments respectively¹⁰² state a number of benefits offered by horizontal monitoring:

- *Rapid certainty in the preliminary consultations*
Questions are answered promptly. The Tax and Customs Administration's preliminary consultations pay due regard to the entrepreneur's commercial deadlines. The business or financial service provider is assigned a permanent contact point at the Tax and Customs Administration.
- *Rapid certainty about assessments*
The processing of compliance agreement returns is based on the principle that the quality of this preliminary assessment is assured in advance and that any differences of opinion, where relevant, have been discussed during the preliminary consultations. As a result, in principle, the returns can be

102 Tax and Customs Administration, *Guide to Horizontal Monitoring within the medium to very large businesses*, The Hague: November 2010; Tax and Customs Administration, *Guide to Horizontal Monitoring within the SME segment, tax service providers*, The Hague: February 2011; Tax and Customs Administration, *Guide to Horizontal Monitoring within the SME segment, sectoral organisations*, The Hague: December 2011.

settled immediately with a final assessment.

- *Resolution of pending tax issues*
This encompasses, in particular, the rapid settlement of (older) returns and notices of objection.

2. *An improved information position*

Making use of the work carried out by others improves efficiency and enables the Tax and Customs Administration to work more in real time.

3. *Reduced Supervision*

The Tax and Customs Administration tailors its monitoring activities to the activities of the taxpayer and/or the financial service provider.

Consideration can also be given to other *sub-objectives* such as more visibility, more preliminary consultations with businesses within the scope of horizontal monitoring and fewer objection procedures. The systematic registration and analysis of the results from the monitoring efforts (such as the results from the *reality checks*) during a number of years provide information for a review of the principles of the policy. The ‘effect indicators’ then provide information about a trend or development that can be used to reach conclusions about the policy.

Supplementary criteria

The Tax and Customs Administration recently drew up a business case for horizontal monitoring in the Small and Medium-Sized Enterprises segment¹⁰³ which states a number of *gains* offered by horizontal monitoring in this segment. These *gains* tie in with the aforementioned *objectives and benefits*.

The Committee is of the opinion that the ‘*the Tax and Customs Administration’s staff exhibit an improved client-oriented attitude and behaviour*’ gain is a valuable supplement to its definition of effectiveness as this gain is the counterpart to the *in improvement in attitude and behaviour of businesses (taxpayers)* aspect.

This can be illustrated by the following list of the *gains* stated in the Tax and Customs Administration’s business case:

1. *Businesses file a larger number of acceptable returns.*
2. *Businesses lodge fewer objections and appeals.*
3. *A higher percentage of enterprises in the Small and Medium-Sized Enterprises segment make use of the services of a tax service provider.*
4. *The Tax and Customs Administration’s staff exhibit an improved client-oriented attitude and behaviour.*
5. *The efficiency and effectiveness of supervision is improved.*
6. *The percentage of rejects is reduced.*
7. *Enterprises in the Small and Medium-Sized Enterprises segment receive greater and earlier certainty.*
8. *Businesses place greater trust in the Tax and Customs Administration.*
9. *The market recognisability of tax service providers who have concluded a compliance agreement is increased.*
10. *The businesses’ internal control is improved.*
11. *The administrative burden imposed on businesses is reduced.*
12. *The self-sufficiency of enterprises in the Small and Medium-Sized Enterprises segment is increased.*

103 Tax and Customs Administration, *Business Case Horizontaal Toezicht Belastingdienst* (‘Horizontal Monitoring Business Case, Tax and Customs Administration’), The Hague: Tax and Customs Administration, April 2012.

4.3.3 The Committee's approach

Pursuant to its assignment, the Committee needed to assess whether horizontal monitoring results in effective and efficient supervision. The Committee cannot reach any conclusions on horizontal monitoring's effectiveness and efficiency of horizontal monitoring on the basis of the results from the Netherlands Tax and Customs Administration's measurements. The Committee gave its opinion on effect measurements in the preceding Paragraph. The following paragraphs review the work carried out by the Committee in the circumstances which it encountered.

The Committee supplemented the information available from the Tax and Customs Administration with (1) information from the round-table discussions, (2) the results from the Tax and Customs Administration staff survey which the Committee requested for this evaluation, (3) information from the Committee's Internet consultations and (4) supplementary information the Committee requested from the Tax and Customs Administration. The Committee made use of the above information in its endeavour to arrive at an opinion on horizontal monitoring's effectiveness and efficiency.

Before continuing with this review, the Committee is of the opinion that a general note is appropriate: the Committee is unable to establish the causal relationship (causality) between the deployment of horizontal monitoring and the degree of compliance since the Tax and Customs Administration did not carry out a benchmark measurement at the time of the introduction of horizontal monitoring. Moreover, a control group is also lacking. It is conceivable that the presumed causality between an established improvement in compliance and the deployment of horizontal monitoring could be determined, for example, by a supplementary qualitative review of taxpayers and the Tax and Customs Administration's staff. The Tax and Customs Administration's Tax Monitor reviews the taxpayers' *attitude* to paying taxes at a fairly abstract level.

The Committee adopted both a qualitative and quantitative approach that, in the first instance, was based on the results from the Tax and Customs Administration's measurements.

The Committee, in line with the intended effect to be achieved by horizontal monitoring, specified the following *criteria* for the (qualitative) review of the effectiveness and efficiency:

- The degree of support for horizontal monitoring amongst taxpayers (and their financial service providers) participating in horizontal monitoring and amongst the Tax and Customs Administration's staff (the degree of acceptance).
- The quality of the approach to horizontal monitoring, whereby the Tax and Customs Administration fulfils the expectations of the benefits offered by horizontal monitoring (rapid answers to questions during the preliminary consultations, rapid certainty about returns and reduced supervision).
- The extent to which capacity is released a result of adjusted (i.e. reduced) supervision which can be deployed for the traditional supervision of taxpayers who do not participate in horizontal monitoring.
- The effect on compliance in terms of improved compliance with the regulations (and, as a consequence, a reduction of the loss of tax revenues).

The achievement of the quantitative targets as expressed in the form of performance indicators is reviewed in a separate Paragraph (4.3.8).

The Committee requested the Tax and Customs Administration's staff to state their opinions on the effectiveness and efficiency of the Tax and Customs Administration's acts. The results are summarised in Paragraph 4.3.9. For the purposes of this survey the Committee defined the concepts of *effectiveness* and *efficiency* in the following terms.

Effectiveness

- *An improvement in the attitude and behaviour of businesses (taxpayers).*
- *An improvement in the businesses' internal control.*
- *An increase in the number of returns filed in time.*
- *A decrease in the number of estimated assessments (in combination with the preceding point).*
- *A decrease in the number of notices of objection (and notices of appeal) lodged by taxpayers.*
- *An increase in timely payments and a reduction in the payment arrears.*

Efficiency

- *A better information position for the Tax and Customs Administration.*
- *An improvement in the preliminary consultations.*
- *An acceleration of return processing.*
- *An increase in the Tax and Customs Administration's information about the businesses.*
- *An adjustment in the supervision due to the fact that the business has control of its tax matters.*

4.3.4 Has horizontal monitoring gained support (acceptance)?

All the participants in the round-table discussions, from both the business community (taxpayers and financial service providers) and the non-profit sector, had a favourable perception of horizontal monitoring. They appreciate the contacts, in particular the fixed point of contact at the Tax and Customs Administration. However, they were under the impression that the Tax and Customs Administration's organisation is not completely ready for horizontal monitoring.

The business community and the non-profit sector were of the opinion that the Tax and Customs Administration still needs to devote attention to the acquisition of adequate support for the new approach. They have observed that some of the Tax and Customs Administration's staff continue to view the concept with scepticism. This impression was confirmed by the results from the survey the Tax and Customs Administration conducted amongst its staff in 2010, which revealed that some staff have yet to endorse approaching taxpayers on the basis of trust: approximately one-third has an unfavourable or neutral perception of this element of the approach (Paragraph 4.2.5).

The survey conducted amongst businesses in the Very Large Businesses and Medium-Sized Businesses segments (Paragraph 4.2.4) in 2011 also revealed a favourable perception of horizontal monitoring. 84% of the businesses in the Very Large Businesses segment that took part in the survey had a favourable perception (half of which had a very favourable perception), 15% had a neutral perception and 1% had an unfavourable perception. 76% of the businesses in the Medium-Sized Businesses segment that took part in the survey had a favourable to very favourable perception, 22% had a neutral perception and 2% had an unfavourable perception.

The survey of the Tax and Customs Administration's staff requested by the Committee asked the staff to state their impression of the experiences of taxpayers and financial service providers have with horizontal monitoring. This survey was restricted to staff who are regularly involved with horizontal monitoring in their in their day-to-day work. The Committee decided to implement this restriction of the target group because it was of the opinion that this would generate the most relevant observations. About half of the staff who took part in the survey had the impression that taxpayers primarily experience the benefits offered by horizontal monitoring. Between more than one-third and 40% of the staff had the impression that the financial service providers primarily experience the benefits offered by horizontal monitoring.

The responses to the Internet consultations also revealed that the concept of horizontal monitoring appeals to the respondents.¹⁰⁴ A large majority endorsed horizontal monitoring as such, although some reservations were expressed about its implementation. The respondents stated that the Tax and Customs Administration thinks actively with them. The preliminary consultations were referred to as a particularly favourable element: one respondent stated that they are an important and promising development although, as was also stated by another respondent, they are acquiring shape only very gradually. Most respondents have the impression that horizontal monitoring has increased mutual understanding.

The Committee's conclusion

The Committee has established that the (large members of the) business community have a favourable perception of horizontal monitoring and they experience an improved relationship between the business and the Tax and Customs Administration.

4.3.5 Has the Tax and Customs Administration provided the expected benefits?

The various discussions with the interested parties (corporate sector, non-profit sector, financial service providers) devoted express attention to the question whether the Tax and Customs Administration can fulfil the expectations of horizontal monitoring. These expectations relate, in particular, to rapid answers to questions during the preliminary consultations, the resolution of pending issues, rapid certainty about assessments and reduced supervision. In general, the taxpayers had a favourable perception of the speed at which opinions are formed during the preliminary consultations. This was also applicable to the speed of the resolution of pending issues. However, several participants were critical about the role of the Tax and Customs Administration's knowledge groups. In the experience of a number of businesses calling in a knowledge group regularly retards the process. The standpoint that is ultimately adopted takes insufficient account of the taxpayer's specific situation.

Several participants stated that the Tax and Customs Administration had begun with taxpayers who, in general, were already compliant and of which the Tax and Customs Administration already had a good insight. This gives cause to a certain degree of caution when arriving at conclusions, since the opinions of these taxpayers could result in a distorted impression.

The umbrella organisations expressed doubts whether the Tax and Customs Administration's staff are sufficiently equipped for their duties. Conducting system supervision and assessing a business control framework and the derivate tax control framework requires new, specialised expertise. However, this is not a regular form of expertise possessed by tax officials (nor, it should be noted, by tax consultants or accountants). This is not beneficial to the uniformity of the implementation. All staff share the opinion that horizontal monitoring cannot succeed without the appropriate technical integration. In general, the staff are of the opinion that the Tax and Customs Administration currently possesses sufficient tax knowledge and expertise.

The survey conducted amongst the Tax and Customs Administration's staff revealed that a two-thirds majority is of the opinion that the Tax and Customs Administration has made insufficient investments in the staff and resources required for the appropriate performance of horizontal monitoring. However, one-third was of the opinion that the Tax and Customs Administration has made sufficient investments. Two-thirds of the staff stated that they had received appropriate assistance during the changes in their duties. Approximately 90% of the staff stated that they were thoroughly familiar with the horizontal monitoring procedure and rules. The Internet consultations resulted in the following impressions: one respondent stated that although the

¹⁰⁴ The Internet consultations resulted in a total of 55 responses, more than half of which were from financial service providers.

Tax and Customs Administration's horizontal monitoring intentions and commitment were favourable, the implementation was "under the threat of becoming bogged down". This was endorsed by one respondent who stated that the staffing level was simply inadequate to deal with the large number of requests for consultations rapidly and in the appropriate manner. Another respondent was interested to learn whether the tax inspectors of smaller businesses, in particular, are assigned sufficient time for the horizontal monitoring concept: the respondent wondered whether tax inspectors have the time – and the willingness – to answer questions immediately and to assess the standpoints adopted by businesses. A further respondent stated that he was under the impression that the government was not sufficiently prepared to make the investments in horizontal monitoring required to build up a pool of officials who are able to audit taxpayers and hold preliminary consultations in the appropriate manner.

The umbrella organisations stated that financial service providers and their clients experience an increased inspection activity within the scope of horizontal monitoring as compared to the period in which vertical supervision was the customary form of supervision. They were of the opinion that this is due to the fact that the Tax and Customs Administration is currently working on meta-monitoring's start-up phase and wishes to gain an insight into horizontal monitoring's performance, as a result of which – in the financial service providers' opinion – the Tax and Customs Administration conducts a relatively large number of inspections. This is, in particular, reflected in the random inspections of compliance agreement returns: the businesses selected for the sample experience this increased supervision as a heavier supervisory burden. Although the supervisory burden may have decreased at a macro level, this is not the experience of the parties involved at micro level.

The Tax and Customs Administration has, for efficiency reasons, implemented what is referred to as the "onion-skin model". The accountant's work plays an important role in this model, which is intended to avoid the duplication of work and rely on the work of the auditor whenever this is feasible. However, the discussions held with the Tax and Customs Administration revealed that in practice virtually no use is made of the work carried out by the external auditor that relates to at least to the specific work carried out by the auditor as intended in the design of the onion-skin model as discussed in Paragraph 3.4.7.

The Tax and Customs Administration's staff view the need to implement a substantial reduction of its staffing level with concern. The business community has also expressed similar concern. This reduction could result in the departure of experienced and expert Tax and Customs Administration staff who possess a great deal of knowledge and many valuable contacts. The staff are firmly convinced that this contraction will be detrimental to the Tax and Customs Administration's performance in general and to the service level for horizontal monitoring in particular.

The Committee's conclusions

The round-table discussions and the Internet consultations gave the Committee the impression that the parties involved are of the opinion that the expectations of rapid answers of questions in the preliminary consultations, resolution of pending issues and rapid certainty about assessments are, in general, being fulfilled.

However, the Committee is concerned about the system-supervision expertise possessed by the Tax and Customs Administration's staff. This form of supervision requires qualities other than those required for the traditional inspection of returns.

It is not as yet possible to arrive at firm conclusions about reduced supervision. The enterprises in the Small and Medium-Sized Enterprises segment experience – in contrast to the forecast decrease – increased inspection activities during this phase. In addition, the Committee has established that in practice the Tax and Customs Administration makes virtually no use of the work carried out by the external auditor as intended in the onion-skin model.

The Committee endorses the concerns about the future level of the quality of horizontal monitoring following the combination of the departure of experienced staff and further reductions resulting from the relevant targets.

4.3.6 Release of capacity for vertical supervision

The Tax and Customs Administration 'markets' horizontal monitoring to its staff on the basis of arguments including the argument that horizontal monitoring in the Very Large Businesses and Medium-Sized Business segments achieves time savings which could then become available for vertical supervision. The general opinion of the participants in the round-table discussions was that these time savings are not being achieved. Holding preliminary consultations and, in particular, discussing tax risks play an important role in horizontal monitoring: both activities cost the Tax and Customs Administration a great deal of time.

The Committee asked the Tax and Customs Administration whether it could provide information about the capacity released as a result of the reduced supervision of businesses that are in Phase 5 of the phase model (*adjustment of the form and intensity of monitoring*). The Tax and Customs Administration was unable to provide this information. It would appear that the Tax and Customs Administration does not keep records of the hours and capacity deployed for businesses in each phase of the phase model.

The survey of the Tax and Customs Administration staff requested by the Committee revealed that the staff were of the opinion that more than 50% of enterprises in the Small and Medium-Sized Enterprises segment experience a reduced supervisory burden. The equivalent figure for businesses in the Medium-Sized Businesses/ Very Large Businesses segments was 40%.

Several respondents taking part in the Internet consultations emphasised the need for an appropriate blend of horizontal monitoring and (visible) vertical supervision. One respondent wondered whether the horizontal monitoring and vertical supervision activities were still in equilibrium. A great deal of time is now allocated to taxpayers for whom the efforts to achieve an improvement in compliance is unnecessary. The respondent was of the opinion that this, in view of the contraction of the staffing level, leaves virtually no time available for traditional tax audits. Businesses need to be made aware both of the implications of the decision to participate

in horizontal monitoring and the implications of the decision *not* to participate in horizontal monitoring.

The Committee's conclusion

The Committee has not received the information required to reach a conclusion as to whether – and, if so, to what extent – capacity has been released that can be allocated to other forms of supervision. For this reason the Committee has also been unable to establish that horizontal monitoring exhibiting an appropriate performance releases capacity – a release was the intention at the time of the introduction of horizontal monitoring.

4.3.7 Effect on tax revenues

Many of the round-table discussions raised the question whether horizontal monitoring might not result in taxpayers and the Tax and Customs Administration adopting an excessively flexible approach to the tax obligations that in turn results in the risk of a fall in tax revenues (caused by reasons including the settlement of old issues). However, on balance, the participants in the discussions were of the opinion that there was no reason to fear any such erosion of tax revenues. A small group was of the opinion that horizontal monitoring has a neutral influence on tax revenues: those who ‘already did it well will continue to do it well’ and those who ‘already cut corners’ are expected to continue to do so. Conversely, a larger group expects that horizontal monitoring will be beneficial to tax revenues: tax revenues will increase due to the improvement in the quality of returns and due to the fact that taxpayers will wish to be in control – taxpayers will wish to do it ‘better’. The participants also drew attention to the improvement in the information position achieved by horizontal monitoring, as a result of which the Tax and Customs Administration has an improved insight into the vulnerable issues in the businesses’ compliance with the regulations.

A number of respondents who took part in the Internet consultations were also of the opinion that horizontal monitoring will be beneficial to compliance, whilst others are of the opinion that horizontal monitoring has a neutral effect: horizontal monitoring will reach solely those businesses that were already prepared to fulfil their tax obligations.

The Committee's conclusion

The majority of the participants in the discussions with the Committee assume that horizontal monitoring is not detrimental to tax revenues. This would appear to be confirmed by the inspections of the compliance agreement returns filed by enterprises in the Small and Medium-Sized Enterprises segment. However, the Committee is of the opinion that in the absence of sufficient quantitative information it is unable arrive at a sufficiently substantiated conclusion on this issue.

4.3.8 Performance indicators

The Tax and Customs Administration, as explained in Paragraph 4.2, has implemented a number of performance indicators to assess the effectiveness of its acts. Two performance indicators that focus specifically on horizontal monitoring were included in the budget and management contract in 2011:

- *insight into the design, implementation and performance of the business’ tax control (Very Large Businesses/Medium-Sized Businesses segments);*

- number of enterprises in the Small and Medium-Sized Enterprises segment governed by a horizontal monitoring agreement.

The Committee makes a general note about these indicators: both indicators measure solely the output and are not a measure of improved compliance.

Very Large Businesses/Medium-Sized Businesses segments

The results from the Tax and Customs Administration's horizontal monitoring in 2011 are enclosed in Paragraph 4.2.2. The number of businesses in the Very Large Businesses/Medium-Sized Businesses segments at which the Tax and Customs Administration has an insight into the design and implementation and performance of the tax control systems fell short of the target. The Tax and Customs Administration attributes this shortfall to the insufficient investments of the businesses in their tax control. The reasons for this are not clear. It is conceivable that the businesses' operating environments compel them to defer (costly) investments in their tax control framework. It is also possible that the Tax and Customs Administration's communications of the benefits offered by horizontal monitoring have been insufficient to fully convince the relevant businesses. Further analysis would be required to arrive at a clear conclusion.

This shortfall is in particular evident in the Medium-Sized Businesses segment. Businesses in the Medium-Sized Businesses segment are, in contrast to businesses in the Very Large Businesses segment, not governed by a formal obligation to draw up a tax control framework. Chapter 3 revealed that both businesses and the Tax and Customs Administration's staff are in need of a specification of the minimum requirements to be met by tax control frameworks. The Tax and Customs Administration, in particular, is concerned that the current phase model retards rather than accelerates the process involved in the conclusion of a compliance agreement. Practice has revealed that Phase 1 (Client profile) and Phase 2 (Horizontal monitoring is /is not feasible) are completed relatively smoothly, but that the process 'stalls' in Phase 3: the businesses would not appear to have an incentive to continue with the process. It would seem that the businesses have already gained the most important benefits by this phase (i.e. a fixed point of contact and preliminary consultations) and no longer have an incentive to enter into further commitments.

The Committee requested the Tax and Customs Administration to provide additional information about the following *effect indicators*:

- the number of timely returns or payments by participants in horizontal monitoring as compared to the other businesses in the segment;
- the number of corporate income tax objections filed by participants in horizontal monitoring as compared to the number of notices of objection lodged by businesses that do not participate in horizontal monitoring;
- the presence of tax-efficient structures.

The Committee received three summaries from the Tax and Customs Administration, i.e. the number of estimated assessments (which is an indirect measure of the timeliness of tax returns), the payment arrears and the corporate income tax objections lodged by businesses. These figures related solely to 2010 and 2011: information for earlier years was not available. The summaries revealed that:

- The number of estimated assessments imposed on participants in horizontal monitoring in 2010 and 2011 was half the number imposed on non-participants (less than 2% as compared to 4%). There was no difference between businesses in the Very Large Businesses segment and the Medium-Sized Businesses segment.
- The payment behaviour of participants in horizontal monitoring would appear to be significantly better

than that of the other businesses (by a factor of two). There are only small differences between businesses in the Very Large Businesses segment and the Medium-Sized Businesses segment.

- The difference in the numbers of lodged notices of objection was less clear, although the percentages were lower than those for other businesses (approximately 5% as compared to 7%). Once again, the percentages for businesses in the Very Large Businesses segment and the Medium-Sized Businesses segment were also approximately identical.

These figures give cause to the question as to the reason for the higher scores for businesses that participate in a compliance agreement. Can these scores be attributed to the implementation of horizontal monitoring? Or is the group of businesses that qualifies for a compliance agreement by definition a more compliant group? Once again, the absence of a benchmark measurement complicates the issue. In the absence of this measurement it is once again impossible to arrive at any firm conclusions on the basis of this information.

The Tax and Customs Administration was unable to provide any information on the implementation of and development in the number of tax-efficient arrangements in the Very Large Businesses/Medium-Sized Businesses segments. This is complicated by the lack of a uniform definition of "a tax-efficient structure".

The Committee's conclusions on effect measurements in the Very Large Businesses/Medium-Sized Businesses segments

The Tax and Customs Administration keeps records of very little information about the effects of horizontal monitoring. Several summaries were drawn up on the Committee's specific request. Effect measurements are not carried out in the Very Large Businesses/Medium-Sized Businesses segments at present.

The Tax and Customs Administration does not have an insight into the results from the preliminary consultations and has no structural insight into the improvement in return behaviour, improvement in payment behaviour or the development of tax-efficient structures.

The information provided to the Committee is insufficient to answer the question whether the policy implemented for the Very Large Businesses/Medium-Sized Businesses segments is effective and efficient.

Small and Medium-Sized Enterprises segment

The results for 2011 reveal that the number of enterprises in the Small and Medium-Sized Enterprises segment which are affiliated with a compliance agreement concluded by a financial service provider has increased from 6,564 in 2010 to 33,462 in 2011.

The Committee also requested the Tax and Customs Administration to provide the following information about the Small and Medium-Sized Enterprises segment:

- the number of timely returns or payment by participants in horizontal monitoring as compared to the other enterprises in the segment;
- the number of corporate income tax objections filed by participants in horizontal monitoring as compared to the number of notices of objection lodged by enterprises that do not take part in horizontal monitoring.

The Tax and Customs Administration was unable to make the requested comparison between enterprises governed by a horizontal monitoring agreement and other enterprises.

As indicated in Paragraph 4.2.4, in 2011 the Tax and Customs Administration began annual random inspections of tax returns of enterprises affiliated with a compliance agreement. The small number of items inspected in that year has yielded insufficient information for conclusions at present. These samples will ultimately result in a control group which can be used to make comparisons.

The Committee's conclusions on effect measurements in the Small and Medium-Sized Enterprises segment

A cautious start was recently made with effect measurements in the Small and Medium-Sized Enterprises segment. Since work on these measurements is still in the initial stage it is not possible to arrive at conclusions at present.

The Tax and Customs Administration does not have an insight into the improvement in the return and payment behaviour of enterprises in the Small and Medium-Sized Enterprises segment that are affiliated with a compliance agreement concluded by a financial service provider.

The information provided to the Committee is insufficient to answer the question whether the policy that has been implemented is effective and efficient.

4.3.9 Opinions of the Tax and Customs Administration's staff

The Committee requested the staff to state their opinion on the effectiveness and efficiency of the Tax and Customs Administration's acts.

General

All the answers revealed that the management has a more favourable perception of the results achieved by horizontal monitoring than the staff. This is in line with the results from the survey the Tax and Customs Administration conducted in 2010 (Paragraph 4.2.5). This is not, as such, a surprising outcome since when viewed from a professional perspective managers will usually (be able to) identify somewhat more with the organisation's policy than the average member of staff.

Effectiveness

More than sixty per cent of the staff stated that horizontal monitoring results in improved compliance in the cases which they process. This overall finding was reviewed against a number of the elements of effectiveness (Paragraph 4.3.3).

The staff primarily concluded that the effectiveness has improved on the basis of:

- an improvement in the attitude and behaviour of businesses;
- an improvement in the businesses' internal control.

This is applicable to the staff assigned to all segments and, above all, to the staff assigned to the Very Large Businesses segment.

About 50% of the staff stated that in their work package horizontal monitoring results in:

- a decrease in the number of estimated assessments;
- an increase in the number of returns filed in time;
- a decrease in the number of objections lodged by taxpayers.

About one-third of the staff stated that they had observed a reduction in payment arrears. The results from the survey reveal a striking difference in the experienced effectiveness in the Medium-Sized Businesses segment: the improvement in the number of estimated assessments, increase in the number of returns filed in time and reduction in the payment arrears are all less marked than in the other segments. A decrease in the number of aggressive tax structures was observed in only one-third of the cases (in all segments).

Efficiency

Opinions on whether horizontal monitoring results in improved efficiency for the Tax and Customs Administration differ to a greater extent. More of the staff assigned to the Small and Medium-Sized Enterprises segment have a favourable perception of the efficiency of horizontal monitoring (62%) than the staff assigned to the Very Large Businesses segment (43%) and Medium-Sized Businesses segment (37%).

This overall finding was reviewed against a number of sub-elements of efficiency (Paragraph 4.3.3). The large majority of the staff (ranging from 66 - 80%) were of the opinion that horizontal monitoring results in:

- an improved information position for the Tax and Customs Administration;
- improved preliminary consultations;
- more frequent preliminary consultation;
- an acceleration of return processing;
- an increase in the Tax and Customs Administration's information about the business;
- an adjustment of the supervision due to the fact that the business has control of its tax matters.

It is striking to note that the staff had a considerably more favourable perception of the elements of efficiency listed above than of the overall efficiency. It would appear that although they have observed an improvement in all the sub-elements that can contribute to an improvement in efficiency, they are not as yet of the opinion that (the implementation of) the horizontal monitoring process is efficient in its entirety.

The more favourable perception of horizontal monitoring of the staff assigned to the Small and Medium-Sized Enterprises segment as compared to the staff assigned to the Very Large Businesses and Medium-Sized Businesses segments is understandable in view of the differences in the approach to horizontal monitoring between the Very Large Businesses/Medium-Sized Businesses segments and the Small and Medium-Sized Enterprises segment. However, the difference could also be explained by the fact that the staff assigned to the Very Large Businesses/Medium-Sized Businesses segments have at least the feeling that their businesses remain in a given phase for an excessive period of time.

4.4 Capacity planning

4.4.1 Introduction

The Tax and Customs Administration's ability to fulfil the expectations of horizontal monitoring depends largely on the availability of a sufficient number of appropriately equipped staff. The participants in the round-table discussions expressed their unanimous concerns about the effects of the announced spending cuts in the Tax and Customs Administration's organisation. The interested parties stated their doubts about the Tax and Customs Administration's ability to fulfil the expectations of horizontal monitoring in the future should the targets result in a contraction of the Tax and Customs Administration's staffing level. However, irrespective

of the targets, the question is: to what extent can the Tax and Customs Administration fulfil its ambitions for horizontal monitoring?

This Paragraph addresses the following question:

How is the capacity available for horizontal monitoring distributed between the Very Large Businesses, Medium-Sized Businesses and Small and Medium-Sized Enterprises segments and to which activities is time devoted?

Paragraph 4.4.2 contains an inventory of the current situation in terms of the number of businesses/enterprises and the Tax and Customs Administration staff. Paragraph 4.4.3 outlines the Tax and Customs Administration's ambitions for horizontal monitoring and Paragraph 4.4.4 reviews the relationship between these ambitions and the targets and investments. The final Paragraph (Paragraph 4.5) contains the Committee's conclusions.

4.4.2 Current Situation

The Tax and Customs Administration makes a distinction between three groups of businesses, namely the Very Large Businesses segment, Medium-Sized Businesses segment and Small and Medium-Sized Enterprises segment. The Tax and Customs Administration makes a further distinction between groups of enterprises in the Small and Medium-Sized Enterprises segment, which are divided into three groups of businesses with employees, self-employed persons without employees and starting businesses.

