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Research Paper

Legal Security: Co-Operative Compliance in The United Kingdom

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ABSTRACT: *This paper explores the co-operative compliance approaches implemented by the Netherlands. The OECD principles on co-operative compliance are the paper's framework. The Dutch approach on co-operative compliance is analysed with the OECD framework. It is concluded that the Dutch co-operative compliance approach is not creating legal security. This research has created the legal framework for comparing the co-operative compliance approach between countries.*

Keywords: *United Kingdom, Co-operative Compliance, tax, controlling, management control*

I. INTRODUCTION

The Organisation for Economic Cooperation and Development (OECD) has initiated the concept of co-operative compliance. Many countries have implemented a form of co-operative compliance. The OECD initiative is changing tax considerations