Number of businesses

The figures for January 2012 were as follows:

- Very Large Businesses segment	2,562 entities of which 1,370, in principle, come into consideration for a horizontal monitoring programme. The other entities form what is referred to as the "target group remainder". ¹⁰⁵
- Medium-Sized Businesses segment	10,101 businesses
- Small and Medium-Sized Enterprises segment	approximately 1.5 million enterprises, 600,000 of which form part of the potential target group for horizontal monitoring (<i>SME Plus</i>) ¹⁰⁶

The Tax and Customs Administration's capacity

The Committee asked the Tax and Customs Administration the following questions about its capacity:

- How is the capacity divided between the Very Large Businesses, Medium-Sized Businesses and Small and

¹⁰⁵ The businesses in the target group remainder are of a size such that they do not qualify for Very Large Business or Medium-Sized Business status and, as a result, for account management. However, they can participate in horizontal monitoring via a compliance agreement concluded with a financial service provider. For organisational reasons the businesses in the target group remainder are processed by a specific Tax district at one national location. This relates to financial institutions (Amsterdam Tax district), energy companies (Rivierenland Tax district) and businesses in the oil and gas sector (Rijnmond Tax district).

¹⁰⁶ In February 2011 the segment was comprised of 600,000 enterprises in the *SME Plus*, 590,000 self-employed persons without employees and 320,000 starting enterprises, amounting to a total 1.5 million. *SME Plus* includes 115,000 one-person private limited companies, self-employed persons without employees with the legal status of a private limited liability company. The target group for horizontal monitoring (*SME Plus*) encompasses the *estimated* number of potential enterprises which are the client of a financial service provider with a quality system that qualifies for horizontal monitoring. Consequently, the consultancies that comply with the quality requirement are determinative.

Medium-Sized Enterprises segments?

- Is an indication of the amount of this capacity allocated to horizontal monitoring available?
- Is a breakdown of the capacity by phase of the phase model for the Very Large Businesses and Medium-Sized Businesses segments available?
- Is a breakdown by capacity allocated to the various types of compliance agreements concluded with the Small and Medium-Sized Enterprises segment (compliance agreements with financial service providers and sectoral agreements) available?

The Tax and Customs Administration provided the following information:

Distribution of capacity between the segments

The Tax and Customs Administration had a total staffing level of 28,454 FTEs in 2012, of which 13,301 FTEs were allocated to Customs, the Fiscal Intelligence and Investigation Service, Benefits, the Central Administration, management, ICT and other support groups. The Tax districts were allocated a staffing level of 15,153 FTEs, of which more than half was assigned to the supervision of businesses. The breakdown by segment is as follows:

- Very Large Businesses segment: 717 FTEs
- Medium-Sized Businesses segment: 1,129 FTEs
- Small and Medium-Sized Enterprises segment: 5,889 FTEs, of which 4,562 for SME Plus.

Distribution between horizontal monitoring and traditional supervision

The time registration for 2011 yields the following breakdown of the capacity deployed for horizontal monitoring and traditional supervision in the Very Large Businesses and Medium-Sized Businesses segments.

Table 12: Distribution of capacity between horizontal monitoring and traditional supervision in 2011

Very Large Businesses segment (VLB)	Hours	FTE 2011	Percentage
VLB horizontal monitoring	289,265	320	51%
VLB traditional supervision	283,522	313	49%
VLB total	572,788	633	100%
Medium-Sized Businesses segment (MSB)	Hours	FTE 2011	Percentage
MSB horizontal monitoring	334,257	370	30%
MSB traditional supervision	779,896	862	70%
MSB total	1,114,153	1,232	100%
Small and Medium-Sized Enterprises segment (SME)	Hours	FTE 2011	Percentage
SME horizontal monitoring	133,315	147	3%
SME traditional supervision	4,738,337	5,242	97%
SME total	4,871,652	5,389	100%

Breakdown by phase of the phase model

The Tax and Customs Administration was unable to provide a breakdown of the capacity deployed for the Very Large Businesses segment and Medium-Sized Businesses segment by phase of the phase model since it does not keep any records of this information. However, the data listed in Table 2 in Chapter 3 (Paragraph 3.4.4)

can be used to derive the percentage of taxpayers in the Very Large Businesses/Medium-Sized Businesses segments with whom the Tax and Customs Administration is holding discussions or has concluded a compliance agreement. The Tax and Customs Administration is holding discussions with 29.4% of the businesses in the Very Large Businesses segment and has concluded a compliance agreement with 12.9% of the businesses in this segment. The corresponding figures for the businesses in the Medium-Sized Businesses segment are 18.1% and 9.4% respectively. These figures imply that – in the current phase of horizontal monitoring – 51% of the time available for the Very Large Businesses segment is devoted to horizontal monitoring relating to 42.3% of the taxpayers in this segment. 30% of the time available for the Medium-Sized Businesses segment is devoted to horizontal monitoring relating to 27.5% of the taxpayers in this segment.

Breakdown of the Small and Medium-Sized Enterprises segment by types of compliance agreement

Virtually all of the capacity available for horizontal monitoring in the Small and Medium-Sized Enterprises segment is devoted to compliance agreements with financial service providers. A small fraction of this time is devoted to sectoral agreements. The allocation of this time is not planned and is not recorded separately.

4.4.3 The Tax and Customs Administration's ambition

The Tax and Customs Administration's 2012 Business Plan stated that the Tax and Customs Administration intended to impart an impetus to its objective of bringing as many businesses as possible under a form of horizontal monitoring. The Business Plan stated that the number of businesses governed by a form of horizontal monitoring is still limited. The sole specific target laid down in the Business Plan stipulates that 20% of the enterprises in the *SME Plus* segment shall be governed by a form of horizontal monitoring by the end of 2012.¹⁰⁷ At 31 December 2011, The numbers of compliance agreements were as follows.

Table 13: Agreements concluded within the Very Large Businesses, Medium-Sized Businesses and Small and Medium-Sized Enterprises segments at 31 December 2011

		Number of Agreements	Number of Businesses/Enterprises
Very Large Businesses segment		177	177
Medium-Sized Businesses segment		954	954
Small and Medium-Sized Enterprises segment	Umbrella agreements	6	
	Compliance agreements with financial service providers	161	
	Enterprises affiliated with a compliance agreement		33,462
	Sectoral agreements	16	

Very Large Businesses and Medium-Sized Businesses segments

The actuals for the 2011 targets reveal that the targets, in particular the targets for the Medium-Sized Businesses

¹⁰⁷ Tax and Customs Administration's 2012 Business Plan, p. 10.

segment, were not achieved (see Paragraph 4.2.2).

The Tax and Customs Administration's activities in the Very Large Businesses and Medium-Sized Businesses segments are managed on the basis of the current status and the quality of the individual strategic processing plans and on the progress in and scope of the activities arising from the strategic processing plans. The teams carry out an analysis of the various types of tax of relevance to the business, assess their importance and the tax risks, and review the feasibility of horizontal monitoring. The teams also make decisions on the specific deployment of the available capacity and the prioritisation, decisions which are made on the basis of professional judgement: the guides do not provide a framework of standards for these decisions. No instruments are available for the efficient allocation of capacity, for example on the basis of a risk classification system (high/medium/low).

Each Tax district prepares for the annual plan by making as an accurate as possible estimate of the number of businesses they can 'serve' in horizontal monitoring with the capacity that they have available. These estimates are made on the basis of their practical experience and professional judgement. The figures in the Tax districts' annual plans are then totalled and compared with the total number of businesses in the Very Large Businesses and Medium-Sized Businesses segments to determine the target to be specified in the budget and management contract. No specific calculations are made for the time to be devoted to the various sub-activities (such as the exploration of compliance and the preliminary consultations).

The Tax and Customs Administration has concluded that the amount of work to be carried out in the Very Large Businesses and Medium-Sized Businesses segments and the capacity available for these segments is not in balance. The 2012 Business Plan concluded that the number of businesses in the Medium-Sized Businesses segment is too large for the implementation of account management for all these businesses.¹⁰⁸ Proposals have since been drawn up for the elimination of the distinction between the Very Large Businesses segment and the Medium-Sized Businesses segment and the formation of one Large Businesses segment. The two standards that will then be adopted are externally visible criteria (linked to the demarcations of the obligation to carry out audits as laid down in the Civil Code) and, in view of the Tax and Customs Administration's staffing level, a manageable number (in the Tax and Customs Administration's opinion) of approximately 9,000 entities (excluding the top 50 businesses) as based on the allocation of 1 FTE to every 6 organisations (excluding the staffing level for the top 50 businesses).¹⁰⁹ Pursuant to these proposals a number of organisations shall be transferred from the Very Large Businesses/Medium-Sized Businesses segments to the Small and Medium-Sized Enterprises segment and a number of enterprises shall be transferred from the Small and Medium-Sized Enterprises segment to the Very Large Businesses/Medium-Sized Businesses segments. These proposals, on which the Tax and Customs Administration's management has yet to reach a decision, would result in the transfer of 3,667 entities from the Very Large Businesses/Medium-Sized Businesses segments to the Small and Medium-Sized Enterprises segment and the transfer of 2,136 entities from the Small and Medium-Sized Enterprises segment to the Very Large Businesses/Medium-Sized Businesses segments.

Small and Medium-Sized Enterprises segment

161 financial service providers had concluded a compliance agreement at the end of 2011. The customer base of these financial service providers encompasses a total of more than 430,000 enterprises in the Small and Medium-Sized Enterprises segment.¹¹⁰ In January 2012, 33,462 enterprises were affiliated with a compliance agreement concluded by their financial service provider: on this date approximately 8% of the potential number

108 Tax and Customs Administration's 2012 Business Plan, p. 11. The Business Plan makes use of the term "individual agreements". The Committee assumes that this refers to account management.

109 The Tax and Customs Administration allocates 2.5 FTEs to each business in the top 50 businesses, amounting to a total of 125 FTEs.

110 The number of 600,000 referred to earlier relates to the number of clients that come into consideration for horizontal monitoring when all financial service providers have concluded a compliance agreement.

of enterprises that could become affiliated with a compliance agreement had actually become affiliated. The target for 2012 stipulates that 75,000 enterprises shall be affiliated with a compliance agreement. The target for 2015 stipulates that between 200,000 and 250,000 enterprises shall file returns governed by a compliance agreement concluded by a financial service provider.

Only a small number of staff, in both relative and absolute terms, (147 FTEs) are allocated to horizontal monitoring in the Small and Medium-Sized Enterprises segment. The staff maintain contacts with the financial service providers who, pursuant to the adopted approach, provide assurances for the acceptability of the returns. The Tax and Customs Administration does not have a detailed framework of standards for its assessment of the control measures.

4.4.4 Savings and investments

Government targets

The national government's targets, targets that will inevitably also impact the Tax and Customs Administration, may have an influence on its ambitions for (horizontal) monitoring. During the period from 2010 onwards the cuts in the the Tax and Customs Administration's budget will gradually increase to € 395 million in 2015. The State Secretary for Finance stated that the spending-cut target can be achieved "without detriment to service or compliance" only when the scope of the Tax and Customs Administration's tasks is reduced by the simplification of the relevant legislation.¹¹¹ The most important principle stipulates that spending cuts of this magnitude may not be to the detriment to tax revenues or contribution revenues.

The approach to the targets is based on two lines of approach. The first line of approach pivots on more efficient operations and economies in the operations. The second line of approach pivots on the reduction of the Tax and Customs Administration's implementation costs by means of the simplification of the relevant legislation and regulations. The State Secretary is of the opinion that this simplification of the relevant legislation and regulations is a precondition attached to the Tax and Customs Administration's continued ability to perform its duties in an adequate manner once its staffing level and budget have been reduced.

Expenditure reviews (Report 16)

The need to implement cuts in national government expenditure was also an issue during the previous Balkenende IV Government's term of office. In 2010, the Government formed a number of official working groups within the scope of its *Brede heroverwegingen* ('Expenditure reviews') which received the assignment to draw up proposals for spending cuts. One of these working groups drew up a proposal for the determination of the profit of businesses in the Very Large Businesses/Medium-Sized Businesses segment and the top segment of enterprises in the Small and Medium-Sized Enterprises segment (a total of approximately 33,000 businesses and enterprises) on the basis of the commercial profit recognised in the financial statements approved by the auditor, an approach which would obviate the need for the Tax and Customs Administration to make further supervisory efforts for the determination of the profit.¹¹²

The report took account of the fact that at present data is frequently subjected to several inspections and audits – and with overlapping objectives – by the relevant business, the business' financial service provider and the Tax and Customs Administration. The working group was of the opinion that efficiency gains in this area were feasible. The Tax and Customs Administration's work could be restricted to random audits to verify that the auditor had performed his or her duties in the appropriate manner when adopting the financial statements. The

¹¹¹ *Parliamentary Documents II* 2011/12, 31 066, No. 117.

¹¹² *Brede heroverwegingen*, sub-report 16, *Uitvoering belasting- en premieheffing* ('Implementation of taxation and the levy of contributions'). This report is part of the expenditure reviews initiated by the Balkenende IV Government for the reduction of the national government's expenditure. The working group received the assignment to draw up variants that would achieve at least 20% savings in the current implementation costs for taxation and the levy of contributions.

report included a note that this approach would be accompanied by the risk of a deterioration in compliance with legislation and regulations due to the fact that the interests of the businesses and their accountancy firms are less in conflict than those of the businesses and the Tax and Customs Administration. According to the working group's calculations the proposal to outsource supervision would result in implementation savings for the Tax and Customs Administration that which could increase to € 70 million in 2015 and could achieve structural savings of as much as € 130 million.¹¹³

This proposal was not – justifiably so, in the Committee's opinion – ultimately adopted. The Tax and Customs Administration submitted a negative opinion on this variant to the Minister and State Secretary for Finance. This opinion was based on two arguments, firstly that the potential detrimental effects on compliance and tax revenues and the weakening of the Tax and Customs Administration's position would not be offset by the estimated savings and, secondly, that the proposal implied a role for auditors for which they had not (yet) received training. The Government, which had changed to a caretaker government during the intervening period, issued the Expenditure review reports to the House of Representatives of the States-General without an accompanying Government standpoint.¹¹⁴

Although a full comparison with horizontal monitoring does not hold water – the Tax and Customs Administration makes the necessary efforts in horizontal monitoring (such as preliminary consultations), whilst these efforts would no longer be made in the situation covered by the variant – the reasons given by the working group and the Tax and Customs Administration's administrative management raise a number of more or less fundamental questions. For example, the working group's assumption 'that the interests of the businesses and their accountancy firms are less in conflict than those of the businesses and the Tax and Customs Administration' strikes at the heart of the horizontal monitoring concept, which pivots on mutual trust, openness and transparency. The critical tone of the comment of the Tax and Customs Administration's administrative management about the auditor's role is also striking: the Committee establishes that there is a discrepancy between the official policy in this field and the internal perception.

Business case for horizontal monitoring in the Small and Medium-Sized Enterprises segment

The Tax and Customs Administration recently drew up a business case for horizontal monitoring in the Small and Medium-sized Enterprises segment.¹¹⁵ The objective of the business case is to visualise the added value offered by horizontal monitoring in the Small and Medium-Sized Enterprises segment and to indicate the extent to which an additional investment will result in a positive cost-benefit ratio. This was the first document drawn up since the introduction of horizontal monitoring to interpret the intended effects in financial terms. The business case's calculation indicated that the temporary deployment of 50 additional FTEs (at a cost of € 38 million) during the years between 2012 and 2018 would achieve savings € 170 million, in part due to savings in the implementation costs (fewer tax and desk audits) and in part due to additional tax revenues generated by more reliable accounting systems (the 'software line of approach').

Although the Committee appreciates this attempt to provide substantiating figures, it has doubts about the substance of the business case. A significant proportion of the supposed benefits – € 114 million – is generated from the 'software line of approach'. As explained in Chapter 2 (Paragraph 2.4), the Committee does not regard this cooperation with software suppliers as falling within the scope of horizontal monitoring. The business case's focus on the software line of approach ignores the favourable effects of compliance agreements

113 The estimate of the - maximum - potential savings was based on the number of staff members that were assigned to the segments concerned (corresponding to approx 50% of the workforce of the Tax districts) at the time, multiplied by the (average) wage sum, plus a surcharge for personal costs, such as housing.

114 Letter of 1 April 2010 from the Minister of General Affairs to the House of Representatives of the States-General.

115 Tax and Customs Administration, *Horizontal Monitoring Business Case Tax and Customs Administration*, The Hague: April 2012.

concluded with financial service providers.

In addition, all the benefits projected by the business case originate from the hotel and catering industry. This implies – on the assumption that the Tax and Customs Administration’s business case is correct – that the implementation of horizontal monitoring (via the ‘software line of approach’) in sectors other than the hotel and catering industry would not achieve any results.

Source: Tax and Customs Administration’s horizontal monitoring business case

The most important driving force for the quantification of these benefits is the achievement of improved compliance and, as a result, increased tax revenues. This quantification is based on the following information:

- *The total of the counter transactions in the Dutch retail sector, bars and cafes, and other hotel and catering establishments amounts to more than € 92 billion per annum;*
- *However, a tax gap is an issue in the hotel and catering industry and retail sector. Entrepreneurs incur a loss of revenues caused by smart customers, customer/staff combinations, the improper use of the return button and the deliberate omission of sales from the books;*
- *The Horizontal Monitoring Programme Team assumes that 90% of all transactions in the hotel and catering industry are compliant and 10% are not, equivalent to € 1.2 billion;*
- *The introduction of the seal of approval and its appropriate implementation should result in a 10% increase in sales accounted for in the books, equivalent to € 120 million.*

In total, the VAT, wage tax and profits tax amount to a tax burden of more than 30% – or, in other words, every 10% per cent increase in hotel and catering industry transactions accounted for in the books results in a € 36,000,000 increase in annual tax revenue.

The calculation of the benefits achieved by horizontal monitoring in the Small and Medium-Sized Enterprises segment is open to doubt. The Committee notes that the achievement of quantitative results of this nature with limited investments in the software line of approach is, as such, of value. However, in the Committee’s opinion this business case cannot serve as justification for the implementation of horizontal monitoring in the Small and Medium-Sized Enterprises segment. It will be self-explanatory that this does not imply that the potential benefits should be ignored: the data could – albeit indirectly – be of use for horizontal monitoring, namely when they are employed in the vertical supervision of the Small and Medium-Sized Enterprises segment. The business case ignores this element.

4.5 The Committee’s conclusions

This Paragraph, which lists the Committee’s final conclusions, addresses the following questions:

1. Which methods has the Tax and Customs Administration implemented to measure horizontal monitoring’s effects (and efficiency)?

- No horizontal monitoring business cases were prepared for the rollout in each segment. No benchmark measurements were carried out for the Very Large Businesses segment, Medium-Sized Businesses segment or Small and Medium-Sized Enterprises segment. The first performance indicators were specified only in 2010 and have been supplemented only very slowly since then. These indicators are still solely output-oriented and offer little assistance in assessments of horizontal monitoring’s effect on the compliance of

businesses governed by the concept.

- In practice, the Tax and Customs Administration makes virtually no use of the work carried out by accountants in the manner intended in the onion-skin model – advocated by the Tax and Customs Administration – that is designed to achieve efficiency gains. The Tax and Customs Administration still carries out a lot of work in phases 2, 3 and 4 of the phase model and makes very little use of the work carried out by the businesses. The Tax and Customs Administration does not manage this process and pays insufficient attention to the management of the progress through the various phases.
- The Tax and Customs Administration has not as yet devoted sufficient attention to the measurement of horizontal monitoring's effectiveness and efficiency. The Committee is of the opinion that the provision of horizontal monitoring management information is totally inadequate. Horizontal monitoring is provided insufficient support from information systems that can assist in decision-making on the appropriate form of supervision and the measurement of the effects and efficiency of the selected form. It is not clear how the Tax and Customs Administration manages the organisation and its staff within the scope of horizontal monitoring.
- In the absence of the necessary (structural) information the Committee is unable to reach any conclusions on the extent to which reality checks are carried out in the Very Large Businesses segment and Medium-Sized Businesses segments or on the results from those reality checks. The first reality checks were carried out in the Small and Medium-Sized Enterprises segment in 2010. These were based on random inspections of compliance agreement returns. The number of items that have been inspected is still too small for any conclusions on this issue.

2. Is it possible to give a substantive assessment of the effectiveness and efficiency of the Tax and Customs Administration's horizontal monitoring and, if so, what is the assessment?

- The information provided to the Committee is insufficient to enable the Committee to answer the question whether the implemented policy is effective and efficient.
- The Committee, even after repeated questions to that effect, has been unable to establish a systematic deployment of capacity for horizontal monitoring and distribution of capacity between the various segments. A government agency that is responsible for a large portion of the state revenue may be expected to have a better insight into the manner in which the relevant circumstances and factors influence the policy on which the agency's management is based. The Tax and Customs Administration is currently navigating a course without an appropriate compass. For this reason horizontal monitoring is still based on following intuition and convictions, whilst the economic rationale of the concept has yet to be provided sufficient substantiation.
- As the management information makes no distinction between horizontal monitoring and other forms of supervision the Tax and Customs Administration is unable to give adequate account for the manner in which – and the reason why – the available capacity is divided between horizontal monitoring and the other forms of supervision.¹¹⁶ Nor is there an insight into the capacity allocated to the various horizontal monitoring activities. For these reasons it is not clear how much attention is currently being devoted to horizontal monitoring as compared to the attention required for the 'growth' of horizontal monitoring and for other forms of supervision.
- The information provided to the Committee is insufficient to enable the Committee to arrive at a sufficiently substantiated conclusion for the question whether – and, if so, to what extent – capacity has been released as a result of reduced supervision that can be deployed in other forms of supervision.

¹¹⁶ This has begun in the Small and Medium-Sized Enterprises segment.

Chapter 5 The legitimacy of horizontal monitoring

5.1 Introduction

The discussions held by the Committee regularly addressed the legal basis for horizontal monitoring or, to be more precise, the potential risks and the consequences of the lack of a legal basis. Questions were asked as to how the conclusion of a compliance agreement – as the most prominent manifestation of horizontal monitoring – relates to the tax law system, the associated principles of proper administration and the principles of the democratic constitutional state. The following issues, in particular, were raised: the principle of equality, the principle of legal certainty and the availability of legal protection.

The key question to be addressed in this Chapter is:

Is horizontal monitoring compatible with the tax system's legal framework in the manner that provides assurances for the legitimacy of the Tax and Customs Administration's acts?

A distinction is then made between the following sub-questions:

1. How do the various stakeholders (taxpayers, financial service providers, academics and Tax and Customs Administration staff and management) experience the legal integration of horizontal monitoring in practice and which legal bottlenecks and vulnerabilities do they perceive?
2. How does horizontal monitoring relate to the principles of legal equality, legal certainty and legal protection? In continuation from this, would it be advisable to implement further legal or other measures to improve the integration of horizontal monitoring in the tax system?

This Chapter of the report examines the opinions on bottlenecks and vulnerabilities relating to the legitimacy of horizontal monitoring that the Committee found in the literature or heard during the round-table discussions and interviews. These opinions are summarised briefly in Paragraph 5.2, which concludes with a reference to the State Secretary for Finance's statements on this issue.

The influence horizontal monitoring can have on the assessment process gives cause to a further analysis of the relationship between the tax inspector (who is responsible for the imposition of assessments) and the (politically) responsible the Tax and Customs Administration's management (bearing the political responsibility) (that organises the work processes). This analysis (enclosed in Paragraph 5.3) was carried out to assess whether there are sufficient assurances that horizontal monitoring complies with the reasonable requirements of legal equality, legal certainty and legal protection. The Committee is of the opinion that these three requirements will determine whether the court regards the Tax and Customs Administration's horizontal monitoring acts to be legitimate. The general legislative framework that governs taxation – and, consequently, the implementation of horizontal monitoring – is outlined in Paragraph 5.4. Issues relating to legal equality, legal certainty and legal protection are examined in more detail in Paragraph 5.5. Paragraph 5.6 discusses the financial service provider's position, in particular in the Small and Medium-Sized Enterprises segment. The final Paragraph, Paragraph 5.7, contains the Committee's conclusions.

5.2 Legal integration in practice

The Committee obtained the information from the literature, round-table discussions, interviews with supervisors, staff survey and Internet consultations required to form an opinion on horizontal monitoring's legal integration in the tax system. The majority of the parties actively involved in individual compliance agreements and compliance agreements with financial service providers have a favourable perception of the horizontal monitoring concept. However there still appear to be a number of legal bottlenecks, vulnerabilities and uncertainties in its implementation. Participants in the round-table discussions with academics and financial service providers drew attention to the fact that in current practice the relationship between principles such as legal equality ("fair play") and legal protection ("equality of arms" and the prohibition on self-incrimination) and horizontal monitoring is often still unclear. The Committee was also perceived some distrust about the Tax and Customs Administration's actual intentions for horizontal monitoring. Some participants asked why there are so many rituals to lay down rules that do no more than confirm the purport of the law. The various round-table discussions raised a large number of (supposed) intentions: the Tax and Customs Administration wishes to achieve economies in its organisation by transferring costs to taxpayers, the Tax and Customs Administration intends to restrict the margins for tax planning, and horizontal monitoring is a preliminary phase in the statutory recognition and regulation of the tax consultant profession, etc. The Committee's following review examines this legal integration on the basis of two approaches.

(Supposed) differences between the positions of taxpayers who are or are not involved in a compliance agreement

- Horizontal monitoring offers taxpayers benefits including more rapid certainty about their assessments and the expectation of fewer time-consuming retrospective inspections. The Committee also observed that the parties involved appreciate the personal contacts, the speed of action and the quality of the settlement of questions and problems, benefits which are offered by the ability of taxpayers and/or their financial service providers, when so required, to discuss their business tax questions and bottlenecks with the competent inspector before filing their returns or paying taxes. In other words, horizontal monitoring is accompanied by the Tax and Customs Administration's provision of service at a higher level. This gives cause to the interested parties' question as to whether this approach can result in legal inequality which is to the detriment of taxpayers who do not participate in horizontal monitoring.
- It was striking to note that some participants drew attention to the opposite, in particular when taxpayers are affiliated with a compliance agreement concluded with a financial service provider. These respondents stated that this affiliation actually resulted in *increased* Tax and Customs Administration inspection, i.e. affiliation is detrimental to taxpayers. The participants in the discussions stated that this can be explained in part. Experience with the quality of the returns needs to be acquired in the initial stage and *reality checks* continue to be necessary at a later stage. Nevertheless, this creates the impression that the opportunity for a win-win situation suggested by the Tax and Customs Administration still does not always (in terms of the workload) materialise for the taxpayer or the taxpayer's financial service provider.
- Some participants also noted that affiliation with a compliance agreement limits the options for tax planning – and this whilst taxpayers and their financial service providers are certainly entitled to make use of tax planning in view of the ruling by the tax division of the court that taxpayers are free to adopt the most tax-efficient approach.¹¹⁷
- One of the benefits of horizontal monitoring referred to by the participants in the discussions lies in the feasibility of the rapid settlement of old points of dispute on joining the horizontal monitoring programme. However, other participants criticised this feasibility. Some groups in the Tax and Customs Administration stated that the Tax and Customs Administration 'would be prepared to incur a loss' on the settlement of past tax years when this resulted in the conclusion of a compliance agreement. This could be indicative of

117 R.E.C.M. Niessen, *De fiscaal voordeligste weg*, Arnhem: Gouda Quint 1994. The demarcation of the legitimacy of the taxpayer's acts is marked by the point at which these come into conflict with the objective and purport of the law (*fraus legis*).

preferential treatment in recruiting participation in horizontal monitoring which could be in conflict with the law and/or the principle of equality. This was also suggested by participants in the discussions other than those from the Tax and Customs Administration, albeit articulated less clearly.

Potential legal bottlenecks for taxpayers who opt for horizontal monitoring

- Financial service providers have a need for clear and objective criteria for the admission process. This need for objective criteria is, in particular, applicable to the assessment as to whether an enterprise is ready for affiliation with a compliance agreement. However, this need also plays a role in other areas, such as the approach to interpretation problems and the procedures for conflict management and the resolution of disputes. The transparency is still experienced as too limited.
- The impression of some financial service providers that there is a lack of objective criteria for admission to a compliance agreement was shared by some of the Tax and Customs Administration staff. They often felt that they had been dispatched with a message while they were still unaware of the precise nature of the implementation. The Internet consultations yielded similar findings.
- Academics and the financial service providers, as stated in Chapter 3, suggested that a decision that is open to objection and appeal be issued on admission to horizontal monitoring as a means of enhancing legal protection. There is also a need for clarity about the consequences of a taxpayer's reporting of an error. In particular, this relates to the question whether, on the adjustment of an established shortcoming, a penalty may – or should – also be imposed on a taxpayer participating in a compliance agreement relationship.¹¹⁸

The Tax and Customs Administration's standpoint

Chapter 3 has already drawn attention to the State Secretary for Finance's repeated statements that the tax treatment of a business with a compliance agreement is completed *within* the framework laid down by the relevant legislation and regulations, as a result of which businesses that are parties to a compliance agreement will not receive a more or less favourable treatment than taxpayers who are not parties to a compliance agreement.¹¹⁹ The State Secretary's standpoint implies that the situation that arises on concluding a compliance agreement which results in participation in horizontal monitoring is not a circumstance of relevance to reviews of the principle of equality. The Committee has adopted the State Secretary's standpoint for the review of the horizontal monitoring policy.

5.3 The Tax and Customs Administration's organisation

Financial service providers and academics, in particular, anticipate potential bottlenecks in the legitimacy of horizontal monitoring. The officers bearing the political responsibility emphasise that from a legal perspective there is no reason to assess horizontal monitoring in a manner other than that used for traditional (vertical) supervision since horizontal monitoring remains within the scope for policy-making as demarcated by the general principles of proper administration and the prevailing legislation and regulations. Prior to forming its opinion, the Committee deems a review of the Tax and Customs Administration's organisation to be necessary since the design of the organisation – alongside the existing legislation and regulations – lays down the framework for the implementation of horizontal monitoring.

One of the Tax and Customs Administration's core activities is to determine the amount of tax each taxpayer is to pay for each type of tax (and the other associated decisions).¹²⁰ The inspector is, from a legal perspective,

118 Cf. Tax and Customs Administration, *Guide to Horizontal Monitoring within the medium to very large businesses segment*, The Hague: November 2010, p. 67 and 68; Tax and Customs Administration, *Guide to Horizontal Monitoring within the SME segment, tax service providers*, The Hague: February 2011, p. 20 and 21.

119 See letter from the State Secretary for Finance of 26 October 2009, No. DB2009/62qM.

120 Chapter 11 of the General State Taxes Act assigns this task to 'the inspector' to the extent that this relates to taxation by means of an assessment: Chapter 20 of the General State Taxes Act assigns this task to the inspector in relation to corrective additional tax

the administrative body which makes the decisions (that are open to objection and appeal) relating to the tax debtor. The tax inspector determines the assessments, within the administrative framework governing the administration of justice, in autonomy. The discretionary scope within this power is referred to as the inspector's '*freies Ermessen*'. However, the inspector's '*freies Ermessen*' in his assessment power is demarcated in the interest of the uniformity of policy. Consequently, the inspector exercises the power assigned to the inspector by law with due regard for the instructions issued to the inspector pursuant to a hierarchical relationship within the Tax and Customs Administration.¹²¹ This *freies Ermessen* implies an increasingly narrower scope for policy-making decisions by individual tax inspectors. Decisions relating to assessments are increasingly made by teams.

The inspector's power to impose assessments is supplemented with the power and responsibility of the Director-General for the Tax and Customs Administration and the Director-General's management team to give shape to the implementation of tax legislation and tax policy. All levels of the Tax and Customs Administration give account for their acts, via the hierarchical lines, to the administrative management. The Minister of Finance and the State Secretary for Finance bear the political responsibility for the entire taxation process.¹²² The inspector adopts a standpoint in specific cases, with due regard for these policy rules. The State Secretary for Finance bears the responsibility at a macro level for the maintenance of an appropriate balance between the interests of the tax inspector's personal administration of justice and the uniformity of policy and implementation.

The Tax and Customs Administration develops a relationship with a business or financial service provider within the scope of a compliance agreement. The formal responsibility for the development of this relationship is borne by the Tax and Customs Administration management. The tax inspector, in the inspector's role as an administrative body, is responsible for the imposition of assessments as the final product of the relevant work process. It is understandable – and desirable – that, in view of the powerful force of the principle of equality, the Tax and Customs Administration monitors tax inspectors closely to ensure that they (in their role as an administrative body) do not issue interpretations of legislation to individual taxpayers or financial service providers within the context of a compliance agreement relationship that – unintentionally and undesirably – bind the Tax and Customs Administration in its entirety.

However, the above issues do not relate to new questions for the Tax and Customs Administration that which are raised by the 'horizontal monitoring' phenomenon: the necessary measures had already been implemented to provide assurances for the legitimacy of the Tax and Customs Administration's acts. The Committee's analysis of this aspect pivots primarily on the *transparency issue*. Legitimacy not only needs to be assured internally, but also needs to be open to monitoring externally. The transparency issue arises as a result of the dual relationship between taxpayers and the Tax and Customs Administration. Firstly, the Tax and Customs Administration staff and taxpayers develop a relationship focused on the taxpayer's business which is based on trust (either directly or via their financial service provider) within the scope of horizontal monitoring and which is confirmed by the conclusion of a compliance agreement. This compliance agreement, which is characterised by its voluntary nature (and which is manifested by its designation as 'horizontal'), results in adjusted (efficient) supervision that is intended to avoid the need to duplicate all the inspection work. However, the Tax and Customs Administration and taxpayers also have a second relationship, the legal relationship between taxpayers and the tax inspectors who impose the assessments that is not voluntary and which is characterised

assessments for the levy of taxes that are paid by means of the settlement of assessments or self-assessments.

121 Letter from the State Secretary for Finance of 27 February 2008, No. DGB 2008-00833 U, V-N 2008/12.4.

122 What is referred to as "the Wibo van der Linden affair" (1985), in which the State Secretary had become involved in the assessment of an individual journalist, caused a commotion and concern about the relationship between the autonomy of inspectors in exercising their assessment power and their hierarchical connection with the Tax and Customs Administration's management and the ministers bearing the political responsibility. The legal autonomy of the inspector was emphatically recognised at the time.

by the equality of all taxpayers before the law. This relationship is manifested in the form of the imposition of assessments that are open to objection and appeal. There is a threat of these two relationships overlapping within the scope of horizontal monitoring.

The Committee's conclusion

The Committee is of the opinion that the transparency issue cannot be resolved in full. This is due to the fact that tax inspectors are, in their role as an administrative body, responsible for determination of assessments and are involved in acts within the scope of the performance of their legal duty to implement tax legislation. It is necessary, for the purposes of transparency, to ensure that the acts of tax inspectors in their role of the official determining assessments and in their role as an official within the scope of a compliance agreement relationship do not – in the perception of external parties – appear to become entangled. For this reason transparency is required in the various roles brought together within the Tax and Customs Administration.

5.4 General tax law framework

Dutch tax law, in contrast to general administrative law, incorporates a ‘closed system’ of administrative appeal whereby the decisions open to objection and appeal are limited to those decisions explicitly specified in the legislation. Assessments are by far the most important of these decisions. In addition, the tax law stipulates that appeals can be lodged solely by the person on whom an assessment has been imposed¹²³, or to whom a decision open to objection has been directed (Article 26(a) of the General Taxes Act). Other persons who are of the opinion that they have an interest in these decisions are excluded from lodging an appeal. In addition, decisions by the Minister of Finance or the State Secretary for Finance which do not relate to an assessment or a similar decision are not, with the exception of a few specific decisions¹²⁴, open to objection or appeal.

This poses the question for the Committee whether, in the assessment of the legitimacy of horizontal monitoring, further (statutory) measures for legal protection are necessary and need to be deemed to be appropriate within the context of the Tax and Customs Administration’s other implementation and inspection activities. The Committee positions this question within the context of the legislative proposal of May 2011 that was submitted by the House of Representatives of the States-General and which related to the tax authority’s obligation to keep records and the expansion of legal protection from tax inspectors’ decisions within the context of the tax authority’s inspection acts (*Bulletin of Acts and Decrees*, 2011, 265). Although the legislative proposal was originally of a very broad scope, during the debate in the House of Representatives of the States-General the scope became limited to a number of highly specific acts laid down in the Act.

The tax law does not include decisions to refuse taxpayers admission to horizontal monitoring in the decisions specified as being open to appeal. For this reason the Committee has concluded that decisions of this nature are classified in the “decisions not open to appeal” category. Self-evidently, an appeal can be lodged with the independent tax division of the court when the correctness of the assessment is at issue. This is feasible when, within the scope of horizontal monitoring, an assessment is imposed which is in conflict with the general principles of proper administration. For this reason, in the Committee’s opinion, a taxpayer may lodge a complaint about a breach of the trust that has been built up and about the principle of equality when the taxpayer is of the opinion that the policy lines known to govern horizontal monitoring (see the various guides)

123 This includes an interested party who has settled or paid the tax declared in the return or from whom the tax was withheld.

124 M.W.C. Feteris, *Hoe is het gesteld met de fiscale rechtsbescherming?* (“What is the situation with respect to legal protection for tax matters?”) (2008 Jan Giele lecture), Amersfoort: Sdu 2008, p. 48.

were, in error, not implemented.

The Committee's conclusions

The Committee has concluded that the closed system of administrative appeal within tax law excludes decisions on admission to horizontal monitoring from objection or appeal, whereby the Committee also takes account of the fact that the implementation of horizontal monitoring falls within the broad policy margins governing the Tax and Customs Administration's implementation and inspection activities.

5.5 The legitimacy of horizontal monitoring

5.5.1 Horizontal monitoring and legal equality

The initial uncertainty about the content of compliance agreements and the requirements imposed on the tax control framework created a mythical ambience around the newly-launched supervisory instrument. The "Guide for Horizontal Monitoring within the medium to very large business segment" stipulates that variances from the standard texts are not permitted when drawing up compliance agreements so as to protect legal equality, efficiency and neutrality. The Guide states that variances are permitted solely in very exceptional circumstances and then solely in consultation with the processing team, the management and the national coordinators and within the limits of the themes for discussion laid down in the Guide.¹²⁵ Although the late publication of this guide (2010) may have provided scope for speculation about a wide range of arrangements laid down in the compliance agreements during the period prior to its publication, the transparency problem would now – in the Committee's opinion – to have been solved in theory. The answers to any doubts that may still linger can be found in the relevant communications.

In addition, a potential legal inequality between taxpayers who participate in horizontal monitoring and do not participate in horizontal monitoring is also an issue, since the working and behavioural agreements laid down in compliance agreements are intended to create a win-win situation for the Tax and Customs Administration and the taxpayer. The great emphasis frequently placed on this win-win situation has at least suggested that entering into a compliance agreement relationship results in a different (and more favourable) legal relationship. This still results in confusion. In practice, two opposite points of view are defended:

- Taxpayers who are not a partner to a compliance agreement who due to identical circumstances are, from a tax/legal perspective, in an identical position to that of taxpayers who have concluded or are affiliated with a compliance agreement can, pursuant to the principle of equality, invoke agreements laid down in compliance agreements and interpretations issued by the Tax and Customs Administration within the context of preliminary consultations (where applicable) or at a later date.
- Taxpayers who have concluded or are affiliated with a compliance agreement are as such in a different position from taxpayers who are not a partner to a compliance agreement by virtue of their participation in a compliance agreement – or, in other words, since by very definition their positions are not identical the application of compliance agreement arrangements for taxpayers who are not a partner to a compliance agreement cannot be enforced by invoking the principle of equality.

The Committee draws attention to the fact that the discussion on legal equality is not a new phenomenon which became an issue on the implementation of horizontal monitoring. Even prior to the introduction of

¹²⁵ Tax and Customs Administration, *Guide to Horizontal Monitoring within the medium to very large businesses segment*, The Hague: November 2010, p. 31.

horizontal monitoring differences in the tax inspectors' estimates of taxpayer frequently resulted in unequal processing strategies for unequal cases (frequent/less frequent tax audits and willingness/unwillingness to hold preliminary consultations, etc.), although these considerations were then of an implicit nature. Horizontal monitoring has made the estimation of the risk on concluding the compliance agreement more explicit. This has resulted in a more transparent situation, which can only be regarded as a favourable development.

The Committee's conclusions

The Committee has concluded that the lack of external transparency, in particular, is or has been the main problem in interpreting the legal significance of compliance agreements.

The Committee is of the opinion that the implementation of horizontal monitoring is not in conflict with the principle of equality, self-evidently provided that, in accordance with the Tax and Customs Administration's policy, the compliance agreements do not include provisions laying down interpretations of the legislation.

However, the Committee is of the opinion that great care should be taken when granting specific facilities to partners to compliance agreements which are not included in the compensatory measures for the advantages and disadvantages laid down in the compliance agreement and from which taxpayers who are not partners to the compliance agreement are excluded.

5.5.2 Horizontal monitoring and legal certainty

Legal certainty is a highly-developed legal principle in tax law. However, the protection provided by legal certainty does not need to reach to an extent that puts the general perception justice in jeopardy. This plays, in particular, a role in the correction of decisions reached and announced at an earlier date. The distribution of the tax burden intended by the legislator needs to be systematically balanced against the principle of legal certainty. Consequently, the demarcations of the principle of legal certainty are determined by the principle of equality and by the interests of others in not paying more than is necessary. This, in analogy with the principle of equality, is a general issue that is not of relevance solely to horizontal monitoring.

Horizontal monitoring is based on a working relationship in which mutual justified trust is the binding factor that the Tax and Customs Administration also wishes to maintain. This requires a willingness to cooperate in solving problems that have arisen, for example, as a result of shortcomings in internal control systems that became apparent at a later date. Financial service providers, in particular, require more clarity about the approach they should adopt in situations of this nature and about the Tax and Customs Administration's response. The Committee emphasises that the customary powers for the enforcement of the law available to the Tax and Customs Administration pursuant to the relevant legislation and regulations can also be exercised in the presence of a compliance agreement. The regular legal protection is available against decisions of this nature.

It is essential that the horizontal monitoring agreements laid down in the compliance agreement are respected by both parties. In practice, businesses or service providers will occasionally make mistakes and, consequently, fail to report a tax matter or file a return that is not entirely correct. The Tax and Customs Administration can also make mistakes. However, a mistake does not automatically imply the total loss of trust. The parties are expected to respond to mistakes with understanding, which implies their willingness to enter into discussions

about the cause of the mistakes and about the compensatory measures to prevent a recurrence.

When one of the parties believes that its trust has been abused to an extent that (ultimately) results in the decision to terminate the compliance agreement then this will damage the relationship and undermine the basis for trust. The compliance agreements provide for this situation by concluding the compliance agreement with a provision for the option of giving notice the termination of the compliance agreement together with a statement of the reasons. However, the specification of an explicit rectification policy governing the procedure for the rectification of non-imputable shortcomings is of at least equal importance. The rigid invocation of penalty provisions – which are usually invoked in the event of intent or imputable serious negligence – in situations of this nature cannot readily be reconciled with a relationship based on trust. The Committee recommends the availability of a flexible rectification option for situations in which good faith is an issue. This is applicable both to individual compliance agreements and compliance agreements concluded with financial service providers in which the interests of the clients also play a role.

The Committee's conclusions

The Committee has concluded that the explanatory note included in compliance agreements and guides relating to shortcomings in internal control systems that become apparent at a later date and to their consequences, in particular for financial service providers, is too limited for the external parties involved.

Any decision made by the Tax and Customs Administration to terminate a relationship governed by a compliance agreement needs to be taken with great care. The regulations governing any such termination are laid down in the compliance agreement. The Committee is of the opinion that the concerns about a fragile legal certainty expressed during a number of discussions are poorly founded and, consequently, are unjustified.

5.5.3 Horizontal monitoring and legal protection

The introduction of horizontal monitoring gives cause to the question whether supplementary legal protection is necessary. Paragraph 5.2 has already established that *if* it may be assumed that there is no actual difference in the application of legislation and regulations in situations which are and are *not* governed by a compliance agreement then the current legal protection is sufficient.

However, legal protection can also be put on jeopardy when the Tax and Customs Administration is of the opinion that a taxpayer cannot participate in horizontal monitoring because the taxpayer does not meet the conditions attached to participation and the taxpayer is of the opinion that the refusal is wrongful. An interested party that is of the opinion that the refusal for admission to a compliance agreement is based on incorrect grounds may, in view of the stated opportunity for a win-win situation in the event of participation in a compliance agreement, wish to submit the difference of opinion to the courts. This is feasible only when the conditions attached to a taxpayer's admission to a compliance agreement are published. Publication impacts a number of other interests. The obligation to publish individual compliance agreements, for example, rapidly comes into conflict with the obligation to maintain confidentiality. Moreover, a multiplicity of legal disputes on the feasibility of participating in horizontal monitoring is not conducive to efficiency. The Committee is of the opinion that the decision on the need for judicial reviews of these cases is a political decision. As an alternative, the parties could be offered the existing options for mediation.

The Committee's conclusion

The Committee does not perceive a need for judicial reviews of refusals of admission to horizontal monitoring. However, should the political arena consider this to be desirable or necessary then the feasibility of requesting a judicial review shall need to be laid down in the legislation.

5.6 The financial service provider's position

The financial service providers, in particular, raised the 'legitimacy' for discussion: consequently, it is desirable to review their position. Although financial service providers are active in every segment, this Paragraph focuses on their position in the Small and Medium-Sized Enterprises segment.

Pursuant to one of the basic principles of horizontal monitoring, the Tax and Customs Administration avoids duplication of work by making use of the inspections carried out by external financial service providers called in by the taxpayers. The justifiable trust in these inspections can be enhanced by means of reviews that guarantee the quality of the financial service provider's specific work processes (in particular, filing returns). Compliance agreements in the Small and Medium-Sized Enterprises segment are concluded with the financial service providers who, as it were, stand surety for the quality of their clients' work processes. Although this compliance agreement is a bilateral agreement, a complex triangular relationship plays a role in the background. Pursuant to the law the taxpayer plays a pivotal role. Taxpayers in this segment who participate in horizontal monitoring are affiliated with the agreements the financial service provider has reached with the Tax and Customs Administration by means of a declaration of affiliation. Within this context the contents of the declaration of affiliation and the compliance agreement can, to the extent that they contain specific agreements, be regarded as a (binding) settlement agreement.

The professionalism of the inspector and tax consultant and the associated 'personal' responsibilities are also recognised in the compliance agreement governing the relationship with the financial service provider. This report has already stated that relationships governed by a compliance agreement retain scope for tax planning. The Tax and Customs Administration needs to appreciate that tax consultants are confronted with a conflict between their wish to maintain a productive compliance agreement relationship and their need to shape their attitude to the prevailing competitive conditions and the resultant necessity of maintaining a good relationship with their clients. Although horizontal monitoring should guarantee the correctness of the presented facts, this does not exclude the possibility that the inspector and financial service provider are in complete disagreement about the application of the law. Both parties should be able to submit their dispute to the tax division of the court in an open and above board manner and without causing damage to their relationship ("agree to disagree").¹²⁶ It would not be proper if – which was referred to as a risk factor accompanying participation in horizontal monitoring during the round-table discussions – the inspector were to discourage the submission of arguable standpoints with threats of criminal or administrative penalties or a deterioration in the relationship with the Tax and Customs Administration due to the tax inspector's interpretation of the intention to challenge a Tax and Customs Administration standpoint as questionable or non-compliant behaviour. An inspector adopting this approach would be confusing his or her roles (see Paragraph 5.3) and disturb the compliance agreement relationship.

A special situation can occur in horizontal monitoring in the Small and Medium-Sized Enterprises segment due

126 Th.W.M. Poolen, 'Horizontaal Toezicht vanuit het perspectief van de Belastingdienst ('Horizontal monitoring from the Tax and Customs Administration's perspective)', *Tijdschrift Fiscaal Ondernemingsrecht*, 2009/101, p. 16.

to the fact that taxpayer can participate in horizontal monitoring solely via a financial service provider who has concluded a compliance agreement. Chapter 3 reviewed the policy-based benefits of this form of participation. However, the discussions the Committee held with parties including financial service providers did not reveal the relationship between these benefits and the associated costs. This can result in the situation in which an enterprise that has implemented a solid tax control framework and a reliable control system for its tax position is nevertheless excluded from an individual compliance agreement or, if the enterprise wishes to participate in horizontal monitoring, is compelled to call on the services of a financial service provider and harmonise the enterprise's financial organisation with that of the financial service provider. This will then result in unnecessary additional costs.

The Committee's conclusions

Several participants in the discussions are not convinced that tax inspectors are always able to separate their two roles (as a compliance agreement partner and an administrative body). The Committee cannot exclude the possibility, in view of the indications received during the round-table discussions and Internet consultations, that these statements could to some extent be motivated by the fact that the horizontal monitoring phenomenon has an influence on the opportunity for individual service providers to position their organisations in the consultancy market. However, these statements at least confirm the need for greater transparency.

In addition, it is essential that participation in horizontal monitoring remains a voluntary option for financial service providers and that the Tax and Customs Administration does not impose pressure on them to file a larger number of 'compliance agreement returns'. The Committee is unable to avoid the impression that quantity takes precedence over quality requirements.

5.7 Conclusions

This Chapter focused on a number of legitimacy issues relating to horizontal monitoring. This review was prompted by the indications received from several interested parties (taxpayers, financial service providers, academics and the Tax and Customs Administration staff and management). Before arriving at its conclusions the Committee is of the opinion that it is worthwhile to draw attention to a horizontal monitoring paradox. The essence of horizontal monitoring is, as known, mutual justifiable trust. The Tax and Customs Administration's staff and the business both need to invest in this trust in two ways:

- Both parties must have an initial degree of trust in the other party that they can expand during the further development of the relationship based on trust. This is accompanied by risks. Both parties have a natural tendency to limit their personal risks but simultaneously expect investments by the other party (see below). One example of trust on the part of the Tax and Customs Administration is its willingness to enable taxpayers to enjoy the benefits of horizontal monitoring before their tax control framework is fully operational (namely in 'Phase 2', instead of 'Phase 5'). One example of trust on the part of the taxpayer is the taxpayer's willingness to disclose any tax constructions being considered, where relevant, in advance.
- The parties take trust-development steps by allowing the other party to 'get to know them'. For example, businesses not only invest in their own quality assurance system but also give the Tax and Customs Administration a certain degree of access to this system and trust the Tax and Customs Administration not to make misuse of this access.

This touches on the classic chicken-and-egg problem: one party is prepared to place trust in the other party only once that party deserves to be trusted, and vice versa. This problem can be overcome solely when both parties take small trusting steps and both parties are prepared to take risks. For this reason building up a relationship based on trust takes time.

The Committee does not wish to play down the importance of the discussion on legitimacy; everyone is bound by legitimacy, above all the government. Nevertheless, the Committee has observed that the *individual* horizontal monitoring arrangements have developed with relatively few problems in the Very Large Businesses segment, in particular, whilst a wide range of discussions on the principle of legal equality are being held in the more *collective settings*. The Committee is of the opinion that the Tax and Customs Administration is correct in refraining from bowing excessively to the (collective) pressure to standardise horizontal monitoring in great detail and implement a complete legal framework. When every aspect is governed completely by legislation and all leeway for flexibility in the implementation is avoided then there is no scope – and, moreover, no need – for mutual trust. The ‘horizontal monitoring’ concept will then be doomed to failure.

In other words, the Committee is not in favour of the implementation of excessive legislation governing horizontal monitoring. However, the Committee is a fervent advocate of Tax and Customs Administration investments that improve external transparency: this is essential if the Tax and Customs Administration is to be a reliable partner in the relationship based on trust that is assumed by the horizontal monitoring concept. This requires a subtle approach. The Committee is also of the opinion that it takes time to build trust. When viewed from this perspective, endeavouring to achieve a forced ‘horizontal monitoring rollout’ is not advisable.

Following this note the Committee answers the sub-questions before answering the key question to be addressed by this Chapter.

1. How do the various stakeholders (taxpayers, financial service providers, academics and Tax and Customs Administration staff and management) experience the legal integration of horizontal monitoring in practice and which legal bottlenecks and vulnerabilities do they perceive?

- Various parties requested the Committee to devote attention to the effects of horizontal monitoring in terms of legal equality, legal protection and legal certainty. These requests were usually accompanied by an argument advocating the implementation of statutory regulations governing horizontal monitoring. The Committee has established that the State Secretary for Finance has made statements that put the need for statutory regulations into perspective. Pursuant to these statements the law does not make a distinction between taxpayers who are and are *not* governed by horizontal monitoring.
- The legitimacy issue relating to the implementation of horizontal monitoring is not a new issue for the Tax and Customs Administration. Issues of this nature also play a role in traditional (vertical) supervision. The Committee is of the opinion that the Tax and Customs Administration’s implementation of appropriate internal horizontal monitoring regulations is insufficient: horizontal monitoring also needs to be rendered transparent for the taxpayers and financial service providers who need to work with the concept. Although the policy that has since been published does address this issue in part, this has not eliminated all criticism.
- The status and scope of the agreements laid down in the compliance agreement must be clear. The fact that these agreements may not relate to legal interpretations is a good beginning. The standardisation of compliance agreements is also conducive to transparency.

2. How does horizontal monitoring relate to the principles of legal equality, legal certainty and legal protection? In continuation from this, would it be advisable to implement further legal or other measures to improve the integration of horizontal monitoring in the tax system?

- The Committee has concluded that a closed system of administrative objections and appeals is in place in tax law, as a result of which decisions on admission to horizontal monitoring are not open to objection and appeals.
- The legitimacy issue is primarily a transparency issue within the scope of the Tax and Customs Administration's implementation practice. It is not necessary to integrate horizontal monitoring in the legislation since, in the Committee's opinion, the implementation of detailed regulations at this stage would result in disadvantages that would be greater than the advantages.
- Transparency can be further increased by the implementation of organisational measures that clarify the role in which the tax inspector makes statements, i.e. either as an administrative body which reaches a decision on an assessment or as one of the many persons involved in a compliance agreement relationship. Taxpayers, financial service providers and other parties involved then need to have a clear insight into the capacity in which a member of the Tax and Customs Administration's staff is acting.
- Consideration can be given to the provision of supplementary legal protection for certain decisions, such as the decision whether a party is to be admitted to a compliance agreement. The Committee does not perceive a need for judicial reviews of refusals of participation in horizontal monitoring. However, should the political arena consider this to be desirable or necessary then the feasibility of requesting a judicial review shall need to be laid down in the legislation.
- The Committee has concluded that the explanatory note included in compliance agreements and guides relating to shortcomings in internal control systems that become apparent at a later date and to their consequences, in particular for financial service providers, is too limited for the external parties involved.
- Any decision made by the Tax and Customs Administration to terminate a relationship governed by a compliance agreement needs to be taken with great care. The regulations governing any such termination are laid down in the compliance agreement. The Committee is of the opinion that the concerns about a fragile legal certainty expressed during a number of discussions are poorly founded and, consequently, are unjustified.
- In addition, it is essential that participation in horizontal monitoring remains a voluntary option for financial service providers and that the Tax and Customs Administration does not impose pressure on them to file a larger number of 'compliance agreement returns'.

Is horizontal monitoring compatible with the tax system's legal framework in the manner that provides assurances for the legitimacy of the Tax and Customs Administration's acts?

The Committee can answer the key question whether horizontal monitoring is compatible with the tax system's legal framework in the manner that provides assurances for the legitimacy of the Tax and Customs Administration's acts in the affirmative. Horizontal monitoring is an instrument which is an element of the performance of the Tax and Customs Administration's statutory duties. During the discussions the Committee held with the various parties the Committee experienced the past existence, due to a number of circumstances at the time, of uncertainties about the status of the compliance agreement and the working agreements laid down in the compliance agreement. Notwithstanding these uncertainties, the publication of the "Guide to

Horizontal Monitoring within the medium to very large businesses segment” and the implementation of model compliance agreements constitute important steps towards the elimination of these uncertainties, although in the Committee’s opinion this clarity was provided only at a late stage.

Chapter 6 Horizontal monitoring from the international perspective

6.1 Introduction

This Chapter reviews the development of horizontal monitoring in the context of international developments in tax supervision.

The pivotal question in this Chapter is:

Is the Tax and Customs Administration's development of horizontal monitoring compatible with international developments in supervision?

The two questions to be answered by this study are:

1. How have 'enhanced relationships' developed with foreign tax administrations?
2. What are the consequences of the development of 'enhanced relationships' for the business community?

The Committee begins by outlining the development of what is referred to as the 'enhanced relationship' at OECD and EU level (Paragraph 6.2) and in a number of individual countries (Paragraph 6.3). The countries (tax administrations) reviewed in this Chapter all received a summary of this Chapter for commentary. Their comments have been taken into account in the definitive text of this Chapter. The states were also requested to provide any additional information that could be of importance to the Committee's work, such as opportunities and threats accompanying the development of enhanced relationships and suggestions for effectiveness measurements.

This Chapter of the Committee's report also discusses the consequences of the development of enhanced relationships for the business community (Paragraph 6.4). The contents of this Paragraph are based on interviews the Committee held with a number of large businesses in the United Kingdom and Sweden. Paragraph 6.5 contains the conclusions, together with a summary of the most important suggestions and recommendations for the development of horizontal monitoring submitted by foreign tax administrations and the international business community.

6.2 OECD and EU

6.2.1 Developments

Globalisation and digitalisation exert an influence on the communications and relationships between tax administrations and businesses. Large businesses are active on a global scale and on an integrated basis, as a result of which the allocation of income and costs is becoming increasingly complex. Tax administrations all over the world are adjusting their enforcement strategies in response to the business community's changing dynamics. They are increasingly sharing information, increasing their focus in enforcement and developing new legislation to provide assurance for their tax revenues. This leads to increased friction and disputes between businesses and the tax administrations, as well as between tax administrations. This trend will only become more evident as the emerging markets gain in importance and influence and opt for a more refined approach to taxation. Large businesses are experiencing increasing difficulties caused by this development.¹²⁷

¹²⁷ Ernst & Young, *Global Tax Policy and Controversy Briefing*, Ernst & Young, January 2012, p. 26 and 27.

Globalisation increases countries' vulnerability to economic shocks and to tax evasion and avoidance. The tax administrations in most industrialised countries find themselves confronted by the same challenge: the provision of a higher level of service to citizens and businesses in combination with adequate enforcement whilst confronted with an increasing number of businesses and at the same time reductions in government department staffing. In addition, the area in which they operate is subject to change due to factors including the world's economic situation, the changing role of government in relation to citizens and businesses and vice versa, as well as the complexity of legislation and regulations.¹²⁸ The OECD and the EU are reviewing the relationship between tax administrations and the business community against the backdrop of these changes in society.

6.2.2 OECD¹²⁹

The OECD's Forum on Tax Administration (FTA)¹³⁰ promotes the development of enhanced relationships between tax administrations, financial service providers and taxpayers.¹³¹ The OECD defines an enhanced relationship as a "more collaborative, trust based relationship (...) between revenue bodies and large corporate taxpayers who abide by the law and go beyond statutory obligations to work together co-operatively."¹³²

A relationship of this nature attaches paramount importance to cooperation, emphasises the personal responsibility of citizens and businesses for compliance and is governed by principles such as transparency and trust. The OECD adopts the standpoint that the basis for a relationship of this nature is present when a tax administration adopts a number of principles, namely mutual understanding, impartiality, proportionality, openness, transparency and responsiveness.¹³³

Entering into a relationship of this nature should result in an improvement in the provision of information to the tax administration due to the earlier accessibility of information and to the taxpayers' greater transparency. This should in turn result in an improved allocation of staff and resources in the management of compliance risks. On their part, taxpayers receive earlier certainty about tax issues and are confronted by fewer (intensive) retrospective audits and, as a result, lower compliance costs.¹³⁴

Within this context the OECD draws attention to the increased public interest in the corporate governance of multinational enterprises. For this reason the central theme of the OECD's *Forum on Tax Administration* meeting held recently in Buenos Aires, which was also attended by representatives from the business community, was a review of the manner in which compliance with tax regulations can be enhanced by more constructive and transparent relationships between large businesses and tax administrations. In its concluding statement the OECD stated: "To this end, we agreed that we need to create innovative strategies for issue resolution that are less time and resource intensive for both, while still promoting a climate that encourages compliance with tax laws."¹³⁵

128 E.C.J.M. van der Hel-van Dijk, *Samen effectief, impuls aan Europees Fiscaal Toezicht* ("Working effectively together, impulse for European Fiscal Monitoring") (Breukelen paper), Breukelen: Nyenrode Business Universiteit 2011, Chapter 3.

129 The Organisation for Economic Co-operation and Development (OECD) is a collaborative arrangement between 34 states for the discussion, study and coordination of social and economic policy. The affiliated countries strive to cooperate in solving problems and endeavour to harmonise international policy.

130 The FTA is a forum for cooperation between tax administrations at director-general level. 43 states participate in the FTA, including all G20 members and selected non-OECD states.

131 OECD, *Study into the Role of Tax Intermediaries*, OECD 2008.

132 OECD, *Study into the Role of Tax Intermediaries*, OECD 2008, Chapter 8 (Paragraph 8.1).

133 OECD, *Study into the Role of Tax Intermediaries*, OECD 2008, Chapter 8 (Paragraph 8.8).

134 OECD, *Study into the Role of Tax Intermediaries*, OECD, 2008, Chapter 8 (Paragraph 8.10-8.14).

135 OECD, *7th Meeting of the Forum on the Forum on Tax Administration: "Strengthening Tax Compliance through Cooperation"*, http://www.oecd.org/document/52/0,3746,en_21571361_44315115_49387124_1_1_1_1,00.html.

The OECD states that taxpayers who do not join an enhanced relationship and who are not transparent cannot expect to 'prosper at the expense of others', i.e. tax administrations shall need to develop an adequate risk management system to identify these taxpayers and shall need to have sufficient staff and resources available to ensure that businesses without an enhanced relationship also fulfil their obligations.¹³⁶ In addition, the OECD also assumes that an effective risk management system increases taxpayer trust in their tax administration: taxpayers who are open and transparent can expect an improved provision of service and lower compliance costs. Conversely, taxpayers who do not adopt this approach can expect more stringent supervision.¹³⁷

The OECD has since developed the enhanced relationship further for banks and high net worth individuals.¹³⁸ The OECD has also created scope for the development of cross-border enhanced relationships. In a report recently published about joint audits conducted by tax administrations, the OECD stated that joint audits can contribute to the development of enhanced relationships between tax administrations and taxpayers.¹³⁹

The response from the OECD (FTA and Large Business Network) indicated that it plans to evaluate the implementation of enhanced relationships in 2012.

6.2.3 EU

This same movement towards enhanced relationships is evident in the EU. In 2008, an initiative was taken to form an ad hoc group with representatives from both tax administrations and the business community (large businesses and small and medium-sized enterprises). Their objective is to examine how information technology can support the relationship between tax administrations and taxpayers in the field of VAT.¹⁴⁰

The European Commission's Green Paper on the future of VAT advocates a simpler, more solid and efficient VAT system. The Commission is also seeking an efficient and effective means of supervising compliance with obligations arising from the VAT regulations. The Commission states that the appropriate performance of the VAT system is largely dependent on businesses and that, consequently, the relationship (enhanced dialogue) between businesses and tax administrations is of importance: "This relationship is determined not only by reporting, payment or auditing obligations but also by the quality, reliability and accessibility of information provided by tax administrations."¹⁴¹

A recent European Commission study reveals sufficient support for entering into enhanced relationships: "So, almost all respondents agreed that an enhanced relationship between traders and tax administrations is of utmost importance and comes as a priority."¹⁴²

In its response, the European Commission stated that it is a strong advocate of the development of enhanced relationships focused on "improving tax compliance and fighting tax fraud". The European Commission perceives benefits including the limitation of administrative errors, reduction of administrative costs, combating of tax fraud and increase in tax revenues. The Commission also states that the current European economic climate gives cause to a European approach to this development. Within this context the European Commission

¹³⁶ OECD, *Fourth meeting of the OECD Forum on Tax Administration, Cape Town Communiqué*, OECD, 11 January 2008.

¹³⁷ OECD, *Study into the Role of Tax Intermediaries*, OECD, 2008, Chapter 5.

¹³⁸ OECD, *Building transparent tax compliance by banks*, OECD, 28 May 2011, <http://www.oecd.org/dataoecd/3/43/42827589.pdf>; OECD, *Engaging with high net worth individuals (HNWI) on tax compliance*, OECD, 28 May 2011, <http://www.oecd.org/dataoecd/3/44/42827651.pdf>.

¹³⁹ *Sixth Meeting of the OECD Forum on Tax Administration (FTA)*, 15-16 September 2010, *Istanbul Communiqué, Annex 1*.

¹⁴⁰ Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee. *On a coordinated strategy to improve the fight against VAT fraud in the European Union*, December 2008, Com (2008) 807 final, Point 4 Reflections going beyond the immediate proposals.

¹⁴¹ European Commission, *Green Paper on the future of VAT. Towards a simpler, more robust and efficient VAT system*, December 2010, Com (2010) 695 final, Chapter 5.5.

¹⁴² The report following a public consultation in connection with the *Green Paper on the future of VAT* (1 December 2010 -31 May 2011). http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/future_vat/summary_vat_greenpaper.pdf.

has made arrangements for a European platform (Tripartite EU VAT Forum) that will enable tax administrations and businesses to meet on a voluntary basis to discuss the control of cross-border VAT risks.¹⁴³

6.3 Enhanced relationships in individual countries

6.3.1 OECD

Tax administrations cooperating at OECD level have been searching for efficient and effective forms of supervision for several years. The affiliated tax administrations, encouraged by states including Australia, Canada, New Zealand and the USA – together with a number of European states (reviewed in Paragraph 6.3.2.) – are holding discussions on adequate methods for managing ‘compliance risks’ on entering into enhanced relationships. This is illustrated by the following table summarising the strategies adopted by Australia, Canada, New Zealand and the USA. Comprehensive descriptions of these states are enclosed in Annex 6.¹⁴⁴

Table 14: Summary of the strategies adopted by Australia, Canada, New Zealand and the USA

Country	Strategy	Core	Target group	Year
Australia	Co-operative compliance: Forward Compliance Arrangements (FCA) and Annual Compliance Arrangements (ACA)	Upfront dialogue and disclosure, providing practical certainty in real time.	LB*	2005 2011* ¹
Canada	Real Time Audits (RTA) Concurrent Audits (CA) A new Approach to Large Business Compliance (ALBC)	Increased co-operation, openness, and flexibility in the audit process (RTA en CA). Transparency and a demonstrated history of responsible tax management, leading to a reduced compliance burden (ALBC).	LB	2002 2011
New Zealand	Enhanced relationships Co-operative Compliance Agreements (CCA)	To develop and foster relationships based on two-way transparency and early disclosure of tax issues. Piloting CCA's with several Large Businesses.	LB	2009 2010
United States	Co-operative compliance: Compliance Assurance Process (CAP)	Greater cooperation and transparency to identify and resolve potential tax issues before the tax return is filed. Leading to shorter and narrower post-filing examinations.	LB	2005 2011

¹⁴³ European Commission, *Green Paper on the future of VAT. Towards a simpler, more robust and efficient VAT system*, December 2010, Com (2010) 695 final, Chapter 5.1.3.

¹⁴⁴ The descriptions, in the form of a memorandum, were submitted to the relevant states and the OECD.

* LB is the abbreviation of Large Businesses.

*1 The years referred to in this column are the year of the adoption of the selected approach followed by the year of its revision.

Notes:

Australia, New Zealand and the United States have adopted what are referred to as 'cooperative compliance' strategies. Although Canada does not use this term it is also nevertheless seeking more in-depth cooperation with large businesses. All the states that were examined refer to advance certainty about tax issues as an element of cooperative compliance. A number of states also indicated that taxpayers benefit from lower compliance costs. Canada, New Zealand and the USA explicitly state that the reduced supervisory burden is a benefit offered by their approach.

The conditions attached to participation are not always stated explicitly. In Australia one condition attached to participation in a Forward Compliance Arrangement (FCA) is 'a high standard of corporate governance' (with a correspondingly 'low' tax risk profile) and a 'demonstrated commitment to continuous disclosure'.¹⁴⁵ A due diligence survey was carried out to meet this condition. In 2008, the FCA was replaced by an Annual Compliance Arrangement (ACA), which is governed by less stringent conditions. The Australian tax administrations no longer conduct a due diligence audit prior to deciding on the conclusion of an ACA: it places its trust in the CEO's confirmation that the business has implemented a healthy risk control process and is open about tax risks.

The figures available to the Committee indicate that a limited number of large businesses entered into an enhanced relationship in Australia, Ireland and the USA during the period 2005/2006 - 2011: Australia, 4 FCAs and 17 ACAs; Ireland, 93 (active) and the USA, 140 CAP participants.¹⁴⁶ No precise figures are known for the number of businesses participating in the UK: however, the number of disputes settled within the 'high corporate risk programme' is limited.

6.3.2 EU

Ireland, the Netherlands and the United Kingdom were the first EU Member States to begin discussions on efficient and effective forms of supervision, including entering into enhanced relationships. The initial experiences of these states are included in the OECD's report, 'Study into the role of tax intermediaries' from 2008. A further number of EU Member States are now active in this area.¹⁴⁷ This is illustrated by the following summary; the comprehensive descriptions of these states are enclosed in Annex 6.¹⁴⁸

Table 15: Summary of the strategies of several EU countries

Country	Strategy	Core	Target group	Year
Belgium	Large Businesses receive a specific treatment	Optimum procedure and full partner in discussions	LB	2009
Denmark	Enhanced relationship	Relationship based on mutual trust and transparency	LB	2008
Germany	Timely Audit	Greater emphasis on working in real time and shortening the audit period	LB	2006

¹⁴⁵ The Forward Compliance Arrangement was stated in the 2006 version of the Large Business Tax Compliance (LBTC) booklet. This version was deleted from the Australian tax administration's website at the time of the publication of the 2010 version of the LBTC booklet.

¹⁴⁶ The Committee has not examined the reason for the limited numbers.

¹⁴⁷ E.C.J.M. van der Hel-van Dijk, *Samen effectief, impuls aan Europees Fiscaal Toezicht* ('Working effectively together, impulse for European Fiscal Monitoring') (Breukelen paper), Breukelen: Nyenrode Business Universiteit 2011.

¹⁴⁸ The descriptions, in the form of a memorandum, were submitted to the relevant states and to the EU. No response was received from Spain.

Ireland	Cooperative Compliance	Mutual understanding of 'business and tax'	LB	2005
The Netherlands	Horizontal monitoring	Relationship based on understanding, transparency and trust	LB* SME	2005 2008
Austria	Horizontal monitoring	Creating a climate of mutual trust and transparency	LB	2011
Slovenia	Horizontal monitoring	Relationship based on understanding, transparency and trust	LB	2010
Spain	Code of Best Tax Practices	Relationship based on mutual trust and transparency	LB	2008
United Kingdom	Compliance Risk Rating and High Risk Corporate Programme	Relationship based on mutual trust and transparency	LB	2006
Sweden	Enhanced dialogue	The timely and efficient resolution of tax issues	LB	2007
	Enhanced relationship	Upgrade of the enhanced dialogue, mutual trust and transparency	LB	2012

* This relates to both Very Large Businesses and Medium-Sized Businesses.

Notes:

Several EU Member States have followed the example set by Ireland, the Netherlands and the UK and have now begun the development of enhanced relationships with taxpayers. Ireland has expressly stated that its cooperative compliance programme is limited to large businesses. It should be noted that this would also appear to be applicable to all the states reviewed in this study, with the exception of the Netherlands where businesses in the Medium-Sized Businesses segment and enterprises in the Small and Medium-Sized Enterprises segment – via their financial service providers – also fall within the scope of horizontal monitoring.¹⁴⁹

Each country interprets the enhanced relationship in its own way. Nevertheless, all interpretations exhibit some common elements, such as providing advance certainty on tax issues and working in real time.

Denmark carried out an enhanced relationship trial with six large businesses during the period 2008/2009 to 30 June 2011. An evaluation was carried out after the trial on the basis of interviews with all the businesses involved and the Danish tax administration's staff.¹⁵⁰ The key findings from the evaluation were:

- The cooperation was based on mutual openness and trust, which was given shape by means of agreements concluded for the duration of the trial.
- The tax administration's internal guidelines revealed a lack of clarity about issues including the types of tax covered by the trial. The status of the agreements was also unclear: the tax administration was of the opinion that they did not have a legal basis but were rather declarations of intent in which the parties

¹⁴⁹ The Committee wishes to note that the Committee bases the above on the information it received and has not examined the criteria governing large and medium-sized businesses in the states reviewed in this study.

¹⁵⁰ *Endelig rapport Evaluering af pilotprojekt i Store Selskaber om udvidet samarbejde* ('Final report, evaluation of the enhanced relationship with large businesses pilot project'), provided by the Danish tax administration at the Committee's request.

stated that they would seek cooperation and clarity.

- No benchmark measurement was carried out, as a result of which the tax administration's time savings could not be measured.
- Most of the businesses had a very favourable opinion of the trial, although they felt that the tax administration occasionally requested a highly excessive amount of information: in their perception this was at odds with the principle of mutual trust. Both the businesses and the tax administration's staff felt a need for a clarification of their mutual expectations.
- The businesses were aware of the developments in enhanced relationships in other countries such as Ireland, the Netherlands and the UK. One of the businesses stated that the tax administration staff in the last two of these states were granted an explicit mandate for the execution of their duties, as a result of which the performance of these countries' enhanced relationships is better than that of the Danish model.

Slovenia, Austria and Sweden have begun to develop enhanced relationships only very recently. Sweden has stated that it intends to begin an enhanced relationship trial with 10 to 12 large businesses during the course of 2012. This pilot will continue from what is referred to as an 'enhanced dialogue' (in which businesses could submit legal issues for discussion). The parties involved in Sweden's enhanced relationships do not expect these relationships to develop very rapidly since the trust between the tax administration and businesses will need to increase gradually.

6.4 The business community's practical experience with enhanced relationships

6.4.1 Introduction

In the years since the introduction of Sarbanes-Oxley Act in the USA and similar regulations in other states, 'tax' has increasingly become a regular item on the agenda for meetings of the executive boards and supervisory boards of large businesses and of the Audit Committee.¹⁵¹ Developments such as the Uncut movement and its successor – in chronological terms – the Occupy movement, have certainly made a contribution to this increased attention. Businesses do not wish to be associated with aggressive tax structures, especially now the risks of this tax attitude harming their turnover and/or profit are greater than ever before.

The business community's perception of the complexity of the regulations and criticisms by society is illustrated by the following excerpt from the Confederation of British Industry (CBI) 'Tax and British business' report of April 2012. "One reason for misunderstanding is that the range of tax incentives used by government, the increasing complexity of the system and the need for multinationals to navigate different tax jurisdictions makes tax management even more important to ensure business pay the tax for which they are liable. The tax system is by its nature very complicated and there are some rules that, while in place for a specific purpose, can add to misunderstandings."¹⁵²

The complexity of the regulations relates, for example, to the regulations governing transfer pricing. One factor complicating this issue is the statement which three BRIC countries (Brazil, India and China) issued in October 2011 in which they gave notification that they will not be following the OECD transfer pricing regulations.¹⁵³ More

151 The first conferences on transparency and the company's reputation have been organised recently. See, for example, <http://www.internationaltaxreview.com/Article/3005501/Latest-News/How-tax-transparency-can-boost-your-corporate-reputation.html>, at which the speakers included the Head of Tax Policy and Administration, OECD, NGOs and the business community.

152 CBI, *Tax and British business. Making the case*, CBI 2012, p. 18, http://www.cbi.org.uk/media/1456721/tax_and_british_business_making_the_case.pdf.

153 More background information is available in the report of the UN meeting, Paragraphs 40-44: http://www.un.org/ga/search/view_doc.asp?symbol=E/2011/45&Lang=E. The Committee is aware that the experts from the states cannot speak formally on behalf of their state. However, the positions adopted by the experts are regularly voiced in other fora by these countries.

recently their position was reiterated clearly in India's letter of 12 March 2012 to the UN/ECOSOC.¹⁵⁴ In addition, problems have become apparent at the interface between the source versus residence approach: a recent example is the Vodafone case in India, in which the Indian tax administration endeavoured to tax a transaction that had no effect in India on the basis of the value of the assets in India.¹⁵⁵ The debate on domestic resource mobilisation (DRM) also plays a role, pursuant to which businesses are obliged to publish detailed tax figures by state.¹⁵⁶ Within this context the OECD very recently launched its initiative for the 'Tax inspectors without borders' concept.¹⁵⁷

All these developments contribute to a climate in which it is logical to create an enhanced relationship between taxpayers and the tax administration. During a meeting of the OECD Forum on Tax Administration in Buenos Aires held in January 2012 the Chief Financial Officers (CFOs) of three large businesses advocated enhanced relationships and their worldwide rollout. A press release issued by the business community stated that businesses "emphasised the need for Tax administrations to understand how business operates and the need for genuine commitment and transparency from both sides and mutual trust, in support of more effective tax administration and enforcement."¹⁵⁸

The Committee's study

Although a large-scale study of the international business community in the states reviewed above would have been ideal the Committee decided, in view of the limited amount of time available, to focus on the business community in two states, namely the UK and Sweden. A number of large businesses in both these states were interviewed by telephone.

The UK was selected since it initiated enhanced relationships several years ago and, in the Committee's opinion, the UK tax administration's drive is comparable to that of the Tax and Customs Administration. In addition, the Netherlands and the UK have initiated a pilot project in which they shall cooperate in the tax treatment of a multinational business active in both states. Sweden was selected since the Netherlands regards Sweden as an example of a state with transparency and open cooperation between the business community and government.

6.4.2 The UK business community's experiences

The Committee's interviews with a number of large businesses in the UK clearly revealed that they are enthusiastic about enhanced relationships and the good relationships with the tax administration. It was striking to note that the UK has not implemented signed agreements, although the parties do draw up a list of arrangements adhered to by both parties. However, HM Revenue & Customs did implement a signed document for a pilot project (of a limited size, carried out in the period between 2001 and 2003).

The businesses interviewed during the survey perceive the differences following the implementation of an enhanced relationship framework as follows:

- HM Revenue & Customs processes the various issues more rapidly;
- The businesses hold regular discussions with HM Revenue & Customs, and at least with the Client

¹⁵⁴ The full letter is available at <http://www.un.org/esa/ffd/tax/2012CTM/LetterIndia.pdf>.

¹⁵⁵ The Committee is cognisant of the Indian government's proposals for the introduction of retroactive statutory regulations to counteract the consequences of the unfavourable ruling by the Supreme Court and of the government's further explanation at the beginning of May 2012. However, this is not of relevance to the report.

¹⁵⁶ In the USA, this obligation is laid down in Article 1504 of the Dodd-Frank Act (2010).

¹⁵⁷ More details about 'Tax inspectors without borders' are available in the OECD press release of 10 May 2012, http://www.oecd.org/document/44/0,3746,en_21571361_44315115_50293932_1_1_1_1,00.html.

¹⁵⁸ See the BIAC press release, http://www.biac.org/news/120118_BIAC_participates_Forum_Tax_Administration.htm; and the presentation by Royal Dutch Shell plc's CFO: http://www.shell.com/home/content/media/speeches_and_webcasts/2012/simon_henry_argentina_18012012.html.

Relationship Manager;

- The relationship offers an opportunity to discuss large transactions before they take place;
- Enquiries are no longer conducted by means of lengthy letters which raise many questions about details: they now focus on important issues matters, even before the tax return is filed; and
- HM Revenue & Customs has a better understanding of the operations and the organisation of the business.

HM Revenue & Customs has classified the large UK businesses into three risk categories, high, medium and low. A business classified into the high risk category is subject to greater supervisory attention than a business classified into a lower risk category. In principle, large businesses – which are usually complex – are classified in the high risk category, although large businesses which have implemented an effective tax control framework can be classified into the low risk category.

The businesses perceive no problems in discussing their tax planning with HM Revenue & Customs' Client Relationship Manager: these businesses also stated that they had not implemented aggressive planning structures in the past.

In conclusion, the businesses proposed themselves for the role of enhanced relationship ambassadors. They called on tax administrations outside the Netherlands and the UK to follow the example set by these two states and, within this context, praised the cross border enhanced relationship being developed by the Netherlands and the UK.

The National Audit Office has recently decided to review five cases settled within the scope of an enhanced relationship. This review will focus primarily on the reasonableness of the agreements reached by the parties.¹⁵⁹

Conclusions about the UK

The UK's work on the development of enhanced relationships with large businesses with international operations dates from the first pilot carried out in 2001. The interviews revealed that enhanced relationships now perform well and that the business community is satisfied with this approach, in particular with the accelerated procedures, rapid certainty and the tax administration's better understanding of the business. The businesses interviewed during the survey expressed their preference for an expansion of enhanced relationships across the world. In addition, they are of the opinion that the future lies with the cross-border enhanced relationship framework.

6.4.3 The Swedish business community's experiences

The interviews with a number of large businesses in Sweden clearly revealed that openness also has its drawbacks: the Swedish businesses stated that many issues regarded as confidential in the Netherlands (communications between the tax administration and taxpayer) regularly appear in the media. This has an influence on the manner in which businesses wish to cooperate with the tax administration. The businesses interviewed in the survey had not concluded an agreement to date: they stated that they perceived little added value offered by entering an enhanced relationship in view of their current (favourable) experiences with 'Dialogue 2006' and the 'advance rulings' framework. The business community stated that pursuant to Dialogue 2006 the tax administration issues its viewpoint on the tax treatment of a proposed transaction within a short space of time, although the tax administration is not under the obligation to do so. However, an advance ruling is binding. This ruling is issued by the International Tax Board, the members of which include representatives from the business community (the Swedish Enterprise Federation, the equivalent of the Confederation of Netherlands Industry and Employers [VNO-NCW]). Both the taxpayer and tax administration

¹⁵⁹ More details are given on page 54 ff of HM Revenue & Customs RC reply, see http://www.hm-treasury.gov.uk/d/hmt_minutes_52_55_57_61_reports_cpas_feb2012.pdf.

may lodge an appeal against an advance ruling.

The interviews with the Swedish businesses clearly revealed their distrust of the Swedish tax administration. The interviewees literally stated when a business raises a specific issue with the tax administration the tax administration will adopt a standpoint that is well within the law to avoid accusations of preferential treatment, an approach which is also influenced by the openness with the media. However, when the tax administration raises an issue, for example within the context of an audit, it is prepared not to seek the extreme limit of the interpretation. The Committee appreciates that this subtle but essential difference is due to the fact that the tax administration, not the business, raised the issue. The businesses interviewed for the survey stated that the tax administration will need to abandon this attitude if enhanced relationships are to succeed.

The interviews revealed that a couple of the Swedish businesses contacted by the Committee have entered into an enhanced relationship in states other than Sweden.

The Committee also interviewed a business that had concluded an agreement at the beginning of 2012. In Sweden, as in the Netherlands, a member of the Executive Board of Directors signs the agreement to provide assurances for the business' commitment at the highest level. The parties also agreed that an 'agree to disagree' approach is feasible in the event of a difference of opinion. The business perceives one of the greatest benefits offered by an enhanced relationship to be the fact that the agreements relate to all types of taxes, including VAT. In addition, the tax administration undertakes to offer good service with rapid answers to questions (for example, within one week). The tax administration has evidently made efforts to listen to this business' questions and problems, which has resulted in a reversal of this business' attitude.

The business community is of the opinion that there are a number of reasons why enhanced relationships are still in their infancy in Sweden.

Conclusions about Sweden

The enhanced relationship has not yet really got off the ground in Sweden. For as far as is known to the Committee, only a few businesses have concluded an agreement to date.

The main reasons for this situation would appear to be the tax administration's failure to make sufficient investments in good relationships with the business community and to explain the win/win proposition as compared to the current, well functioning framework to obtain tax certainty¹⁶⁰ – and all this within the context of a relationship between businesses and the tax administration that is still characterised by little trust in each other. This is illustrated by the following quote from one of the interviews: "There is a relationship which varies from cooperation to hostility, but with a history of confrontation."

It should be noted that the Swedish business world is not opposed to enhanced relationships, as is demonstrated by the enhanced relationships Swedish businesses have entered into in other states.

6.5 Points for attention revealed by the evaluation of the states consulted in the survey

Tax administrations

The responses of a number of tax administrations in other states indicated that they intend to evaluate

¹⁶⁰ The Swedish tax administration (Skatteverket) has discussed enhanced relationships with the business community. The business community raised a number of important issues that will first need to be answered and solved. These include, for example, questions relating to legal aspects of the interpretation of the tax regulations, stock exchange regulations governing confidentiality (the tax administration's access to confidential information) and the need for a CEO's signature on the agreement. Skatteverket has neither addressed these concerns in its proposals nor explained why they were not addressed. This has resulted in the loss of trust in a new and improved form of cooperation.

enhanced relationships within the shorter term or longer term. The responses from the states, pursuant to the Committee's request, also included vulnerabilities and points for attention that need to be evaluated. The issues which, in their opinion, require attention include:

- How can the increasing number of businesses be managed by tax administrations with significantly decreasing staffing levels?
- The reallocation of the necessary capacity to provide both the promised level of service and address the high-risk items outside enhanced relationships (an adequate risk management system);
- The determination of adequate action to be taken in the event of the abuse of enhanced relationships;
- The reconsideration of the service provided to taxpayers who do not participate;
- The achievement of consistency in the implementation of enhanced relationships (by individual members of staff);
- The voluntary nature of the programme in relation to the lag in the number of voluntary disclosures;
- The determination of the consequences of enhanced relationships for compliance and for the attitude and behaviour of businesses participating in the concept;
- The closing of the gap between the tax administration and taxpayers caused by the traditional approach (establishing an improved relationship);
- The retention of alertness to the application of the principle of equality before the law;
- The contribution to the improved allocation of the tax administration's staff and resources;
- The improvement of the compliance costs and supervisory costs;
- The retention of the integrity of the tax system;
- The allocation of the capacity required for the dialogue with taxpayers may not be to the detriment of efficiency;
- The avoidance of the perception that an enhanced relationship will result in preferential treatment (taxpayers who do not have an enhanced relationship need to perceive their treatment as being fair and reasonable).

The business community

The International Fiscal Association (IFA) – a global organisation of the tax specialists at businesses, consultancies, in science and at tax administrations working at an international level, and with 12,000 members from 106 states – began a study of enhanced relationships three years ago. The results from this study, which will include data from a large number of states, will be published later in 2012.

6.6 Conclusions

1. How have 'enhanced relationships' developed with foreign tax administrations?

The Committee has drawn the following conclusions in answer to the question how enhanced relationships have developed at foreign tax administrations (question 1 to be addressed by the study):

- The above reveals that a number of tax administrations all over the world are seeking effective and efficient supervisory models based on entering into relationships with taxpayers founded on trust and cooperation.¹⁶¹
- It is striking to note that the approach varies greatly by state, as is illustrated by the OECD report in which a number of states share their experiences in the optimisation of large businesses' compliance behaviour.¹⁶²

¹⁶¹ Opening Statement by Pier Carlo Padoan, Deputy Secretary General, OECD, The OECD's Forum on Tax Administration, Cape Town, South Africa, 10-11 January 2008, <http://www.oecd.org/dataoecd/27/36/39884402.pdf>.

¹⁶² OECD Forum on Tax Administration: Compliance Management of Large Business Task Group. Experiences and practices of eight OECD countries, July 2009. <http://www.oecd.org/dataoecd/36/32/43241144.pdf>.

However, a number of elements in the different strategies are comparable, such as working in real time, transparency and offering a commercial level of service.

- The summary reveals that a number of the pioneers in this area – Australia, the USA and, to a lesser extent, Canada – revised their strategies in 2011. For example, the US Internal Revenue Service (IRS) announced in March 2011 that it would be expanding the CAP programme in 2012 and definitively integrating the programme in its compliance strategy.¹⁶³ Australia had already completed a revision in 2008, on its decision to terminate the further conclusion of FCAs and to switch to the ACAs, thereby obviating the need for due diligence audits as a condition attached to participation.
- All the tax administrations examined in the study decided to approach *the same target group* for enhanced relationships, namely the group of (very) large businesses. The Netherlands constitutes an exception, since the Tax and Customs Administration also decided to introduce horizontal monitoring in segments other than the (Very) Large Businesses segment.

2. What are the consequences of the development of ‘enhanced relationships’ for the business community?

The Committee reached the following conclusions in answer to the question on the consequences of the development of enhanced relationships for the business community (question 2 to be addressed by the study):

- The development of enhanced relationships with the business community, at least with the (Very) Large Businesses, has gained in importance. The ‘Guidelines for International Investment’ calls on states and businesses all over the world to work on the basis of an enhanced relationship framework.¹⁶⁴
- For the business community, the success or failure of the new form of cooperation with the tax administrations is determined by the presence of mutual trust (an actual ‘partnership’) and the development of a win/win-situation.
- The top of the UK’s business community – and, on the basis of other indications, also in other states – is satisfied with enhanced relationships and wish to see the concept rolled out all over the world. This impression was confirmed by the round-table discussions the Committee held with representatives from large Dutch businesses. The Swedish business community’s hesitation about entering into enhanced relationships would appear to be a teething problem that is in turn caused by a communication problem, since these same Swedish businesses have entered into enhanced relationships with other tax administrations, for example with the Tax and Customs Administration.

Is the Tax and Customs Administration’s development of horizontal monitoring compatible with the international developments in supervision?

The contents of this Chapter give cause to the Committee’s conclusion that the Tax and Customs Administration’s development of horizontal monitoring is as such compatible with international developments in supervision. However, the Committee is of the opinion that three comments need to be made within this context, namely:

- The Netherlands is the only state to have implemented the approach indirectly (via financial service providers) for the Small and Medium-Sized Enterprises segment. The other states’ development of enhanced relationships is (for the time being) limited to the (very) large businesses.

¹⁶³ 140 businesses participated in the CAP programme in 2011.

¹⁶⁴ ‘Guidelines for International Investment’, International Chamber of Commerce, 23 April 2012, Chapter IV, http://www.iccwbo.org/uploadedFiles/2012_ICC_Guidelines_Intl_Investment.pdf.

- The pace of the other states' development of enhanced relationships – comparable to the Tax and Customs Administration's horizontal monitoring concept – is not as rapid as in the Netherlands. This is revealed by the number of businesses participating in an enhanced relationship in those states that have been active in with the concept for a somewhat longer period of time (such as Australia, Ireland, the UK and the USA).
- The Committee is of the opinion that the Netherlands is playing a pioneering role in the development of enhanced relationships and, consequently, is in the vanguard. For this reason the Committee wishes to note that the Tax and Customs Administration should allow sufficient time to implement, evaluate and (if so required) reassess its horizontal monitoring programme.

Chapter 7 Summary, conclusions and recommendations

7.1 The tasks assigned to the Committee

The Committee was assigned the following tasks:

- I. to evaluate the horizontal monitoring conducted by the Tax and Customs Administration since 2005, and to submit an opinion on the policy change implemented at the time for the adoption of this new approach,
- II. to identify any bottlenecks in and vulnerabilities of this approach,
- III. to submit proposals for the further development of horizontal monitoring in Very Large Businesses, Medium-Sized Businesses and the Small and Medium-Sized Enterprise (SME) segments, as well as to submit proposals for the effect measurement procedure.

Paragraphs 7.2 to 7.4 inclusive of this Chapter review these three tasks on the basis of the information enclosed in chapters 2 to 6 inclusive and in the annexes to this report. For this purpose a brief summary is given for the first two of these tasks and the sub-questions raised in Chapter 1 are answered, followed by the conclusions. The third task is future-oriented and has been addressed primarily by the formulation of recommendations. The Chapter concludes with an analysis of the context and a closing Paragraph.

7.2 Evaluation and assessment of the Tax and Customs Administration's policy change

The first task assigned to the Committee relates to an evaluation and assessment of the Tax and Customs Administration's policy change encompassing the introduction of horizontal monitoring. Three sub-questions were formulated for this task in Chapter 1, namely:

- Which principles were adopted for the formulation of the policy?
- Were these principles observed on the implementation of the policy? Are these principles still valid?
- How does horizontal monitoring fit in the range of the instruments that the Tax and Customs Administration has at its disposal to promote compliance with tax legislation and combat non-compliance?

What were the leading principles?

The Tax and Customs Administration's introduction of horizontal monitoring in 2005 was in line with a number of social developments. Chapter 2 of this report explained that these developments included an increasing regulatory pressure which in turn resulted in an increased administrative burden. The Scientific Council for Government Policy had already established (in 2002) that the services provided by the government needed to be optimised. The Council proposed a differential treatment of citizens on the basis of the degree to which they were able and willing to bear their responsibility. In addition, the developments within the context of corporate governance and the more stringent internal control systems offered the Tax and Customs Administration an opportunity to rely more on the work that had been carried out for, by and in connection with the Very Large Businesses. Further incentives for the adoption of a new procedure were also provided by the government frameworks for supervision introduced by different Governments. In conclusion, it should be noted here that various compliance studies have revealed that compliance behaviour is not promoted solely by stringent supervision and the imposition of sanctions, but can also be promoted by giving positive incentives and exhibiting trust.

When the above is interpreted in terms of the principles adopted for the introduction of horizontal monitoring the Committee arrives at the following hypotheses that were determinative for the Tax and Customs

Administration's approach:

- Compliance with the regulations can be promoted by giving taxpayers more trust and personal responsibility. The taxpayers in turn need to place more trust in the Tax and Customs Administration. Ultimately, the success of this approach depends on both parties demonstrating that the trust placed in them is justified.
- The Tax and Customs Administration's supervision can be conducted more effectively and more efficiently when it can rely on measures implemented for the administrative organisation and internal control, as well as internal and external audits of, in particular, Very Large Businesses.
- The above two points will result in a reduction of both the supervisory burden imposed on taxpayers and the implementation costs incurred by the Tax and Customs Administration.

In addition, it is noted that the Tax and Customs Administration does not and cannot compel participation in horizontal monitoring: participation is on a voluntary basis since *it takes two to tango*. In other words, the Tax and Customs Administration can formulate principles for and objectives to be achieved by horizontal monitoring, but the actual implementation depends on the willingness of taxpayers to place trust in the Tax and Customs Administration and assume the responsibility for the reliability of their financial data and returns.

The first hypothesis – in brief, more trust and more personal responsibility – resulted in the willingness to conclude agreements in which the Tax and Customs Administration and taxpayers laid down mutual working agreements based on 'trust', 'transparency' and 'mutual understanding'.

The second hypothesis – in brief, that horizontal monitoring can result in more effective and more efficient supervision by relying on the control and audit measures of third parties – resulted in a pilot at a number of Very large Businesses, the development of tax control frameworks and the detailing of what is referred to as the 'onion-skin model'.

The third hypothesis – in brief, that horizontal monitoring will result in a decline in the supervisory burden and the implementation costs – has not been proven to date. Some taxpayers and financial service providers, although not all, doubt the truth of this hypothesis. The Committee has received insufficient reliable data to test this hypothesis in all segments in which horizontal monitoring is employed. This is discussed, by segment, in more detail below.

Very Large Businesses: were the principles observed and are they still valid?

The truth of the first two principles (hypotheses) has been more than confirmed for the Very Large Businesses segment. The pilot within the Very Large Business segment demonstrated the willingness of the businesses taking part in the trial to give shape to the trust placed in them by the Tax and Customs Administration: they also assumed the responsibility for the more adequate fulfilment of their tax responsibilities. In addition, they made demonstrable investments in the implementation and maintenance of a tax control framework both during and after the pilot. They then used the measures that had been implemented for the administrative organisation, internal control and internal audits. In so doing, the conditions for the first two layers of the 'onion-skin model' were met.

In practice, the Tax and Customs Administration's efficient and effective use of the third layer of the onion-skin model – relying on external audits as conducted by auditors – has not been demonstrated to an adequate extent. This is a point for improvement.

A second point for improvement relates to a more explicit specification of the tax control framework design for the business community, financial service providers and, last but not least, for the Tax and Customs

Administration staff. The Tax and Customs Administration states emphatically that customisation is required for tax control frameworks and it has been unable to provide – on the pretext that this relates to individual account management – the Committee an adequate insight into the manner in which the Tax and Customs Administration actually assesses the quality of tax control frameworks in practice. Conversely, the Committee has experienced the tension caused by the tax control framework issue within the three groups.

This constitutes an important point for improvement, since the tax control framework is a vital element of horizontal monitoring in the Very Large Businesses segment and the (ability) to carry out an adequate review of the soundness of the tax control framework constitutes the *essence* of horizontal monitoring in the Very Large Businesses segment.

It should be noted that the Committee concurs with the proposition that the design of a tax control framework requires customisation. The standard the Tax and Customs Administration imposes may certainly be of the nature of an open standard, provided that there are, on balance, sufficient assurances that the tax control framework will result in acceptable returns.

A third point (which is not so much a point for improvement) which requires continuous attention is the qualitative and quantitative staffing available to the Tax and Customs Administration for the Very Large Businesses segment. The business community and financial service providers have expressed their doubts about this capacity on a number of occasions and in a number of manners. Doubts have also been heard from within the *Vereniging van Hogere ambtenaren van het Ministerie van Financiën* (Ministry of Finance senior staff association, VHMF), from the staff and various management levels of the Tax and Customs Administration. There is, in particular, concern about the appeal of the work to the accountants active within the Tax and Customs Administration. Their work has been – and is being – largely transferred from conducting material audits to reviewing tax control frameworks, a development which a number of officers interviewed by the Committee experienced as less dynamic and less interesting.

In conclusion, the question as to whether the supervisory burden and implementation costs have actually been reduced in this segment: the Committee has observed satisfaction on the part of taxpayers in the Very Large Businesses segment. Although solid substantiation in the form of data is lacking, the perceived supervisory burden imposed on businesses in the Very Large Businesses segment would appear to be lower. However, the Tax and Customs Administration has not been able to demonstrate to the Committee that the supervisory burden imposed on the Very Large Businesses segment has also been reduced in an absolute sense. The Committee assumes that taxpayers in this segment will actually be prepared to withdraw from agreement relationships that are unfavourable to them, since this option is available to them by virtue of the mutual voluntariness: *it takes two to tango*.

The Committee is also of the opinion, on the basis of the practical experiences stated by the partners to the discussions, that it is probable that the Tax and Customs Administration's implementation costs have not declined until at least to date. This opinion is based on the fact that a lot of time will need to be devoted to the development of a relationship based on trust in the initial phase of horizontal monitoring: time will be required to conclude the agreements, gain an insight into the business and its culture, review the tax control framework, give the appropriate shape to the preliminary consultations and, in particular, to the Tax and Customs Administration's development of an adequate organisation for horizontal monitoring in this segment.

Medium-Sized Businesses: were the principles observed and are they still valid?

The Tax and Customs Administration is 'struggling' with the Medium-Sized Businesses segment: the businesses grouped in this segment are, as it were, too big for one approach (in this instance: participation in horizontal monitoring via a financial service provider agreement) but too small for the other approach (in this instance:

participation in horizontal monitoring via an individual agreement). This struggle would appear to be due to the Tax and Customs Administration's capacity required for individual account management and to the efforts this group of businesses needs to make in establishing an adequate tax control framework. The majority of these businesses are not governed by the most stringent corporate governance requirements (such as the SOx, Netherlands Corporate Governance Code and the Netherlands Authority for the Financial Market's reporting supervision).

The Tax and Customs Administration now (2012) wishes to find a practical solution for this 'struggle': the upper range of the Medium-Sized Businesses segment will be merged with the Very Large Businesses segment and the lower range will be brought under the service provider agreements governing the Small and Medium-Sized Enterprises segment.

The Committee notes that although the merger of part of the Medium-Sized Businesses segment with the Very Large Businesses segment is (or would appear to be) a pragmatic decision, it does give rise to the question which compensatory measures will be implemented for this part of the Medium-Sized Businesses segment. Medium-Sized Businesses that are required to comply with the same requirements governing the Very Large Businesses segment shall need to incur costs of a level that (may) result in horizontal monitoring losing its appeal to them. How will the Tax and Customs Administration retain horizontal monitoring's appeal to this group whilst maintaining the certainty of receiving acceptable returns?

The Committee observes that the Tax and Customs Administration exhibits a certain degree of 'leniency' towards these businesses with respect to the requirements imposed on their governance: the Tax and Customs Administration is satisfied with less stringent internal control systems in this segment, without compensatory measures that provide assurances for the quality of the returns. This, the Committee notes, is not without risks.

Nor would it be recommendable to 'push' a group from the Medium-Sized Businesses segment towards financial service provider agreements when this group has implemented internal control systems et cetera which are of substantially higher quality compared to those of the Small and Medium-Sized Enterprises that take part in financial service provider agreements. Moreover, the 2007 decision to create a separate Medium-Sized Businesses segment was done for good reason.

In summary, the Tax and Customs Administration will need to give good reasons for the manner in which the segments were created and the criteria governing classification into the segments were specified, as well as for any changes to the current form of segmentation. In addition, attention will need to be given to the clarity and recognisability for the Tax and Customs Administration's clients (taxpayers and financial service providers). The, as it were, repeated amendments of the rules when this is more convenient for the Tax and Customs Administration management or is deemed to be necessary due to political cost-cutting measures creates uncertainty on the part of the taxpayers, financial service providers and Tax and Customs Administration staff – and certainly when both parties have already invested in the development of the relationship based on trust and have acquired the necessary knowledge of and skills in horizontal monitoring. A modification of the classification into segments which is not accompanied by adequate substantiation will result in negative sentiments that will not contribute to compliance or to the willingness to make further investments in a sustainable relationship of trust.

When determining the criteria governing the classification into segments the Tax and Customs Administration will – more than is currently the case – need to make clear how these enable the Tax and Customs Administration to conduct more effective and efficient supervision of each segment. How, precisely will the Tax and Customs Administration rely on the control measures implemented by the taxpayer as formulated in the second hypothesis? When the Tax and Customs Administration is unable to rely sufficiently on a tax control

framework and other internal control measures or similar assurances, then the Tax and Customs Administration will need to make clear – in a transparent and tangible manner – which compensatory measures it deems to be necessary. In the Committee’s opinion this is not adequate at present. As a result, it is not possible to state either that the Tax and Customs Administration observed the principles governing horizontal monitoring in the Very Large Businesses segment when the Administration introduced horizontal monitoring in the Medium-Sized Businesses segment or that the principles are valid for this segment.

Nor is it possible to demonstrate that the supervisory burden imposed on the Medium-Sized Businesses segment or the implementation costs incurred by the Tax and Customs Administration have actually fallen.

Small and Medium-Sized Enterprises: were the principles observed and are they still valid?

The relationship of trust with the Small and Medium-Sized Enterprises segment is not, in contrast to the Very Large Businesses segment, developed directly with the taxpayers but rather with their financial service providers. Since agreements are concluded with the financial service providers, an agreement cannot be concluded with taxpayers in the Small and Medium-Sized Enterprises segment in the absence of an agreement concluded between a financial service provider and the Tax and Customs Administration. In essence, these agreements require financial service providers to organise their processes in a manner that results in acceptable returns from their clients. As a result, horizontal monitoring in the Small and Medium-Sized Enterprises differs fundamentally from horizontal monitoring in the Very Large Businesses segment.

Since the principle stipulating that the Tax and Customs Administration can rely on an individual tax control framework and the onion-skin model is abandoned in the Small and Medium-Sized Enterprises segment – in analogy with a large part of the Medium-Sized Businesses segment (but now to an even greater extent) – it is necessary to review the compensatory measures which replace this principle. In contrast to the Medium-Sized Businesses segment, the search for compensatory measures in the Small and Medium-Sized Enterprises segment is clearly visible: the Tax and Customs Administration relies on the financial service provider’s quality assurance system via its meta-supervision. However, this results in the loss of horizontal monitoring’s individual nature in this segment.

The integration of a quality assurance system via the financial service provider is not necessarily detrimental to horizontal monitoring: however, the shape given to meta-supervision is then important. In addition, this is complicated by the extremely diverse group of financial service providers. The quality assurance systems of accountancy firms which conduct statutory audits are governed by the Netherlands Authority for the Financial Markets (AFM). Moreover, these accountancy firms require a licence issued by the AFM to perform their duties. The group of accountancy firms affiliated with the SRA accountants association are also governed by requirements (imposed by the association) for their quality assurance systems and are subject to supervision. This is also the case for accountancy firms affiliated with other accountants’ organisations. However, there is also a large group of accountancy firms which conduct their practice without a licence. They are not governed by specific requirements and, as a result, not subject to explicit supervision (although assurances are provided by the disciplinary measures that govern their work as accountants).

Tax consultants are not required to possess a licence and are not subject to supervision in a form identical to the supervision conducted by the AFM, although they have implemented internal rules that provide assurances for the reliability of their acts.

It will be evident that the Tax and Customs Administration can place more trust in accountancy firms that have been issued a licence by the AFM and are subject the AFM’s supervision than in other accountancy firms. However, the Tax and Customs Administration has not adequately demonstrated the specific requirements imposed on each group of financial service providers, the consequences these have for the intensity of the

meta-supervision of each group or, ultimately, the resultant consequences for the quality of the returns.

Once again, no facts are available to assess whether the supervisory burden and implementation costs have actually been reduced in the Small and Medium-Sized Enterprises segment. However, it is clear to the Committee that the Tax and Customs Administration can record the greatest ‘gain’ in its implementation costs in this segment, since this segment is comprised of a large number of taxpayers, many financial service providers perceive opportunities to serve clients in this segment and many financial service providers – for commercial reasons or otherwise – support horizontal monitoring.

Nevertheless, the Committee, in part on the basis of a number of round-table discussions, is not convinced that the taxpayers’ administration burden can or will be reduced – quite the converse, in fact: the Committee is of the opinion that this is unlikely. This is because the financial service providers can only vouch for the acceptability of returns when they perform more duties than in the past (in part, pursuant to the principle of communicating vessels: the tax service providers’ duties increase when the Tax and Customs Administration’s duties decrease). Moreover, the financial service providers will need to observe the Tax and Customs Administration’s Audit Approach that stipulates more stringent materiality and sampling standards than those customarily adopted by, for example, accountants. It is evident that the financial service providers will charge their clients for these extra duties.

The Committee wishes to make a number of comments about the validity of the horizontal monitoring principles to the Small and Medium-Sized Enterprises segment. Firstly, when viewed from an international perspective the Tax and Customs Administration is out of line with other tax authorities – or, formulated in positive terms, is clearly in the vanguard. The Committee established in Chapter 6 of this report that the horizontal monitoring term is not used at an international level, but rather the term ‘enhanced relationships’. The tax authorities in the states that were studied enter into enhanced relationships with (very) large businesses, not with businesses in other segments. Moreover, the number of businesses which develop this enhanced relationship with the tax authority is relatively limited and, in comparison with the Tax and Customs Administration, extremely limited.

However, the above does *not* imply that the Tax and Customs Administration’s decision is invalid, although it *does* imply that the principles governing horizontal monitoring in the Small and Medium-Sized Enterprises segment *differ* from those governing horizontal monitoring in the Very Large Businesses segment. For example, a triangular relationship can be discerned in the Small and Medium-Sized Enterprises segment in which the division of the interests and responsibilities between the Tax and Customs Administration, financial service provider and taxpayer is not always clear: nor are the specific advantages and disadvantages associated with participation in horizontal monitoring evident, in particular from the perspective of taxpayers in the Small and Medium-Sized Enterprises segment.

Secondly: although the Committee has noted the growth in the number of agreements concluded with financial service providers and the number of taxpayers in the Small and Medium-Sized Enterprises over the course of the years, the Committee also notes that – and in spite of all the Tax and Customs Administration’s efforts and promotion of the ‘horizontal monitoring’ concept – the number of clients falling under financial service provider agreements (taxpayers in the Small and Medium-Sized Enterprises segment) has yet to increase to above 8% of the potential number of participants. The Tax and Customs Administration’s message is not as yet sufficiently persuasive to entice taxpayers to take part in horizontal monitoring, on a voluntary basis, either via a horizontal monitoring agreement concluded by their financial service provider or otherwise. Whether the ‘benefits’ horizontal monitoring offers taxpayers in the Small and Medium-Sized Enterprises segment are sufficiently clear and greater than the (additional) compliance burden is still a moot point for the Committee (or, and actually more importantly, for taxpayers in the Small and Medium-Sized Enterprises segment).

A third issue relates to the observation that the Tax and Customs Administration will, in view of the above, need to make substantial investments in the implementation of horizontal monitoring in this segment – a segment with a very different structure. The Committee is of the opinion that this all gives extra cause to the need for the Tax and Customs Administration to make evident refinements to its business case for the Small and Medium-Sized Enterprises segment. The Small and Medium-Sized Enterprises segment is the sole segment for which the Tax and Customs Administration has (recently) drawn up a business case. However, this still does not provide the convincing substantiation for the horizontal monitoring decisions which the Committee would welcome. The assumptions made in this business case are based more on perceptions than on validated facts and the financial substantiation – in particular on the revenue side – gives cause for doubt. It should also be noted – an issue discussed later in this report – that explicit measurement and management criteria need to be defined.

The position of horizontal monitoring in the Tax and Customs Administration's range of instruments

Following the successful pilot with Very Large Businesses the Tax and Customs Administration proceeded to the rapid rollout of horizontal monitoring – at some moments, at least in the Committee's opinion, too rapidly.

For example, some of the staff have not as yet developed adequately to keep pace with the developments in horizontal monitoring: these staff could not, would not, or did not dare to take up the challenge of the horizontal monitoring adventure and often feel that the Tax and Customs Administration no longer devotes any attention or time to other (vertical) forms of supervision. However, the above does *not* imply that these staff were or are simply 'wrong'. Horizontal monitoring in the form of a convincing concept that is implemented in the appropriate manner will sell itself – including internally, within the Tax and Customs Administration. In addition, the management is under the obligation to make investments in the change in the organisation's culture required following a major policy change and to manage the change in the culture in the appropriate manner. In the Committee's opinion this culture change programme – albeit to a lesser extent in the Very Large Businesses segment – has been implemented too late and to an inadequate extent.

The need to break through the traditional we/them attitude gave cause to the Tax and Customs Administration management's – understandable – decision to promote the horizontal monitoring concept in an appealing manner: a different approach would probably have resulted in failure or a troublesome implementation. However, following this 'paradigm change' the Tax and Customs Administration continued to convey the message, both internally and externally, that horizontal monitoring was *the* supervision instrument of the future for too long. After the introduction too little attention was devoted to the fact that Tax and Customs Administration staff would need time to make the transition from 'healthy distrust' to 'justifiable trust': the *it takes two to tango* adage was also applicable to the Tax and Customs Administration, in this instance the management and staff.

The Tax and Customs Administration also conveyed the message that horizontal monitoring was *the* supervision instrument of the future to outside the organisation for many years: as a result, many gained the impression that there would ultimately be no alternative to horizontal monitoring. The Committee is of the opinion that this could never have been the intention: nor would this appear to have been what the Tax and Customs Administration intended. The Tax and Customs Administration's communications are now putting this message into perspective, since the Tax and Customs Administration has recently been explicitly conveying the concept of *compliance risk management strategy*. Pursuant to this strategy the behaviour of citizens and businesses is to be influenced in a manner such that the available staff and resources can be deployed to achieve optimum compliance. The Tax and Customs Administration has a wide range of instruments at its disposal for the achievement of this objective, including the provision of service, vertical supervision, investigation – and horizontal monitoring, not as *the* compliance instrument but as *a* compliance instrument.

The instrument to be selected in a given instance is then determined on the basis of the principle of *trust*

when possible, repression when necessary. The Committee endorses this approach and concept: moreover, and as explained in Chapter 6, this approach is also endorsed at an international level (OECD). This approach is also highly compatible with the social developments outlined at the beginning of this Chapter.

The Committee draws attention to the following table to illustrate that, in practice, compliance risk management strategy encompasses more flavours than solely horizontal monitoring (Table 16 is based on Table 12):

Table 16: Distribution of capacity between horizontal monitoring and vertical supervision in 2011

Very Large Businesses segment (VLB)	FTE 2011	Percentage
VLB horizontal monitoring	320	51%
VLB traditional supervision	313	49%
VLB total	633	100%
Medium-Sized Businesses segment (MSB)	FTE 2011	Percentage
MSB horizontal monitoring	370	30%
MSB traditional supervision	862	70%
MSB total	1,232	100%
Small and Medium-Sized Enterprises segment (SME)	FTE 2011	Percentage
SME horizontal monitoring	147	3%
SME traditional supervision	5,242	97%
SME total	5,389	100%

In conclusion: evaluation and assessment

The Committee is of the opinion that the Tax and Customs Administration's policy change, in which an explicit decision was made to introduce horizontal monitoring, is understandable and compatible with the social developments referred to at the beginning of this Paragraph. The evaluation has revealed that the concept is sound and clear at an abstract level, but that there are still a variety of bottlenecks and vulnerabilities in its implementation in practice. These are reviewed in the following Paragraph.

7.3 Bottlenecks and vulnerabilities

The Committee's second task was to identify horizontal monitoring's bottlenecks and vulnerabilities. The following sub-questions were formulated in Chapter 1 for this task:

- How do the various stakeholders (taxpayers, consultants, academics and the Tax and Customs Administration) experience the implementation of horizontal monitoring in practice and which bottlenecks (including legal bottlenecks) and vulnerabilities do they perceive?
- What contribution does horizontal monitoring make to the effectiveness and efficiency of supervision? How are the effectiveness and efficiency measured?

Before answering these sub-questions, the Committee wishes to draw attention to the detailed discussion

of the bottlenecks and vulnerabilities that arise in practice which is enclosed, in particular, in Paragraph 3.6 (Horizontal monitoring in practice), Chapter 4 (Effectiveness and efficiency) and Chapter 5 (Some legal considerations).

The Committee also wishes to draw attention to the annexes containing position papers from various sources, the minutes of the round-table discussions and a document containing the Committee's findings from these discussions, the results from a staff survey, the information obtained from the Internet consultations and the documents in the list of literature compiled by the Committee.

The Committee is of the opinion that it would not be functional to list all the bottlenecks and vulnerabilities identified in the previous Chapters, let alone discuss each issue in detail. For this reason the Committee has decided to discuss a number of themes specified at an abstract level, namely:

- From intuitive choices to a rational model;
- The pace of the introduction and change in culture;
- The need for segmentation;
- The rules governing horizontal monitoring;
- Legal aspects: legitimacy;
- Effect measurement, effectiveness and efficiency;
- Reduction of costs / increase in burden;
- The Tax and Customs Administration's capacity.

From intuitive choices to a rational model

The Committee has concluded that the Tax and Customs Administration's introduction and further development of horizontal monitoring was for a long time based entirely or virtually entirely on intuitive considerations – on 'belief' in horizontal monitoring. Solely a concise start document listing the principles had been prepared. In the first instance the horizontal monitoring concept was developed further in an incremental process: follow-up decisions were subsequently made which had major consequences for the rollout to all segments, but all without supplementing intuition with a more rational compass, comprised of a policy strategy with rational substantiation, and without a stable policy recognisable to and practicable for taxpayers, financial service providers and Tax and Customs Administration staff which included specific targets and the resultant management information.

In addition to the lack of a vision document in the initial phase of the introduction of horizontal monitoring, the Committee also notes that at the time of the implementation of horizontal monitoring there was no business case, no benchmark measurement had been carried out and no explicit performance indicators and/or critical success factors had been formulated, as a result of which an adequate management mechanism has been lacking to date. The first business case, for the Small and Medium-Sized Enterprises segment, was drawn up no earlier than April 2012 – seven years after the introduction of horizontal monitoring. The Committee is of the opinion that it is nevertheless necessary to draw up a convincing business case for each segment which demonstrates that the horizontal monitoring approach offers benefits and that horizontal monitoring does not result in the loss of tax revenues.

The pace of the introduction and change in culture

The Tax and Customs Administration's decision to introduce horizontal monitoring on a broad scale was a courageous and pioneering decision. However the subsequent and lengthy absence of rational substantiation - with the associated specific targets and approach -, could also be criticised as being insufficiently considered and balanced. The Committee has met exponents of both standpoints inside and outside the Tax and Customs Administration organisation. For this reason the Committee recommends – in particular in the Medium-Sized

Businesses and Small and Medium-Sized Enterprises segments – that the pace of the implementation be delayed slightly to provide sufficient time for the next steps in horizontal monitoring’s development. This recommendation is in part based on the following analysis of the context.

The gap between the management’s willingness and the willingness and ability of a substantial group of Tax and Customs Administration staff is too large, as is the gap between the willingness of the management and willingness of many taxpayers and financial service providers. Conversely, the staff engaged in and persons participating in horizontal monitoring do, in general, have a favourable opinion of horizontal monitoring – a situation which offers the prospects for horizontal monitoring’s further development.

However, the question is then whether the adoption of a more rational approach will give cause to the need for new skills and insights on the part of the Tax and Customs Administration’s horizontal monitoring (operational) managers. The Committee is of the opinion that a change in the organisation’s culture towards a more rational approach is also required in this respect. In the absence of this change in culture there will be a risk that the ultimate objective is not achieved or is not achieved to an adequate extent due to the continuation of approaches adopted in the past without attention to the necessary changes of the policy. In short, the (operational) managers also need to view horizontal monitoring from a fresh (or fresher) perspective in the current stage of the concept’s development.

The need for segmentation

The introduction of horizontal monitoring began with the Very Large Businesses segment, the group of taxpayers who would also appear to appreciate the concomitant benefits to the greatest extent. Both these factors contribute to the relatively far-advanced development of horizontal monitoring in this segment. The horizontal monitoring concept has also developed further in the Small and Medium-Sized Enterprises segment and amongst financial service providers, although the detailing of meta-supervision and the triangular relationship (between taxpayers, financial service providers and the Tax and Customs Administration) both still exhibit plenty of scope for improvement. Major developments have also yet to be achieved in the Medium-Sized Businesses segment: the Committee referred to the Tax and Customs Administration’s ‘struggle’ in this segment earlier in this report.

Within this context the Committee notes that the Tax and Customs Administration’s approach and professional assurances for horizontal monitoring are integrated for the Very Large Businesses and Medium-Sized Businesses segments in a manner that differs greatly from that for the Small and Medium-Sized Enterprises segment, namely in the standing organisation (Very Large Businesses and Medium-Sized Businesses) as compared to a programme (Small and Medium-Sized Enterprises). This is all the more striking since solely 147 FTEs are deployed for horizontal monitoring in the Small and Medium-Sized Enterprises segment (3% of the capacity available for this segment, in contrast to 51% of the capacity available for the Very Large Businesses segment). The Committee is of the opinion that the large group of taxpayers in the Small and Medium-Sized Enterprises segment gives cause to the need to deploy sufficient capacity in this segment to the benefit of the Tax and Customs Administration’s standing organisation within the not too distant future.

This in turn gives cause to the recommendation that the further rollout of horizontal monitoring be organised in a manner that does justice to the specific aspects, requirements, needs and circumstances in each segment. In addition, the Tax and Customs Administration needs to adopt clear and recognisable criteria for the segment. This is currently not, or not adequately, the case.

The rules

As stated earlier the Committee is, in general, an advocate of open standards. However, experience gained in practice reveals that various parties (taxpayers, financial service providers and the Tax and Customs

Administration) staff have a need for more guidance on the meaning of terms such as ‘justifiable trust’, ‘acceptable return’, ‘tax control framework’, ‘material tax issues’, ‘materiality’ and ‘meta-supervision’.

Legal aspects: legitimacy

Chapter 5 referred to a number of theoretical and practical legal risks associated with horizontal monitoring, such as the risks relating to the statutory integration of horizontal monitoring, the position of taxpayers participating in agreements versus those who do not, decisions open to objections and appeals and the tax inspector’s ‘freies Ermessen’. Chapter 5 contains more extensive information. Legal risks are perceived in the fields of legal certainty, legal equality and legal protection, three principles which – in combination – largely determine whether the Tax and Customs Administration’s acts can be deemed to be legitimate.

The Committee is aware that these risks are of relevance from the financial service providers’ perspective and to academic insights. However, the Committee is not concerned that the legitimacy risks – in particular, the risk that horizontal monitoring would imply a legal inequality of a magnitude that would be in conflict with the principles of our democratic constitutional state and the general principles of proper administration – will actually materialise in an unacceptable manner. The State Secretary for Finance has repeatedly stated that the tax treatment of a business with a compliance agreement operates within the framework laid down by the relevant legislation and regulations, as a result of which businesses that are parties to a compliance agreement will not receive a more or less favourable treatment than taxpayers who are not parties to an agreement. Any provisions in these agreements that extend beyond the State Secretary’s words are in conflict with the policy. The tax division of the court shall ultimately need to give an opinion on the influence of the horizontal monitoring system on the legitimacy of the return.

The Committee cannot help noting that the legitimacy discussion is occasionally blown up out of all proportion and often of a theoretical nature. Horizontal monitoring pivots on the development of mutual trust between the Tax and Customs Administration and taxpayer or financial service provider, and a chicken and egg problem can occur all too easily: one party is prepared to place trust in the other party only once that party deserves to be trusted, and vice versa. Obstacles of this form can be overcome solely when both parties take a series of small trusting steps and both parties are prepared to take risks. The horizontal monitoring ‘baby’ is thrown out with the bathwater when every issue is set out in the tiniest legal detail and all flexibility is banned from the implementation. In other words, the Committee is not an advocate of the excessive legalisation of horizontal monitoring, but is an advocate of optimum transparency for society: this is absolutely necessary if the Tax and Customs Administration is to be a reliable partner in the relationship of trust assumed in horizontal monitoring.

Effect measurement, effectiveness and efficiency

Chapter 4 contains a comprehensive review of the effect measurement, effectiveness and efficiency issues. The Committee was surprised to discover how little (relevant) information the Tax and Customs Administration has at its disposal to measure and manage the development and effect of horizontal monitoring. On several occasions it proved impossible either to obtain self-evident qualitative and quantitative policy information or to obtain this information on the basis of regular (management) information. On several occasions the Committee was confronted with the fact that the required information could, for example, be obtained solely by means of specific questionnaires.

This problem is due to the Tax and Customs Administration’s navigating without a rational compass for too long – without defining specific targets for the development and implementation of horizontal monitoring – and continuing to navigate on the basis of its intuition. The problem is also due to the Tax and Customs Administration’s introduction and rollout of horizontal monitoring without beginning by drawing up a business case, carrying out a benchmark survey or formulating virtually any performance indicators and measurement mechanism. Consequently, it is not clear how the Tax and Customs Administration determines the degree

of success achieved by horizontal monitoring. Although the Committee notes that the Tax and Customs Administration has devoted a great deal of effort to a variety of qualitative studies – including the Tax Monitor – the Committee is of the opinion that these do not yield sufficient information about horizontal monitoring in its entirety.

The *efficiency* can be reviewed solely on the basis of the relationship between the available capacity and the financial resources, the activities carried out within the scope of horizontal monitoring and the results achieved by these activities (output management). Moreover, it is also necessary to review whether the horizontal monitoring efforts made by the Tax and Customs Administration have been *effective* (outcome management) and are resulting in an improvement in compliance with tax regulations – and certainly in these times in which the same work needs to be carried out with fewer staff and fewer resources and the Tax and Customs Administration is compelled to make choices.

It should be noted that this is also applicable to all forms of supervision. The Tax and Customs Administration has, in general, insufficient information about the effectiveness of supervision at its disposal. The manner in which this effect is measured has not been made clear and the cost-effectiveness is not transparent. As a result, it is virtually impossible to substantiate the consequences of exchanges of supervisory instruments with specific input and output data: the necessary indicators need to be developed.

The Committee is of the opinion that the administrative information about horizontal monitoring is totally inadequate. Horizontal monitoring is provided insufficient support from information systems that can assist in decision-making on the appropriate form of supervision and the measurement of the effects and efficiency of the selected form. It is not clear how the Tax and Customs Administration manages the organisation and its staff.

Moreover, this lack of insight into the effectiveness and efficiency of horizontal management results in uncertainty about its effect on compliance with tax regulations and, consequently, on tax revenues. The Tax and Customs Administration failed to carry out a systematic review of the potential effects of horizontal monitoring on tax revenues at the time the system was introduced and failed to assess the effect on clearing up old problems (outstanding tax issues from the past). The argument the Tax and Customs Administration raised on several occasions, namely that the effects of the traditional supervision model are not traceable either, is not valid: quite the converse, in fact, from a government agency responsible for a large portion of the state revenue may be expected to give accurate account for its acts and to provide an adequate insight into the elements on which its policy is based and its operations are managed.

The second paragraph, in accordance with the third task assigned to the Committee, reviews the Committee's proposals and recommendations for effect measurements.

Reduction of costs / increase in burden

The following issue continues from the aforementioned issues. Participants in agreements will, self-evidently, wish to receive gains to compensate for the extra burden horizontal monitoring imposes on them – such as fewer audits, less laborious procedures or the more rapid settlement of current problems – since these are elements of their business case. However, it is a moot point whether the Tax and Customs Administration can fulfil the expectations of participants in agreements in either a qualitative and/or quantitative sense. A number of participants in the round-table discussions were of the opinion that it must be feasible to implement horizontal monitoring in a cost-neutral manner and that the Tax and Customs Administration provides insufficient clarity for the preparation of a justifiable cost-benefit analysis.

The policy governing horizontal monitoring must be clear to all participants in agreements with an interest in

this form of supervision and the associated cost structure must be clear to all parties involved. The Tax and Customs Administration also needs to possess an insight into, for example, the costs it incurs in concluding an agreement and maintaining a horizontal monitoring relationship.

In the absence of information of this nature, or in any case insufficient information, there is a risk that taxpayers will experience horizontal monitoring primarily as a government endeavour to shift the supervisory burden and risk of gaps in the supervisory system onto taxpayers and financial service providers, as a result of which horizontal monitoring results solely in a semblance of efficiency and the transfer of the burden within the chain. This concern was also voiced during a number of round-table discussions. The Tax and Customs Administration staff, in particular, are concerned that although the efficiency benefits offered by horizontal monitoring will materialise the pressure imposed by the government economies will curtail the necessary associated intensification of the (vertical) supervision of taxpayers who do not participate in horizontal monitoring and of non-bona fide taxpayers. On balance, this could then result in an increased volume of fraud. In view of the above the Committee is of the opinion the Tax and Customs Administration shall need to convincingly demonstrate that the efficiency gains achieved from the improved relationship with taxpayers is actually converted into capacity that can be deployed to reinforce vertical supervision as required.

The Tax and Customs Administration's capacity

Various parties (taxpayers, financial service providers and Tax and Customs Administration staff) have expressed the concern that the introduction of horizontal monitoring is accompanied with the loss of high-grade knowledge within the Tax and Customs Administration on the termination of investments in this knowledge, which is apparently no longer of importance. Self-evidently a balanced horizontal monitoring system will need to prevent this knowledge-drain.

The Tax and Customs Administration needs highly-qualified and expert staff (within this context, see also our earlier comment about the appeal working at the Tax and Customs Administration has for accountants). The staff need to possess the correct attitude and adequate (professional) knowledge, skills and resources. It will then need to be borne in mind that the competences required for horizontal monitoring differ from those for vertical supervision.

In conclusion

Although the Committee has not endeavoured to provide exhaustive conclusions in this Paragraph, it is of the opinion that it has fulfilled task 2 in the appropriate manner. In conclusion, we wish to draw attention to the Chapters referred to at the beginning of this Paragraph and the annexes containing more detailed information.

7.4 Proposals for the further development of horizontal monitoring and effect measurement

The third and last task assigned to the Committee was to submit proposals for the further development of horizontal monitoring at Very Large Businesses, Medium-Sized Businesses and the Small and Medium-Sized Enterprises (SME) segment, as well as to submit proposals for the effect measurement procedure. The Committee, on its initiative, supplements this with a brief analysis of the context.

The Committee has decided to combine the recommendations for the Very Large Businesses and Medium-Sized Businesses segments in view of the individual account management practiced in the Very Large Businesses and Medium-Sized Businesses segments and the partial overlap of the proposals. The summary and the conclusions in the above Paragraphs give cause to the following main recommendations from the Committee:

General

1. The Committee recommends, for the purposes of clarity and recognisability, that the term 'horizontal

monitoring' be used solely for those activities which pivot on the tax return and for which the Tax and Customs Administration performs its duties on the basis of a relationship of trust in combination with system and supplementary supervision designed to provide for the acceptability of the return. Consequently, pursuant to this definition horizontal monitoring does not encompass agreements, albeit useful agreements, concluded with parties such as sectoral organisations and software developers.

2. Transparency on the part of the Tax and Customs Administration is dispensable if it is to operate as a reliable partner within a relationship arising from an agreement. The Tax and Customs Administration needs to be both clear and transparent when it integrates horizontal monitoring in the tax system, both in terms of the substance (clear criteria) and the procedure (clear division or responsibilities, processes and working methods). Clarity and consistency are, for example, urgently needed for the classification into segments, in particular for the Medium-Sized Businesses 'intermediate' segment.
3. The standardisation of the substance of the horizontal monitoring concept may not be to the detriment of the actual concept. The normative criteria adopted by the Tax and Customs Administration, for example for the reliability of a tax control framework, need to specify *the result* that is that to be achieved, *not the method* to be used to achieve that result (target standards rather than resources standards).
4. Horizontal monitoring increases the 'risk of attachment': Tax and Customs Administration staff must not lose their ability to form objective opinions on entering into relationships based on trust and operating with an understanding for the taxpayers' interests. This requires the provision of extra assurances and accommodating policy on the part of the Tax and Customs Administration.
5. In the medium-term, and at at least within the period in which horizontal monitoring has been fully developed and is fully operable, the Committee recommends that the Tax and Customs Administration enters into cooperation with other implementing organisations to review the feasibility of a further expansion of the compliance agreements, in the first instance in the Very Large Businesses and Medium-Sized Businesses segments.

Very Large Businesses/Medium-Sized Businesses

6. Horizontal monitoring must result in a win/win situation, which is usually feasible for many businesses in the current Very Large Businesses segment. However, the tax control framework requirement is frequently too stringent for businesses in the Medium-Sized Businesses segment and many of these businesses will not be inclined simply to take part in the system on a voluntary basis. The Tax and Customs Administration must not allow itself to be enticed to respond by loosening the requirements imposed on the Medium-Sized Businesses segment to an extent that negates the 'benefit' offered to government. However, the Tax and Customs Administration does need to implement measures that compensate the absence of an adequate tax control framework.
7. Within this context the onion-skin model, in particular with respect to the accountant's assessment of the design, implementation and performance of internal controls, needs to be implemented more in practice and used more intensively than is currently the case.
8. The Tax and Customs Administration staff need to be able to provide a uniform specification, within a specific bandwidth, of the level of internal control that needs to be achieved by a tax control framework and the consequences this will have for the adjusted supervision. Recognisable and practicable terms need to be developed for this purpose.
9. Meta-supervision and system supervision as employed within the context of horizontal monitoring deserve more attention. The meta-supervision and system supervision need to include reality checks, whereby it will be necessary, for example, to provide an insight into the requirements for reviews of this nature at each level of internal control.
10. The Tax and Customs Administration plays an international pioneering role in the development of horizontal monitoring (internationally referred to as 'enhanced relationship'). The further development of horizontal monitoring should be carried out in cooperation with tax authorities outside the Netherlands, in

particular in the interests of (very) large businesses.

Small and Medium-Sized Enterprises

11. The Tax and Customs Administration should communicate more clearly that the principles governing the Small and Medium-Sized Enterprises segment differ from those for the Very Large Businesses and Medium-Sized Businesses segments. In essence, the benefit the Tax and Customs Administration is offered in the Small and Medium-Sized Enterprises segment lies in the increased trust in the filing of acceptable returns by taxpayers in this segment, whilst the agreement relationship is established between the Tax and Customs Administration and the financial service provider. The triangular relationship (taxpayer, financial service provider and the Tax and Customs Administration) raises issues that need to be addressed in detail, such as issues relating to the interests and responsibilities of the parties involved.
12. The number of taxpayers taking part in horizontal monitoring via their financial service providers (8%) reveals the need for the Tax and Customs Administration to study the benefits offered to these taxpayers and to draw more attention to them than is currently the case, with the ultimate objective of convincing the remaining 92% of the benefits offered by horizontal monitoring.
13. In view of the diversity of financial service providers (subject to supervision by the Netherlands Authority for the Financial Markets and a licensing system, supervision by an umbrella organisation, no supervision, solely a system of disciplinary measures and similar), the Tax and Customs Administration needs to make clear which requirements are imposed on the various categories, for example for quality assurance, and the consequences of the differences for the design of meta-supervision. It will then also be necessary to provide an insight into the compensatory measures to be implemented when a category of service providers does not comply with the most stringent requirements.

Effect measurement

Chapter 4 discussed effectiveness and efficiency in detail. The Committee is neither an advocate of number fetishism or unnecessary bureaucracy nor a proponent of the adage that only 'to measure is to know'. Nevertheless, this is without prejudice to the need for the Tax and Customs Administration's further development of effect measurements. The Tax and Customs Administration will need to carry this out at a detail level, when issues such as those referred to in Chapter 4 could be addressed. The Committee makes the following recommendations at an abstract level.

14. The Tax and Customs Administration needs to draw up a business case for each segment (Very Large Businesses, Medium-Sized Businesses and Small and Medium-Sized Enterprises) which demonstrates that the horizontal monitoring approach offers benefits to all those involved (taxpayers, financial service providers and the Tax and Customs Administration). It will then be necessary to demonstrate that horizontal monitoring achieves increased compliance, does not result in the loss of tax revenue and, moreover, to provide an insight into the 'gains and costs' (not just in a quantitative sense, but also in a qualitative sense) associated with the implementation of horizontal monitoring.
15. Within this context the Tax and Customs Administration also needs to carry out a benchmark measurement for each segment. This is necessary to begin to make comparisons of the development in the level of compliance and of the influence of horizontal monitoring on other measurable effects over the course of time.
16. In continuation from the above, *a coherent entirety of indicators* needs to be developed for each segment that can be used to provide an insight into (1) the input (in terms of human and financial resources), (2) the quality of the activities that are carried out, (3) the output (the number of each type of activity and the results) and (4) the effect on compliance (for example, an improvement of the scores for compliance indicators and a decline in the number of errors). The determination of the causality between a specific intervention and its effect on taxpayer behaviour requires, whenever feasible, the use of a control group

and/or a benchmark measurement. When this is not feasible supplementary studies can be carried out to assess the plausibility of a given relationship.

17. It will also be necessary to provide a clearer and more explicit insight into the manner in which the Tax and Customs Administration carries out reality checks and the number of those checks (in all segments), the results from these checks and the extent to which an improvement on behaviour (as measured by the number of errors) is visible. The efforts (reality checks) currently made within the context of the system supervision of the Very Large Businesses and Medium-Sized Businesses segments are not sufficiently clear and those currently made within the context of the meta-supervision of the Small and Medium-Sized Enterprises segment are inadequate. Moreover insufficient account is taken of the differences between the quality assurance systems of the various categories of financial service providers on which the Tax and Customs Administration relies for the Small and Medium-Sized Enterprises segment.
18. The Tax and Customs Administration also needs to collect information for the reviews of the hypotheses on which the specific form of horizontal monitoring in each segment is based to determine whether they agree and continue to agree with practice. The measurement of effects then needs to be based on targets or subtargets for each segment which, for example, provide an insight into:
 - the improvement in the working relationship (in terms of understanding, trust and transparency),
 - the materialisation of the benefits (more rapid certainty, preliminary consultations and working in real time),
 - the improvement in the information position (internal control and internal and external audits), as well as
 - the reduction in the amount of supervision (decline in the supervisory burden).
19. The Committee proposes that a periodical, external and objective (academic) study be organised to examine the effect of the employment of the horizontal monitoring instrument on the attitude and behaviour of taxpayers and the indicators that are then determinative.

The *measurement of effects* is required for management at the highest level of abstraction. The structural integration of this measurement process within the organisation requires a process that is tailored as closely as possible to the need for management at the operational level of the work processes, or in other words, this relates to the provision of management information. Self-evidently, the Committee – which, as stated earlier is not an advocate of number fetishism or unnecessary bureaucracy – appreciates that this is accompanied by the risk of the maintenance of excessive records of operational decision-making and the associated bureaucracy. Consequently, a selective approach is required. For this reason:

20. The Committee recommends that the deployment of capacity be based much more on planning than is currently the case and that this deployment be linked to the effect that is to be achieved (by segment). This will then provide an insight into the capacity allocated to each aspect of the compliance risk management strategy, as well as the effect this is intended to achieve and actually achieves. In addition, it will be possible to assess the truth of the hypothesis formulated by the Tax and Customs Administration, namely that horizontal monitoring is effective and efficient: it will also be possible to assess whether capacity is actually released by the use of horizontal monitoring that can be deployed elsewhere as required for other forms of supervision.

Analysis of the context

The Committee has already referred to the Tax and Customs Administration's policy change and decision to introduce horizontal monitoring – in particular, from the perspective of the development of a broader range of instruments and an element of compliance risk management strategy – as understandable. This is a policy change and decision which dates from the middle of the last decade. It will be self-explanatory that there have been many changes since then, both in the field of horizontal monitoring and, and above all, in the broader

context in which the Tax and Customs Administration operates. For this reason the Committee encloses a brief analysis of the context, although this is certainly not intended to be exhaustive:

- Horizontal monitoring was introduced at a time when the economy was much more favourable than in the current turbulent conditions. Consequently, the question could be raised whether a trust based approach and compliance strategy can function equally well in the current context as under more favourable conditions. Experience has shown that entrepreneurs who are up to their neck in difficulties may take desperate measures, whereby excessively creative and even fraudulent behaviour cannot be excluded.
- The lessons the supervisors in the financial and economic fields, in particular the Netherlands Authority for the Financial Markets and De Nederlandsche Bank, have been compelled to learn is that a trust approach may not result in ‘easy trust’ rather than ‘justifiable trust’. As a result, these supervisory authorities have now adopted a more stringent approach to some issues. Although the Committee is of the opinion that this is not in conflict with the principle of a trust approach (but more in line with the adage ‘flexible when possible, strict when necessary’), the Tax and Customs Administration also needs to pay due heed to the lesson learnt by others. For this reason the range of instruments in the Tax and Customs Administration’s compliance risk management strategy will always need to include the most extreme instrument, investigations by the Ministry’s Fiscal and Intelligence and Investigation Service.
- All national government bodies, including the Tax and Customs Administration, are confronted with targets and cost reductions. The Tax and Customs Administration has been able to absorb consecutive spending cuts implemented in recent years by achieving continual improvements in the efficiency of its processes. However, the opportunities available to do so are finite. New targets can, when they are not accompanied by a material reduction of the Tax and Customs Administration’s tasks, be detrimental to the Tax and Customs Administration’s ability to perform its supervisory duties and, ultimately, have consequences for tax revenues. All the above can also be detrimental to the image, intentions, management, choices and policy relating to the introduction and rollout of horizontal monitoring.
- This last is a specific issue that has been revealed by the internal discussions (within the Tax and Customs Administration) about horizontal monitoring in its guise as an efficiency-improvement operation. These discussions also refer to horizontal monitoring as a cost-cutting and rationalisation operation, whereby the recent criticism from, for example, the Abvakabo FNV and VHMf trade unions also needs to be borne in mind.
- Nor is it possible to simply ignore the effect on work ethics resulting from horizontal monitoring’s coincidence with the large-scale reorganisation of the Tax and Customs Administration, which has such fundamental consequences for the personal life of the staff, and with the centralisation of the Tax and Customs Administration’s network of district offices.
- The context also includes the dimension of a high regulatory pressure, as discussed – in particular – in Chapters 2 and 3. When horizontal monitoring is rolled out further it will be necessary to give consideration to alternatives, such as a reduction of the regulatory pressure since this can also achieve great improvements in efficiency and effectiveness. Consequently, the alternatives also need to be considered in the horizontal monitoring business case.
- In conclusion, the context also includes an evident international dimension. International developments are also ongoing, national borders are becoming less distinct and the continuing internationalisation is raising new issues, certainly for the senior management level in the business community. This latter is also applicable to the Tax and Customs Administration: this will also have an influence on the Tax and Customs Administration’s operations and – and more than in the past – give cause to the need for cooperation with tax authorities outside the Netherlands.

Closing Paragraph

Within this context the Tax and Customs Administration deserves praise for its decision to continue with a

major transition in these turbulent times. However, this context also gives cause to the need to navigate with a reliable compass. In essence, the Committee's report endorses the horizontal monitoring concept, although the Committee is of the opinion that a number of improvements in the implementation of the concept are both desirable and necessary. The Committee hopes that this report will be of assistance in making these improvements and that it has made some useful suggestions for the development of horizontal monitoring introduced on the basis of the Tax and Customs Administration's intuition into a rational concept.

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Annex 2

Introduction to the minutes of the round-table discussions

The issues raised during the various discussions that, in the Committee's opinion, are of greatest relevance are discussed below. These are followed by the Committee's conclusions.

The 'horizontal monitoring' term

- The participants in a number of the discussions were of the opinion that 'horizontal monitoring' is not a wholly apt term as 'horizontal' implies that the parties are equal, whilst the parties are *not* equal because, by very definition, the government is in a stronger position – laid down by law – and has specific powers at its disposal.

Should horizontal monitoring be integrated in the law?

- The question has arisen whether, from a perspective of the principle of legal equality, a legal framework for horizontal monitoring is either desirable or necessary. It has been suggested that a decision open to objection is issued to parties when they begin to participate in horizontal monitoring which provides them an opportunity to appeal.

Change in the organisation's culture

- Some Tax and Customs Administration staff are in favour of horizontal monitoring whilst others exhibit a greater or lesser degree of resistance to the concept. These contrasts within the Tax and Customs Administration are, above all, a manifestation of an as yet incomplete change in the organisation's culture. In addition, staff feel that the Tax and Customs Administration's Board and management imposes pressure on them to adopt horizontal monitoring.

Relationship between businesses and the Tax and Customs Administration (are the ties too close?)

- There is a risk that an excessively cosy relationship with taxpayers may result in Tax and Customs Administration staff relinquishing their critical attitude towards taxpayers. It would be logical to reduce this risk of an excessively cosy relationship by rotating staff at regular intervals, although this is at odds with the objective of developing and maintaining a relationship with the specific taxpayer.

(Un)clear criteria

- The criteria for the classification into the Very Large Businesses, Medium-Sized Businesses and Small and Medium-Sized Enterprises segments are not clear and have not been communicated outside the Tax and Customs Administration.
- The admission criteria to be met for horizontal monitoring are not clear: participants in the discussions refer to this unfamiliarity as a vulnerable element within the context of legal equality.
- The compliance agreements do not lay down details of the arrangements for this form of supervision, such as the tax control framework, whilst the tax control framework constitutes the essence of horizontal monitoring. Some participants expressed the wish for the specification of at least a minimum framework.
- The assessment of a tax control framework is a new and special form of expertise that is not a regular form of expertise possessed by the Tax and Customs Administration staff.
- The Tax and Customs Administration's recent change in policy, whereby part of the Medium-Sized Businesses segment will be brought under the Small and Medium-Sized Enterprises has resulted in uncertainties.

Rollout of horizontal monitoring in the Small and Medium-Sized Enterprises segment

- Various parties have expressed doubts about the feasibility and desirability of the rollout of horizontal monitoring in the Small and Medium-Sized Enterprises segment.
- The Tax and Customs Administration would not appear to be (completely) ready for the rollout.
- Financial service providers, who support the concept, experience pressure imposed on them to supply clients for horizontal monitoring.
- They cite as an alternative the outsourcing of specific tax inspections to the financial service providers on the basis of certification or some form of statutory system.

The consultant's role

- The option was proposed of concluding individual compliance agreements in the form of tripartite agreements in which the financial service provider is a party to the agreement. However, there are differences of opinion about the value of a tripartite agreement of this nature.

Are the costs reduced – or increased?

- There is no clear answer to the question whether horizontal monitoring reduces or actually increases the costs. The additional inspection work will increase costs for taxpayers, although they do then benefit from certainty and, consequently, from the elimination of retrospective inspections.

Personal choice and discretion

- Horizontal monitoring, the Tax and Customs Administration's preferred strategy, is based on the taxpayer's voluntary decision to take part in the system.

Extension of the Tax and Customs Administration

- The Tax and Customs Administration possesses tax enforcement powers assigned to the Administration by law. Vertical supervision is a Tax and Customs Administration cost item. Horizontal monitoring transfers a proportion of these costs – the costs of the supervisory burden – to the tax payers.

Consequences of errors and inaccuracies

- The administration of justice may not be influenced by the form of supervision, i.e. vertical supervision or horizontal monitoring. The objective is to ensure that the taxpayer files an acceptable return. However, what are then the consequences of the discovery of an error within the context of meta monitoring? Will this result in an adjustment? And, if this results in an adjustment, will a penalty be imposed? Or will this be an issue solely for future returns? When an error is discovered which is imputable to a financial service provider, then will this result in an audit and adjustment of the returns from all the financial service provider's clients? In practice, this gives cause to uncertainty.

Quantity, rather than quality

- There is an impression that the Tax and Customs Administration's implementation of horizontal monitoring focuses more on quantity than quality. This (supposed?) eagerness could result in concessions being made on the quality of the horizontal monitoring system process and the inclusion of offices and businesses in horizontal monitoring which are not yet ready for the concept.

The onion skin model and tax control frameworks

- Horizontal monitoring includes the optimisation of the internal and external audit 'layers' involved in filing an acceptable return. This is manifested by the internal control system and tax control framework: the Tax and Customs Administration relies on these elements, in part on the basis of its concept of making

use of work already carried out by the external auditor. However, since most of the Tax and Customs Administration's client coordinators are tax specialists rather than accountants this causes tension in meetings the Tax and Customs Administration staff hold with taxpayers which discuss issues such as the administrative organization and the provision of administrative information.

- Minimum requirements governing tax control frameworks have not been specified. In practice, there is a need for more certainty about these requirements.

(Meta) supervision of the Small and Medium-Sized Enterprises segment

- The umbrella organisations state that tax service providers and their clients experience increased inspection activity within the scope of horizontal monitoring as compared to the period prior to the introduction of the concept.
- It has been suggested that a certification system be introduced for financial service providers, whereby the taxpayers receive some form of compensation for the additional costs they incur.

Exploring the limits of the tax legislation

- The acts of taxpayers and their financial service providers must lie within the limits prescribed by the legislation, regulations and case law, whereby financial service providers can exercise their discretion in seeking the most favourable result for their clients within these limits.
- The tax risks must be reported and discussed, although in practice the substance of these financial risks is not entirely clear ('tax risk' has not been defined in more specific terms).
- There are differences in insights within the context of the fair-share discussions and the exploration of the limits of the tax legislation issue.
- The umbrella organisations noted that the Tax and Customs Administration regularly states – when discussing a specific act or question during the preliminary consultations – that adopting a standpoint on the basis of an exploration of the limits of the tax legislation is not expected from a 'horizontal monitoring office'.

Can the Tax and Customs Administration fulfil the expectations?

- The business community is regularly confronted with inspectors and auditors of the old school who are focused primarily on finding errors. The Tax and Customs Administration's Board and management are certainly prepared to adopt the horizontal monitoring attitude: now the staff need to be prepared to do so as well!
- The Tax and Customs Administration 'markets' horizontal monitoring to its staff on the basis of arguments including the resultant time savings that could then be allocated to vertical supervision. However, the staff feel that these savings have yet to be achieved.
- Discussing tax risks and holding preliminary consultations cost the Tax and Customs Administration a great deal of time. The Tax and Customs Administration staff and the business community view the politicians' decision to implement a substantial reduction of the Tax and Customs Administration's staffing level, in analogy with other government departments, with concern. This reduction of the Tax and Customs Administration's staffing level and the plans to concentrate work within the Tax and Customs Administration are at odds with the fulfilment of the ambitions for horizontal monitoring.

Relationship between horizontal monitoring and vertical supervision

- It is necessary to warn against the risk of horizontal monitoring evolving into a dogma. The Tax and Customs Administration staff will need to be guided smoothly in the implementation of the overall compliance concept, one element of which is horizontal monitoring.
- A taxpayer participating in horizontal monitoring voluntarily reports an error which results in an adjustment: will a penalty also be imposed on the taxpayer? This is an interesting question. It has been

argued that the imposition of a penalty would not be logical. When viewed from the perspective of the principle of legal equality, opting for horizontal monitoring may not exert an influence on substantive law, since horizontal monitoring and vertical supervision are both governed by the same legislation and regulations.

- The Tax and Customs Administration must have sufficient capacity available for vertical supervision: this is also beneficial to the credibility of horizontal supervision.

Effect of horizontal monitoring on tax revenues

- A small group of the participants in the discussions are of the opinion that horizontal monitoring has no influence on tax revenues, whilst a larger group are of the opinion that horizontal monitoring is beneficial to tax revenues.

Effectiveness of the policy and the efficiency of the implementation

- No benchmark measurement has been carried out, no business case has been prepared and no measurement figures are available for an assessment of the effectiveness and efficiency of horizontal monitoring.
- The participants in the discussions did state a number of relevant performance indicators, such as the completeness of the registration, the timeliness of the return, the speed at which the assessment is determined and the payment of the assessment, the speed with which the Tax and Customs Administration answers questions and responds to requests for preliminary consultations (service level agreement). The Tax and Customs Administration works increasingly in real time and fewer adjustments are necessary. The perception of businesses participating in horizontal monitoring as manifested by the results from the Tax Monitor also provides an indication of the effectiveness of the concept.
- Effect measurements are still in their 'infancy' and need to be developed further.

Introduction

A series of round-table discussions were held to gain an insight into the relevant parties' experiences with horizontal monitoring. These discussions were held with:

- the taxpayers: representatives from Very Large Businesses, Medium-Sized Businesses (directors/majority shareholders), representatives from sectoral organisations and representatives from the non-profit sector
- the consultancy sector: umbrella organisations of tax specialists and accountants
- the academic community
- The Tax and Customs Administration: the Board, regional management (hereinafter referred to as management), members of the Medium-Sized Businesses/Very Large Businesses and Small and Medium-Sized Enterprises horizontal monitoring programme and other Tax and Customs Administration staff (including a delegation from the VMHF staff association).

Discussions about horizontal monitoring were also held with Customs, with delegates from Very Large Businesses and with Customs' directors. A discussion was also held with the Director of the Fiscal Intelligence and Investigation Service. The parties invited to take part in the round-table discussions were usually requested to prepare a position paper in advance of the meeting in which they stated their experiences with horizontal monitoring, the bottlenecks they encounter in practice, potential risks and any suggestions they might have for improvements in the opportunities for the use of horizontal monitoring. The minutes from these round-table discussions and the position papers submitted to the Committee are enclosed in this Annex. All minutes of the meetings were submitted to the participants for approval. This was followed by the compilation of the most important findings and points for attention resulting from the discussions. This information was compiled by subject.

The 'horizontal monitoring' term

The participants in a number of the discussions were of the opinion that 'horizontal monitoring' is not a wholly apt term as 'horizontal' implies that the parties are equal: however, this is not the case. The government is, by very definition, in a stronger position – laid down by law – and has specific powers at its disposal. Consequently, when viewed from this perspective the relationship is *not* horizontal. However, it is important to bear in mind that the Tax and Customs Administration is confronted with an information backlog relating to the body of facts of relevance to taxation. It should also be noted that the parties must not feel that they are being treated unequally: this necessary feeling of equality would appear to be the case with horizontal monitoring. Horizontal monitoring should primarily be regarded as a form of appropriate cooperation between the Tax and Customs Administration and the taxpayer which is in the parties' mutual interest. Giving shape to mutual trust, understanding and transparency can result in the development of a more equal relationship between the parties. Although an examination of the 'horizontal monitoring' term reveals that the name is not entirely correct, the name is now in general usage and a change in the name at some point in the future would not appear to be a logical choice.

Should horizontal monitoring be integrated in the law?

At the time the Tax and Customs Administration reached a carefully-considered decision *not* to formalise horizontal monitoring: preference was given to the development of horizontal monitoring's form and substance during the implementation of the concept. Within this context it is important to note that horizontal monitoring relates to attitudinal and behavioural aspects. The Tax and Customs Administration has been granted discretionary powers in giving shape to its enforcement tools and inspection options. Horizontal monitoring is highly compatible with these tools and options. The question arose in several discussions whether a legal

framework for horizontal monitoring is either desirable or necessary. Many participants in the discussions were of the opinion that, on the basis of the principle of equality, horizontal monitoring should be open to all taxpayers who comply with the requisite conditions. However, this is not currently the case: for example, a taxpayer in the Small and Medium-Sized Enterprises segment cannot take part in horizontal monitoring when the taxpayer's financial service provider has not concluded an agreement and is not affiliated with an agreement concluded by an umbrella organisation. In addition, what are the consequences when the Tax and Customs Administration refuses to conclude a compliance agreement with a taxpayer in view of the taxpayer's poor track record? It has been suggested that a refusal of participation in horizontal monitoring of this nature should be open to objection and appeal. For this reason, it would be necessary to be able to lodge an objection and/or appeal against a decision on participation in horizontal monitoring. However, granting this entitlement would be rather odd: horizontal monitoring is based on mutual understanding, transparency and trust – and these cannot be compelled! For this reason the parties need to be able to exercise their discretion in deciding whether to cooperate. It should also be noted that concluding a compliance agreement and developing the associated working methods can be regarded as preparatory acts which are also ineligible for legal recourse at present. However, in the event of a material difference between taxpayers who do or do not participate in horizontal monitoring a statutory basis would be desirable or even necessary. What the Tax and Customs Administration *does* regard as sufficient for a taxpayer to participate in horizontal monitoring is then an interesting question. It is indubitable that there may be no differences in the tax treatment of taxpayers who do or do not participate in horizontal monitoring.

More mutual understanding

It has repeatedly been stated that the horizontal monitoring concept has resulted in the devotion of increased attention to mutual interests. One of horizontal monitoring's major benefits lies in the ability of the Tax and Customs Administration to settle tax dossiers more rapidly. Mutual understanding for each other's standpoints has had an evident beneficial effect on the dialogue between the parties. However, a number of businesses stated that calling in a knowledge group regularly retards the process. In addition, the standpoint that is ultimately adopted takes insufficient account of the taxpayer's specific situation.

Blind trust versus justifiable trust

It was emphatically stated that trust may never be *blind* trust. Taxpayers must specify, implement and arrange for the audit of their tax control framework. The Tax and Customs Administration should specify the minimum conditions to be met by the tax control framework. Horizontal monitoring makes the trust between the Tax and Customs Administration and taxpayer explicit. Most Very Large Businesses have their internal control in order. The Tax and Customs Administration should then be able to trust these systems, i.e. on the basis of justifiable trust. However, the question is then how this can be verified. This is also an issue that would appear to play an important role with the smaller businesses: in essence, this relates to the culture, the person taking part in the discussions and the tone at the top, whereby a behavioural psychology element is also involved. In essence, the compliance agreement constitutes a letter of intent that includes behavioural provisions. Although a compliance agreement has been concluded, verification is still necessary.

Win-win situation

Horizontal monitoring primarily relates to the parties' adoption of a fundamentally different attitude. The business decides to actively and more intensively communicate tax risks to the Tax and Customs Administration. This has ramifications throughout the business. The Tax and Customs Administration is able to work more in real time – assuming that the information it receives is reliable – and will be able to respond to any implementation problems that arise more rapidly. Important issues can be submitted for discussion during interim periods between returns. The criterion governing these interim consultations is the expectation that the Tax and Customs Administration may have an opinion on the regulations that differs from the business'

interpretation of those regulations. Actively communicating and being open about these issues generates mutual trust and avoids a situation in which differences in interpretation linger on and result in lengthy periods of uncertainty. The parties may also agree to disagree on certain issues. Differences of opinion in the interpretation of the relevant legislation do not constitute an impediment to the conclusion of a compliance agreement. The parties' approach to each other has changed: they are more open to each other. In the past, the Tax and Customs Administration did not inform the business what exactly would be inspected and the audits were often of the nature of a fishing expedition. However, the situation is now different: the Tax and Customs Administration gives notification of any issues discovered during the inspection so that the discussions between the business and the Tax and Customs Administration can focus on the essence of horizontal monitoring – arriving at an opinion on the internal control processes and making any necessary adjustments. As a result, the emphasis has shifted to the internal control system and, in turn, has resulted in more effective supervision. The round-table discussions revealed that the major benefits for the taxpayer are more rapid certainty about the tax position and the rapid determination of the assessment, and for the Tax and Customs Administration the reduced need to resolve tax problems retrospectively, with all the concomitant irritation. The reduction of inspection work of this nature saves time and effort for both the Tax and Customs Administration *and* the taxpayer. It was also noted that horizontal monitoring also offers the Tax and Customs Administration the major benefit of being able to fulfil its duty of providing for compliance with the legislation with less effort.

Change in the organisation's culture

Horizontal monitoring is not autonomous: it is an element of responsive enforcement. The Tax and Customs Administration's Board stated that much of the work on horizontal monitoring in the initial phase was carried out on the basis of intuition, when the Tax and Customs Administration listened carefully to the business community's desiderata. The Tax and Customs Administration Board, management and staff state that the pilot trial with 20 large businesses that began in 2005 was a success. However, at the time the entire process was excessively regarded as a dogma. A paradigm change was an issue. Over the course of the years horizontal monitoring has been expanded, although not in an excessive manner: for example, the number of Tax and Customs Administration staff involved in horizontal monitoring has remained limited (in total, about 850 FTEs). Some Tax districts have focused exclusively on horizontal monitoring with the intention of supporting the change in the organisation's culture. However, this was not without risks: a backlash has now become apparent. The processing teams now decide on the deployment of their capacity for individual processing and on the distribution of their attention to all elements of the package. The Tax and Customs Administration implements horizontal monitoring on the basis of its guidelines and other instructions. Regional and national intervision meetings also play an important role. The 'Tour de horizon' which calls at all Tax districts is intended to draw the Tax and Customs Administration staff's attention to horizontal monitoring.

The discussions with the umbrella organisations drew attention to the apparent presence of two groups within the Tax and Customs Administration, one of which is in favour of horizontal monitoring and the other is not. Within this context the dichotomy between tax inspectors who took part in horizontal monitoring experiments and tax inspectors who are only now confronted with horizontal monitoring is striking. The participants in these discussions also stated that this is the reason for the discernable differences between Tax districts: the Tax districts that were the first to introduce horizontal monitoring are now clearly in the vanguard. Although there is pressure from the top to continue with horizontal monitoring, staff at lower levels would appear to be either unwilling or unable to observe this requirement. This might be due to unfamiliarity with the horizontal monitoring concept and approach. Moreover, some Tax and Customs Administration staff now taking part in horizontal monitoring still inspect the relevant taxpayers in the traditional manner, which does not square with the intention of horizontal monitoring. It was also noted that the contrasts within the Tax and Customs Administration are, above all, a manifestation of an as yet incomplete change in the organisation's culture. Since this change is incomplete taxpayers do not have a uniform impression of the Tax and Customs

Administration's approach to horizontal monitoring, as a result of which taxpayers accept the horizontal monitoring concept to a lesser extent than they could or should. The Tax and Customs Administration could increase its management of the change in the organisation's culture. In addition, the accounting firms and tax consultancies also need to become familiar with the concept. The participants in the discussions also stated that many tax inspectors 'think along with' the client in a worthwhile manner, which is a favourable development: Tax and Customs Administration staff need to be able to think along with taxpayers and adopt a solution-oriented approach, with due regard for the specific sector's issues. The change in culture at taxpayers depends on commitment from the senior management /Executive Board (the tone at the top). Newly-appointed supervisory directors (after a management change) may need to begin by becoming familiar with the horizontal monitoring concept.

Relationship between businesses and the Tax and Customs Administration (are the ties too close?)

The participants in the discussions emphasised that they experience consistent behaviour by both the parties as a success factor. The contacts with the Tax and Customs Administration are rapid and good, as a result of which account management remains an important point for attention. Tax inspectors need to maintain their contacts with care. The substance of the discussions needs to be restricted to important issues. However, in practice the situation varies: in some instances the Tax and Customs Administration is inundated with work, whilst in others too few issues are submitted for discussion. The Tax and Customs Administration draws attention to the risk that the relationship becomes too cosy, as a result of which the Tax and Customs Administration staff may relinquish their critical attitude towards the business. It would be logical to reduce this risk of an excessively cosy relationship by rotating staff at regular intervals, although this is at odds with the objective of developing and maintaining the relationship the specific business. At least a 1-year induction/preliminary consultation period is required for a large business. This is followed by a 2 to 3 years' harvest, after which there is an ample period for the transfer of the account to another member of staff. Self-evidently, a good transfer to the successor is of great importance. Even the advocates of horizontal monitoring state that an excessively amicable relationship gives rise to the member of the Tax and Customs Administration's staff losing the necessary critical attitude towards the business. The Board of the Tax and Customs Administration appreciates this risk. They note that some staff would appear to be afraid of damaging the relationship. This dilemma needs to be opened to discussion. The academic community has stated that concluding compliance agreements and mutually determining the rules could limit or actually prevent recourse to law. Unimpeded recourse to the law must remain unimpaired and may not cause damage to the relationship governed by the agreement. It was also stated that it must be possible, as the occasion arises, to replace a client coordinator when a taxpayer has complaints about the original client coordinator. However, practice reveals that many taxpayers are reluctant to open situations of this nature to discussion.

What's new?

The non-profit sector, in particular, has commented that horizontal monitoring is in fact a continuation of existing practice, although now formalised by the conclusion of a compliance agreement. In addition, advance discussions about important tax issues were often held with the business community in the past.

(Un)clear criteria

In practice, there is uncertainty about many horizontal monitoring issues due to the obscurity of the admission process, the requirements governing the monitoring arrangements (such as the tax control framework) and the Tax and Customs Administration's recent change in policy relating to the transfer of part of the Medium-Sized Businesses segment to the Small and Medium-Sized Enterprises segment.

The academic community has indicated that there is unfamiliarity with the horizontal monitoring admission criteria and that this can be detrimental to legal equality. It is recommended that the admission processes be

made transparent and that the compliance agreements and the associated working agreements be published. However, the Tax and Customs Administration has stated that a variety of manuals, etc., are available which provide the necessary details. Moreover, these documents are public and can be consulted by all visitors to the www.belastingdienst.nl website. In addition, a model compliance agreement was published some years ago. However, this does not provide more details about the sensitive issue of ‘settling past difficulties’. It provides scope for customisation since these difficulties can be settled in or pursuant to the compliance agreement.

The Tax and Customs Administration was urged to outline the framework of the monitoring concept that will be subjected to a review. The Tax and Customs Administration’s Guide to Horizontal Monitoring refers to the ‘how’ (page 49) as ‘tailored to the specific organisation and, consequently, involves customisation’. These are not very specific standards and, consequently, give rise to the risk of arbitrariness. At least minimum standards are required. The compliance agreements do not lay down any details of the arrangements for this form of supervision, whilst this constitutes the essence of horizontal monitoring. It was also noted that the essence of horizontal monitoring is monitoring, not the administration of justice – which is a fundamental difference. Conducting system supervision and assessing a business control framework and the derivative tax control framework require new, specialised expertise. However, this is not a regular form of expertise possessed by tax officials (nor by regular tax consultants or accountants). This can readily give cause to a lack of clarity. As yet, it is argued, there is neither a communal language nor a minimum framework.

The umbrella organisations stated that many facets of horizontal monitoring are neither clear nor explicit and that this clarity is of great importance to the clients and their financial service providers and, consequently, to the success of horizontal monitoring. A great deal of attention should be devoted to forms and checklists, although the personal tax opinion may not be neglected: this professional opinion is of great importance.

The policy change relating to a substantial reduction of the number of entities in the Medium-Sized Businesses and Very Large Businesses segment also gives cause to uncertainty. The new, more stringent criteria have shifted the demarcation between the Medium-Sized Businesses segment and the Small and Medium-Sized Enterprises segment. The classification is now determined by the annual accounts as adopted by the auditor. This is a logical demarcation, since the monitoring is now compatible with a form of supervision that was already available. Consequently, the need for spending cuts was not the only reason that played a role in the decision to amend the criteria. The stringency of the criteria governing the Medium-Sized Businesses and Very Large Businesses segments has been increased, as a result of which a large number of businesses that had concluded an individual compliance agreement have landed in a situation in which they shall need to make use of the services of a financial service provider. Although a transitional period has been arranged for the businesses affected by this policy change, they do not find the change agreeable – and certainly when the individual agreement had been concluded very recently and the taxpayer had devoted a great deal of time and effort to the conclusion of the compliance agreement. The Board states that the Tax and Customs Administration will never issue unilateral notice of the termination of any such agreement. Discussions will then be held with the businesses to review the advantages and disadvantages of a financial service provider approach. However, any business wishing to continue an individual approach will be able to do so.

Rollout of horizontal monitoring in the Small and Medium-Sized Enterprises segment

The Board stated that the Very Large Businesses pilot trial was evaluated and that the favourable results gave cause to the decision to roll out horizontal monitoring further to include the Small and Medium-Sized Enterprises segment. The Tax and Customs Administration originally had the impression that the Very Large Businesses segment, in particular, would be favourably inclined to participation in horizontal monitoring. However, according to the Programme Management, studies have revealed that businesses in the Small and Medium-Sized Enterprises segment also felt a need for clarity and certainty. It was also stated that the

approach to the sectoral organisations that was adopted in 2006 also has its limitations. In 2007, the policy's attention shifted to the financial service providers (umbrella organisations of tax specialists and accountants). The intermediaries' line of approach was then adopted in 2010: individual consultancies then began to affiliate themselves with the agreements concluded with the umbrella organisations. In 2011, the emphasis was placed on the actual enterprises. The Programme Management states that the strength of the procedure adopted for the introduction of horizontal monitoring in the Small and Medium-Sized Enterprises segment lies in the programme-based approach. A distinction can be made between three lines of approach: agreements concluded with (1) financial service providers; (2) providers of administrative software and online services; and (3) sectoral organisations. In the sectoral organisation line of approach the bottlenecks specific to the relevant line of approach are reviewed in horizontal discussions and resolved whenever possible. The Tax and Customs Administration's introduction of horizontal monitoring in the Small and Medium-Sized Enterprises segment is focused on the upper group in the segment (600,000 of the total of 1.2 million entrepreneurs in this segment, namely the enterprises with employees and fulltime self-employed persons without employees). Pursuant to the Tax and Customs Administration's ambition for this segment, one-third of this target group is to participate in horizontal monitoring by the end of 2014. The Tax and Customs Administration does not contact enterprises in the Small and Medium-Sized Enterprises segment directly. Consequently, enterprises with a tax consultant who has decided not to participate in horizontal monitoring cannot apply for participation in horizontal monitoring. This gives rise to a delicate issue: does this result in legal inequality? The umbrella organisations has stated that horizontal monitoring is, above all, a form of customised supervision in which the Tax and Customs Administration makes use of the work already carried out by the financial service provider or the financial service provider's relations, an approach which avoids the duplication of work by the parties involved. The financial service provider will then need to contribute to this approach by providing for an appropriate administrative organisation and reliable control processes within an enterprise. The umbrella and sectoral organisations can then play a role in which they provide incentives and promote quality. This ultimately increases the ability to benefit from the existing control mechanisms. Nevertheless, in the umbrella organisations' opinion the Tax and Customs Administration would not appear to be completely ready for horizontal monitoring in the Small and Medium-Sized Enterprises segment – a comment which is also applicable, albeit to a lesser extent, to the Medium-Sized Businesses segment. This was illustrated by the example of the standardised and automated letters issued to these taxpayers – letters which should not be issued within the horizontal monitoring context. In addition, the financial service providers' automated files have yet to be linked to the Tax and Customs Administration's systems, whilst this should be feasible with the necessary software. The agreements with the providers of administrative software relate to the first links in the chain, from transaction to return, and pivot on reaching agreements intended to achieve improvements in the internal control within the chain and in the quality of the data. The Tax and Customs Administration is not of the intention to make accounting packages but is entering into consultations with the developers of in-the-cloud packages to ensure that they incorporate as many tax control points as possible and, ultimately, increase the quality of the returns. Consequently, the Tax and Customs Administration is not going to offer packages and is not going to implement seals of approval.

Various groups expressed doubts about and criticism of the rollout of horizontal monitoring in the Small and Medium-Sized Enterprises segment. Members of the academic community have stated that the government should not adopt all-too high ambitions for horizontal monitoring in the Small and Medium-Sized Enterprises segment: its introduction shall need to be based primarily on intrinsic growth. At present, the Tax and Customs Administration imposes pressure on financial service providers to participate in horizontal monitoring, but without providing specifications of the quality system that will then be required. The Tax and Customs Administration needs to issue at least basic specifications, conceivably in the form of a protocol that is approved by a tax declaration. Horizontal monitoring relates to an assessment of the process: the Dutch Association of Tax Advisors has suggested a separation of duties, whereby the Medium-Sized Businesses and

Very Large Businesses segments and horizontal monitoring are assigned to a Tax and Customs Administration organisational unit other than the units engaged in the more traditional operations involved in vertical supervision. The VHM staff association is of the opinion that horizontal monitoring in the Medium-Sized Businesses and Very Large Businesses segments is feasible, but that introducing horizontal monitoring by means of compliance agreements and relationships of trust with financial service provider umbrella organisations is not the appropriate approach, in part due to the long or very long period of time required for this procedure and the uncertain outcome. An alternative was cited in which specific tax inspections would be outsourced to the financial service providers on the basis of certification or some form of statutory system. This would involve the market in the government's supervision and, in so doing, would achieve a form of horizontalisation of the supervision. It was suggested that, in exchange for the option of filing returns (or, in the longer term, even an obligation to file these returns) via these horizontal monitoring consultants filing returns, these businesses could be entitled to extra horizontal monitoring tax relief on their profit reported in the income tax and corporate income tax return of, for example, € 1,000.

The consultant's role

The consultant's role depends largely on the type of agreement. The consultant's position for a taxpayer with an individual compliance agreement differs from that for a taxpayer who makes use of the services of a financial service provider who is affiliated with the agreement concluded by the provider's umbrella organisation. The Dutch Association of Tax Advisors has stated that its members are surprised to observe how financial service providers are regularly shut out by their clients and tax inspectors. (Very) many of their clients make direct contact with tax inspectors with requests for advice. Conversely, tax inspectors with questions often contact taxpayers directly rather than contacting their financial service providers. Other participants in the discussions were of the opinion that the client is certainly entitled to make direct contact with the Tax and Customs Administration. However, the Dutch Association of Tax Advisors is of the opinion that this is not the correct approach, since the tax consultant can offer the client added value. Nor is the reverse situation – in which the tax inspector contacts the client – desirable since the taxpayer has authorised the tax consultant to represent him or her in dealing with tax issues. For this reason the Dutch Association of Tax Advisors is of the opinion that the tax inspector should primarily address taxpayer's tax consultant. The business community recognises and appreciates these objections to a lesser extent. This problem could be resolved by advocating the conclusion of a tripartite agreement in which the financial service provider is a party to the agreement, although opinions differ on the value of a tripartite agreement of this nature.

The financial service provider plays a slightly different role in the Small and Medium-Sized Enterprises segment. Financial service providers affiliated with an umbrella organisation that has concluded an agreement with the Tax and Customs Administration can prepare an agreement return for enterprises in the Small and Medium-Sized Enterprises segment that participate in horizontal monitoring. The financial service provider then seeks clients who (wish to) come in consideration for participation in horizontal monitoring. The consultant's role in the conclusion of the agreement can then be regarded as that of restoring the communications and personal contacts between the taxpayer and tax inspector. The financial service provider will also be active in the preliminary consultations, when the financial service provider will adopt a position which is independent from the Tax and Customs Administration and will act in accordance with the prevailing legislation and regulations. An umbrella organisation agreement can be regarded as not-unimportant confirmation of compliance with the quality requirements.

Are the costs reduced – or increased?

Once again, a distinction can be made between individual compliance agreements and financial service provider agreements. The government is and remains responsible for the supervision of compliance with taxation and, as a result, for the concomitant costs. Within this context it is also necessary to make a clear distinction

between the various categories of costs incurred by taxpayers. The compliance costs should be borne by the taxpayer, which is also the case with both horizontal monitoring and vertical supervision. The supervisory costs, which supplement the compliance costs, are usually borne by the government. In general, it will be simpler for Very Large Businesses to comply with the regulations than smaller businesses, as Very Large Businesses will possess the necessary in-house knowledge. The preliminary consultations held within the context of horizontal monitoring can prevent lengthy and expensive retrospective inspections and, as a result, reduce the costs. However, it should be noted that there is a group of taxpayers for whom there is no difference between prior consultations and retrospective inspections: why, then, should these taxpayers decide to take part in horizontal monitoring when the number of inspections is already minimal and participation would result in extra costs? Some also state that horizontal monitoring will at least reduce the Tax and Customs Administration's costs but will not necessarily increase the taxpayer's costs.

It has been stated that trust between the Tax and Customs Administration and the taxpayer should not be linked to a government cost-reduction measure: a link of this nature could muddy the discussions about horizontal monitoring. It is also important that businesses which are prepared to participate in horizontal monitoring will wish to observe that the time savings achieved with horizontal monitoring are allocated to *increased* inspections of businesses that do not participate. For this reason there is no clear answer to the question whether horizontal monitoring in the Small and Medium-Sized Enterprises segment reduces or increases the costs. It should be noted that financial service providers spend additional time on extra inspection activities and that the clients are confronted with this in the form of a higher bill. Consequently, costs savings for the client – as suggested in the political arena at the time – would not appear to be feasible. In fact, horizontal monitoring is more a masked form of outsourcing Tax and Customs Administration activities in which the man-hours involved are transferred to the market. However, this needs to be put into perspective, since the client benefits from the more rapid settlement of returns.

Another phenomenon in the Small and Medium-Sized Enterprises segment relates to the conclusion of sectoral agreements. The benefits of concluding sectoral agreements with the Tax and Customs Administration lie in the elimination of the need for individual enterprises to incur consultancy fees and in the more rapid certainty about the tax interpretation of specific issues provided for in the sectoral agreement. Some state that entrepreneurs purportedly wish to participate in horizontal monitoring solely for cost reasons since, as stated earlier, the resultant rapidity of legal certainty is also a form of cost advantage. In addition, the option was stated of providing taxpayers a financial or some form of incentive to 'entice' them to take part in horizontal monitoring: suggestions for this incentive included granting the taxpayer a tax credit or refraining from imposing a penalty in situations in which a penalty *would* have been imposed under vertical supervision. However, transparent regulations will then need to be adopted. It was also suggested that entrepreneurs who arrange for their returns to be filed by a consultant with horizontal monitoring certification could be entitled to extra horizontal monitoring tax relief on the profit reported in their income tax or corporate income tax return of, for example, € 1,000.

Personal choice and discretion

First of all, it should be noted that there is no statutory obligation to participate in horizontal monitoring: participation is voluntary. Nevertheless, according to the Board, the Tax and Customs Administration regards horizontal monitoring as its preferred strategy. The general opinion is that the participation in horizontal monitoring should be the voluntary decision of the individual taxpayer. It was also stated that the relationship is of decisive importance in the Medium-Sized Businesses and Very Large Businesses segments. The Tax and Customs Administration must not try to persuade taxpayers to conclude a compliance agreement: this is a gradual process that may conceivably end with the conclusion of an agreement. The Tax and Customs Administration notes that it focuses on the larger offices and umbrella organisations. It was emphasised that

taxpayers must not be compelled to participate in horizontal monitoring. Some have the strong impression that the Tax and Customs Administration puts pressure on taxpayers to participate in horizontal monitoring. However, once a taxpayer is interested in participation the financial service provider in fact makes the decision as to which clients will participate in horizontal monitoring. The client and the Tax and Customs Administration can exert little or no influence on this decision unless, for example, the client is one of the financial service provider's important clients. However, the client is not usually the taxpayer selected by the Tax and Customs Administration for an inspection. However, it should be noted, as stated earlier, that there is a group of taxpayers for whom there is no difference between prior consultations and retrospective inspections. All enterprises in the Small and Medium-Sized Enterprises segment should be able to exercise their discretion in deciding whether to participate in horizontal monitoring, even when their financial service provider is not affiliated with horizontal monitoring. In practice, some entrepreneurs in the Small and Medium-Sized Enterprises segment adopt a passive attitude to horizontal monitoring. Nevertheless, financial service providers will have set up an internal organisation tailored to horizontal monitoring, irrespective of whether their clients actually wish to participate. However, it is extremely important that the automated systems of the financial service providers can be linked to the Tax and Customs Administration's system. In conclusion, it is necessary to bear in mind that a (large) group of taxpayers will wish to comply with the regulations but will not wish to participate in horizontal monitoring. This plays a role, in particular, at enterprises in the Small and Medium-Sized Enterprises segment that do not perceive any benefits for resulting from participating in horizontal monitoring.

Extension of the Tax and Customs Administration

The Tax and Customs Administration possesses tax enforcement powers assigned to the Administration by law. The Tax and Customs Administration can exercise its discretion in the manner in which it exercises these powers. The umbrella organisations emphasised that financial service providers should not become an extension of the Tax and Customs Administration. Financial service providers bear an individual responsibility to both their clients and the Tax and Customs Administration. It should be noted that tax consultants, in particular – and to a lesser extent, accountants – exhibit involvement. Solely the taxpayer and the Tax and Customs Administration are, in the first instance, the parties to a compliance agreement. Although accountants can play a role, they do not usually sign the agreement concluded with a business in the Very Large Businesses and Medium-Sized Businesses segments. The Tax and Customs Administration may then enter into discussions with the relevant financial service provider to review the feasibility of relying on the tax control framework implemented by the business.

It was stated that vertical supervision is a Tax and Customs Administration cost item. In horizontal monitoring a proportion of these costs are transferred to businesses. In addition, costs are also incurred in implementing and maintaining a tax control framework. Various parties have, within this context, advocated the issue of a tax declaration and, in view of the resultant increased certainty for the Tax and Customs Administration, the award of a tax credit to the taxpayer. It has been noted that clients in the Small and Medium-Sized Enterprises segment rely greatly on their consultants and, as it were, sign for horizontal monitoring unseen when their financial service provider recommends that they do so – because they trust their financial service provider. However, the clients' trust in their financial service provider can be impaired if they feel that the autonomy of their financial service provider is put in jeopardy. The umbrella organisations state that taxpayers wish to retain their discretion in setting their personal course.

Consequences of errors and inaccuracies

Whether a compliance agreement has or has not been concluded is of no relevance to the possibility of errors being made in an (in-house) quality inspection. The question is then: which approach is to be adopted to errors? Taxpayers and their consultants taking part in horizontal monitoring will wish to deliver quality *and* avoid errors. It should be noted that the objective is to file an acceptable return. Some observe a certain degree of fear of

making errors. In practice, numerous errors remain unanswered. For example, when meta monitoring reveals an error then will an adjustment then be made? And, if so, will a penalty also be imposed? Or will this be an issue solely for future returns? When an error is discovered which is imputable to a financial service provider will this result in an audit and adjustment of the returns of the financial service provider's clients? The Tax and Customs Administration has stated that the administration of justice may not be influenced by the form of supervision, i.e. vertical supervision or horizontal monitoring. The Tax and Customs Administration needs to adopt a much more explicit position: priority must always be assigned to the administration of justice, even in a horizontal monitoring relationship. Although taxpayers may find this extremely annoying, the law may never be set aside.

Quantity, rather than quality

The umbrella organisations have the impression that the Tax and Customs Administration is focused exclusively on the larger sectors and financial service providers, as a result of which the Tax and Customs Administration would appear to concentrate on quantity rather than quantity. This approach enables the Tax and Customs Administration to achieve high targets for participation in horizontal monitoring. It has been observed that the Tax and Customs Administration, as a contracting organisation, wishes to achieve the greatest possible effect with as few resources as possible. This (supposed?) eagerness could result in concessions being made on the quality of the horizontal monitoring system process and the inclusion of offices and businesses in horizontal monitoring which are not yet ready for the concept, with all the concomitant risks to the quality of the returns and to tax revenues. When requested, the Tax and Customs Administration Board stated that the number of concluded compliance agreements is not an issue discussed in the job performance and appraisal interviews conducted with the Tax and Customs Administration staff as the number is specified in the form of a quantitative collective Tax and Customs Administration target.

However, the Tax and Customs Administration did state that financial service providers who have concluded an agreement will need to broaden and expand support for the agreement by bringing as many of their clients as possible under the horizontal monitoring approach. A growth route is needed to achieve a higher degree of participation, which is the reason why the Tax and Customs Administration exerts pressure on financial service providers to increase participation in horizontal monitoring. Conversely, it is necessary to ensure that 'phantom participants' do not enrol, i.e. parties who participate solely because this speeds meeting with the Tax and Customs Administration and who do not intend to actually participate in horizontal monitoring. The Tax and Customs Administration has stated that the Tax and Customs Administration exerts pressure when an agreement was concluded a long time ago but no or an insufficient number of businesses have enrolled in the intervening period. This gives cause to a tough meeting. Nevertheless, the Tax and Customs Administration (Board) has stated that it is not the intention that horizontal monitoring in the Medium-Sized Businesses and Very Large Businesses segments be managed on the basis of the number of compliance agreements. However, the Tax and Customs Administration does appreciate that this can be a risk accompanying the phase model employed to arrive at an agreement: placing the emphasis on the phasing rather than on the substance of and progress in the process can result in the degeneration of the process into the management of the numbers. An internal communication has explicitly stated that the Tax and Customs Administration will not manage horizontal monitoring on the basis of numbers. The management contracts have since been adjusted accordingly.

The onion skin model and tax control framework

The tax control framework is described in the *Tax Control Framework, van risicogericht naar in control: het werk verandert* ('Tax Control Framework: from risk-oriented to in control: the work is changing') brochure of 21 March 2008. In a logical continuation of this brochure, the 'Guide to Horizontal Monitoring within the medium to very large businesses segment' of 30 November 2010 compiled the experiences and best practices of the Medium-

Sized Businesses and Very Large Businesses segments, together with a description of the various phases and steps involved in the implementation of horizontal monitoring. Horizontal monitoring includes the optimisation of the internal and external audit 'layers' involved in filing an acceptable return. This is manifested in the form of the internal control system, in particular the elements of the internal control system of fiscal relevance that are included in the tax control framework. The onion skill model is in part based on the concept of enabling the Tax and Customs Administration to make use of work already carried out by the external auditor. The various discussions revealed the general endorsement of and support for this concept. However, most of the Tax and Customs Administration's client coordinators are tax specialists rather than accountants, which is at odds with the fact that discussions with taxpayers wishing to participate in horizontal monitoring also extend to issues including the administrative organisation and the provision of administrative information. Consequently, it would appear that the assessment of a tax control framework is a task for an accountant rather than for a tax specialist. The consultancy sector is also confronted with this challenge of linking tax matters and accountancy (to a greater degree). It was stated that accountants do not always include tax matters in the scope of their work, which may also be the reason why some businesses have not explicitly included duties relating to tax matters in their internal control processes. Moreover, many public accountants have an inadequate knowledge of tax matters – whilst these tax matters can play a role in the adopted materiality. Interdisciplinary cooperation will then be more appropriate. It should also be noted that it was stated that the selection of the processing method is in part determined by the tax issues and the specific knowledge required to address those issues. Practice has revealed that Phase 1 (Client profile) and Phase 2 (Horizontal monitoring is/is not feasible) can be completed relatively smoothly. However, doubts were expressed about the Tax and Customs Administration ability to obtain an insight into the work carried out in Phase 3 (Insight into the design and implementation of the administrative organisation/internal control) and Phase 4 (Insight into the implementation and performance of the administrative organisation/internal control) of the horizontal monitoring process. Moreover, a number of discussions revealed that no criteria specifying the (minimum) requirements for Phase 3 and Phase 4 have been formulated. Some have the impression that the Tax and Customs Administration introduced these phases in draft form and with the expectation that they could subsequently be worked out in more detail on the basis of best practices once they became available. The Tax and Customs Administration stated that pursuant to its policy the Tax and Customs Administration reviews the results from phases 3 through 5 using the work carried out by the taxpayer's consultant: this is an explicit element of the Netherlands Tax and Customs Administration's Audit Approach. The Tax and Customs Administration has stated that in the coming period the attention will need to focus on phases 3 through 5. This will require the renewed attention and efforts of the management, technical staff and other staff. It should be noted that the Tax and Customs Administration's horizontal monitoring process is based on the statement of the facts as submitted by the taxpayer. In addition, the compliance agreement includes an explicit statement of the mutual intentions and the parties are aware of the following phases that need to be completed. It should be noted that it was denied that in the past compliance agreements were concluded only once all phases had been completed: the phase model was introduced (only) in 2010. An interesting question within this context is: who determines the pace of the horizontal monitoring process? It was stated that that the taxpayer determines the answer to the question whether, and if so when, the horizontal monitoring process can move on to the next phase. Self-evidently, the Tax and Customs Administration keeps track of the process and a meeting or a progress meeting is no more logical when the progress is too slow. It should be noted that there are still relatively few businesses in the Very large Businesses and Medium-Sized Businesses segments in the concluding phase of the horizontal monitoring phase. This was stated to be a time-consuming process. In addition, it was stated that the Tax and Customs Administration may devote excessive time to the tax control framework as the Tax and Customs Administration does not always keep tabs on the responsibilities of the parties: the taxpayer bears the primary responsibility for the internal control system (including the tax control framework) and must invest in the system – which costs time and effort. Moreover, by their very nature the Tax and Customs Administration staff feel a need for (maximum) certainty, as a result of which they occasionally assume responsibilities that should be borne

by the businesses. The Tax and Customs Administration staff are engaged in a continual exploration of the demarcation of their duties. Within this context, the question arises whether a separate tax control framework is absolutely necessary when the Board of a business has issued an in control statement. It is conceivable that the Tax and Customs Administration staff are too cautious – but, conversely, businesses are not inclined to issue explicit statements of this nature all too rapidly. It should be noted that businesses stating that they are in control in tax matters are immediately placed in Phase 5. Members of the academic community taking part in the discussions stated that (meta) monitoring could be developed further by linking it to specific incentives and, for example, developing a tax declaration or an audit protocol. This would not then need to be carried out by the relevant entrepreneur, but rather by an autonomous person. This will offer the Tax and Customs Administration an increased certainty of receiving an acceptable return. During the discussions with the non-profit sector the participants recommended that an ex ante implementation review should be carried out with respect to new regulations: this would provide for the timely tailoring of the processes, ICT and supervision to the new regulations, for example new regulations governing the work-related expenses scheme.

(Meta) monitoring of the Small and Medium-Sized Enterprises segment

The umbrella organizations state that tax service providers and their clients experience increased inspection activity within the scope of horizontal monitoring as compared to the period prior to the introduction of the concept. Their explanation of this situation is that the Tax and Customs Administration conducts these inspections for statistical reasons. They also noted that the Tax and Customs Administration is currently working on meta monitoring's start-up phase and wishes to gain an insight into the performance of this monitoring, as a result of which it conducts a relatively large number of inspections. The horizontal monitoring entrepreneurs selected for the sample experience this increased supervision as a heavier supervisory burden. Although the supervisory burden may have decreased at a macro level, this is not the experience of these entrepreneurs at micro level. It was stated that investigations and assessments are of great importance to the supervision system: the Tax and Customs Administration then needs to formulate an assessment framework to prevent arbitrariness. The meta monitoring of the financial service providers is based on the returns and, consequently, the financial service provider's processes and quality systems are not reviewed in isolation: this would rapidly degenerate into solely 'checking boxes'. Consequently, the Tax and Customs Administration's examination of the quality of the return is based on the question: is this an acceptable return? The Tax and Customs Administration employs reality checks for this purpose. Endeavours are being made to carry out meta monitoring more in real time, which reduces the burden on the consultant and entrepreneur. When errors are discovered the consultant will need to modify the consultant's processes. It is important to note that sectoral agreements do not impose a general obligation on the affiliated members and do not usually contain a supervision clause: the agreements usually relate (solely) to agreements on cooperation and the interpretation of tax legislation and regulations. The temporary employment agency sector plays a special role in this respect. The Tax and Customs Administration notes that with the current inspection density (one every sixty years was cited) businesses gain no benefits from participating in horizontal monitoring since the expenditure on the financial service provider's additional work increases costs. These higher costs could be absorbed by providing compensation to entrepreneurs who make use of a financial service provider who has been granted certification, since a proportion of the Tax and Customs Administration's inspection work is transferred to the financial service providers. It was observed that whether this transfer will increase or decrease the costs to society, instead of deploying additional tax officials, is ultimately a political decision. A system for the certification of financial service providers will require the implementation of statutory measures, when it will also be necessary to formulate stringent requirements governing the certification of financial service providers. It will then be necessary to implement meta monitoring, inclusive of the imposition of sanctions, of financial service providers who do not conduct appropriate supervision (suspension and disqualification). This is to some extent comparable to the statutory periodic inspections of motor vehicles, whereby the financial service will then need to receive statutory recognition.

Exploring the limits of the tax legislation

The acts of taxpayers and their financial service providers must lie within the limits prescribed by the legislation, regulations and case law, whereby financial service providers can exercise their discretion in seeking the most favourable result for their clients within these limits. This gives cause to the question whether taxpayers participating in horizontal monitoring are offered less scope than clients who do not participate. This could be the case, although it was stated that this should not be automatically be regarded as a disadvantage because the taxpayers are offered the benefit of the more rapid settlement of their returns. In addition, they are also compensated by the Tax and Customs Administration's more rapid resolution of problems. It was stated that tax ethics play an increasingly important role in this tax discretion in practice, whereby reference was also made to the fair share discussions: the tale that according to the Tax and Customs Administration horizontal monitoring precludes the exploration of the limits of the tax legislation is spreading like wildfire amongst the clients of financial service providers, as it is assumed that the special horizontal monitoring relationship reduces the tax bandwidth. This is also stated explicitly by some tax inspectors. However, it should be noted that the umbrella organisations have a different opinion, in part due to the fact that no explicit provisions on this issue are included in the financial service provider agreements. The umbrella organisations also noted that the Tax and Customs Administration regularly states – when discussing a specific act or question during the preliminary consultations – that adopting a standpoint of this nature is not expected from a 'horizontal monitoring office'. According to the participants in the discussions this is a fundamentally incorrect approach, especially since the Tax and Customs Administration would appear to assume that the consultancy observes the horizontal monitoring agreements for all its clients, including the clients who (emphatically) do not participate in horizontal monitoring. This causes friction. Pursuant to the horizontal monitoring concept any tax risks must be reported and discussed in preliminary consultations. However, the exact nature of 'tax risk' has not been specified in detail. In practice, the reporting of any tax risks is based on the estimation that the Tax and Customs Administration will adopt another standpoint. However, this does not imply that every trifle shall need to be submitted to the Tax and Customs Administration: this would create an impossible situation for both the Tax and Customs Administration and the financial service providers. The submission of tax risks pivots on the substantiation of the substance of the standpoint. One of the benefits of the new approach is stated to lie in the fact tax risks are now open to discussion and do not immediately result in threats of the imposition of a penalty. It should be noted that the possibility of persistent differences in insights is highly compatible with the agree to disagree provision included in the agreements. The sectoral organisations noted that the agreements included in the sectoral agreements concluded with the Tax and Customs Administration usually lie well within the statutory frameworks. They argue that businesses are certainly entitled to sail closer to the wind if they so wish.

Can the Tax and Customs Administration fulfil the expectations of horizontal monitoring?

The business community and the non-profit sector have stated that they have the impression that the Tax and Customs Administration is not completely ready for horizontal monitoring. The Tax and Customs Administration still needs to work on the acquisition of adequate support for the new approach. Some of the Tax and Customs Administration's staff view the concept with the scepticism. All too often the business community is still confronted with inspectors and auditors of the old school who are focused primarily on finding errors. The Tax and Customs Administration's management is certainly prepared to adopt the concept – now the staff need to do so as well. Horizontal monitoring requires a type of inspector other than the traditional inspector. The business community is observing that the Tax and Customs Administration is making the necessary investments. The Tax and Customs Administration's programme management confirmed this impression and stated that a variety of means of communication (interviews, articles and free publicity) are being deployed to promote the horizontal monitoring programme. What is referred to as the 'Horizon tour' is of great importance to all staff in the Small and Medium-Sized Enterprises segment: these meetings are held to transfer knowledge and exchange experiences. The 'cooperation & negotiations' master class, 'commercial skills' and attention to

technical aspects are all part of the 'professionalisation of the staff management' programme. The Horizon tour is intended to eliminate the resistance to the concept and create more scope for the acceptance of horizontal monitoring. Some of the Tax and Customs Administration's staff perceive the Horizon tour as a means of persuading disbelievers to accept horizontal monitoring. Some of this group do not find this agreeable. The Tax and Customs Administration 'markets' horizontal monitoring to its staff on the basis of arguments including the resultant time savings that could then become available for vertical supervision. However, the staff feel that these savings have yet to be achieved. All staff share the opinion that horizontal monitoring cannot succeed without the appropriate technical integration. One of the major challenges confronting the Tax and Customs Administration is to fulfil its promises. i.e. good and rapid consultations together with the associated adoption of a standpoint and the rapid settlement of the return – or, in other words, can the Tax and Customs Administration do all this? Within this context the question arises whether the Tax and Customs Administration has (or can expect) capacity problems and/or expertise problems. In general, the Tax and Customs Administration currently possesses adequate amounts of tax knowledge and expertise. However, horizontal monitoring pivots on attitude and behaviour. Discussions of tax risks and holding preliminary consultations are of great importance to horizontal monitoring but both activities cost the Tax and Customs Administration a great deal of time. The Tax and Customs Administration's staff view the politicians' decision to implement a substantial reduction of the Tax and Customs Administration's staffing level, in analogy with other government departments, with concern. The business community has also expressed similar concern. It is highly likely that this reorganisation will result in the departure of experienced and expert Tax and Customs Administration staff who possess a great deal of knowledge and many valuable contacts. The staff are firmly convinced that this contraction will be detrimental to the Tax and Customs Administration's performance in general and to the service level for horizontal monitoring in particular. The trend toward concentration initiated on the reorganisation of the Tax and Customs Administration staffing level would also appear to have detrimental consequences for account management. In summary, the general opinion is that the reduction of the Tax and Customs Administration is at odds with the fulfilment of the ambitions for horizontal monitoring.

Relationship between horizontal monitoring and vertical supervision

Although account management has always been practiced for the Very Large Businesses, horizontal monitoring provides additional assurances (such as a tax control framework) and the Tax and Customs Administration is cognisant of any tax issues and risks at an earlier stage. It has been stated that horizontal monitoring constitutes a paradigm change, since the Tax and Customs Administration was traditionally focused on the discovery of errors rather than the prevention of errors. The Tax and Customs Administration needs to tailor its supervisory approach to the behaviour and motives of the businesses (responsive enforcement). This paradigm change is also reflected in the Tax and Customs Administration's management contracts, which do not include any vertical supervision targets but do include horizontal monitoring targets. Horizontal monitoring is not autonomous: it is one of the compliance tools. It is also necessary to warn against the risk of horizontal monitoring evolving into a dogma. The Tax and Customs Administration staff will need to be guided appropriately in the overall compliance concept. It should be noted that horizontal monitoring is not a means of coercion, but rather another form of supervision in the range of supervisory tools such as traditional inspections on the basis of risks and indications. The Board is of the opinion that the current dichotomy between the proponents and opponents of horizontal monitoring is unfortunate, especially since in practice supervision needs to be based on a mix of tools. A distinction can be made between two lines of approach within horizontal monitoring: the legal line of approach, with stringent criteria, as detailed in the tax control framework, and the relationship based on trust line of approach for which stringent criteria are not appropriate. Appropriate agreements on inspection activities can be reached within the context of horizontal monitoring, which can also result in a high level of trust. The one does not exclude the other. This also includes the taxpayer's reporting of errors. However, what would the probability of the discovery of the error have been if it had not been reported? And what is the relationship to the ability or inability of addressing vertical supervision due to a lack of Tax and

Customs Administration capacity? A taxpayer participating in horizontal monitoring voluntarily reports an error which results in an adjustment: will a penalty also be imposed on the taxpayer? This is an interesting question. It has been argued that the imposition of a penalty would not be logical. When viewed from the perspective of the substantive law outcome, opting for horizontal monitoring should not be a significant factor, since horizontal monitoring and vertical supervision are both governed by the same legislation and regulations. Consequently, the benefits offered by participation in horizontal monitoring need to be sought elsewhere, for example in the form of (more) rapid certainty about the tax position and a reduced inspection pressure. However, taxpayers who do not participate in horizontal monitoring will need to be subjected to vertical supervision and, consequently, to more frequent inspections. This principle is generally supported, since otherwise horizontal monitoring would become a farce. Consequently, horizontal monitoring implies that taxpayers who do not participate in the concept and do not act correctly will not be able to escape the consequences. They will need to be confronted with a high probability of detection and should be issued both an adjustment and the associated penalty. However, the inspector will need to keep an eye and ear open for taxpayers participating in horizontal monitoring who do not fulfil the obligations and commitments laid down in the compliance agreement. For this reason the inspector will need to retain a measure of healthy distrust and carry out inspections in the event of a suspicion of non-compliance with the regulations. The business community states that it will then occasionally be necessary to take harsh action to ensure that horizontal monitoring retains its credibility.

Some Small and Medium-Sized Enterprises will be able to manage well with sectoral agreements – which usually contain practical elaborations of tax issues – without reaching agreements on the organisation of horizontal monitoring. These enterprises will then in effect continue to be governed by vertical supervision. Conversely, some Small and Medium-Sized Enterprises *will* have interest in participating in horizontal monitoring via an agreement concluded with a financial service provider. Horizontal monitoring requires inspections – but vertical supervision many more. For this reason the Tax and Customs Administration must have sufficient capacity for vertical supervision. However, as a result of the political decision to reduce the Tax and Customs Administration’s staffing level and the Tax and Customs Administration’s major horizontal monitoring efforts there would appear to be little remaining capacity for vertical supervision.

Is there an alternative to horizontal monitoring?

The Tax and Customs Administration’s Board has the the ambition to achieve a substantial expansion of participation in horizontal monitoring. It is evident that the Tax and Customs Administration is unable to inspect everything. Vertical supervision is subjected to restrictions in view of the Tax and Customs Administration’s available capacity and the large number of taxpayers. The number of taxpayers has grown rapidly in recent years. Moreover, tax legislation has become more complex. Nevertheless, tax revenues need to be maintained at the necessary level. When viewed from this perspective, horizontal monitoring can be regarded as a methodical answer to these developments. The Tax and Customs Administration, as a contracting organisation, wishes to achieve the greatest possible effect with as few resources as possible. It has been noted that the Tax and Customs Administration would be unable to carry out its work at its current staffing level without horizontal monitoring. This is applicable not just to the Medium-Sized Businesses and Very Large Businesses segments, but also – in view of the current inspection density – to the Small and Medium-Sized Enterprises segment.

Effect of horizontal monitoring on tax revenues

The question was raised whether horizontal monitoring might not result in taxpayers and the Tax and Customs Administration adopting an excessively flexible approach to the tax obligations and in turn result in the risk of a fall in tax revenues. In the first instance, it should be noted that it will be difficult to measure whether and, if so, to what extent tax revenues are affected by horizontal monitoring. The general impression is that this will not result in the erosion of tax revenues. A distinction can be made between the differing opinions of two groups. A small group is of the opinion that horizontal monitoring has no influence on tax revenues: those who ‘already

did it well will continue to do it well’, whilst those who ‘already cut corners’ will continue to do so. Conversely, a larger group thinks that horizontal monitoring will be beneficial to tax revenues: tax revenues will stabilise both as a result of horizontal monitoring *and* the wish of taxpayers to adopt their corporate social responsibility and be in control. Since horizontal monitoring improves the relationship between the Tax and Customs Administration and taxpayers – and, as a result, improves compliance – this can also be expected to result in an increase in the number of acceptable returns and, in turn, in an increase in tax revenues. The improved transparency on the part of taxpayers is expected to result in higher tax revenues: taxpayers will wish to do it ‘better’. A further argument is based on the expectation that ‘the good [will] do it well’, as a result of which less capacity is needed for this group: the ‘savings’ in capacity can then be allocated to vertical supervision and, as a result, increase tax revenues. Moreover, horizontal monitoring could actually *increase* tax revenues since the financial service providers carry out some of the inspection activities, inspection activities that the Tax and Customs Administration would not have been able to carry out for capacity reasons.

Effectiveness of the policy and the efficiency of the implementation

The Committee asked whether a benchmark measurement had been carried out, whether a business case had been prepared and whether measurement figures were available for an assessment of the effectiveness and efficiency of horizontal monitoring. The answer to these questions was: No! Although a qualitative assessment was made at the time, this was not subsequently detailed in quantitative terms. Effect measurements are still in ‘their infancy’. Although the costs can be determined with a reasonable degree of precision, this is more difficult on the benefits side. Contacts with participants in the academic community also indicated that this is a complex issue. It should be noted that the business community has also advocated that endeavours be made to specify horizontal monitoring’s macro-economic returns in objective terms and to measure the returns. It is difficult to determine the costs of the Tax and Customs Administration’s traditional form of supervision and the costs and savings accompanying the new approach. Although the added value is clearly evident at an individual level, the question is how an objective insight can be obtained for the entire target group, for example the gains achieved by holding preliminary consultations and the value provided by improved internal controls or enhanced business compliance. Nevertheless, the Tax and Customs Administration delegates did state a number of relevant performance indicators during the discussions, such as the completeness of the registration, the timeliness of the return, the speed at which the assessment is determined and the payment of the assessment, the speed with which the Tax and Customs Administration answers questions and responds to requests for preliminary consultations (service level agreement). The Tax and Customs Administration works increasingly in real time and fewer adjustments are necessary. The perception of businesses participating in horizontal monitoring as manifested by the results from the Tax Monitor also provides an indication of the effectiveness of the concept. However, the instruments for effect measurement need to be developed further. The Horizontal Monitoring in the SME segment Programme Management stated that it is not currently possible to obtain an appropriately substantiated insight into the compliance of horizontal monitoring participants as compared to the entire group of entrepreneurs. It was also stated that the necessary mass needs to be developed. Horizontal monitoring is a relatively expensive form of supervision due to the labour-intensive nature of account management. Since records are kept of the time spent on each taxpayer in the Medium-Sized Businesses and Very Large Businesses segment an outline determination of the costs is feasible. The Horizontal Monitoring in the SME segment Programme Management states that a comparison of these costs with the tax revenues from this segment reveals that the concept is efficient. The Tax and Customs Administration shall need to carry out a critical review of the justifiability of account management for each group of taxpayers. The business community drew attention to the risks accompanying the further rollout and the risks of damage to the Tax and Customs Administration’s reputation. In addition, no hard data is available about horizontal monitoring’s effectiveness in the Small and Medium-Sized Enterprises segment since the mass is inadequate at present. Since more horizontal monitoring items will be included in the annual sample in the future it will ultimately be possible to draw further conclusions about the concept’s effectiveness. However, it should be noted that a random sample

of this nature is at odds with the intention of reducing the supervision of this category of taxpayers. The Board stated that horizontal monitoring in the Small and Medium-Sized Enterprises segment is both valuable and justifiable.

The Board was asked whether the horizontal monitoring in the Small and Medium-Sized Enterprises segment policy would be adjusted should it transpire that the current approach is not effective. Although the Board was not inclined to make any bold statements, they did say that the policy would then be adjusted, although any such changes would not impact working in real time and holding preliminary consultations on issues whenever feasible.

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Ministry of Finance

Po Box 20201

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The Netherlands

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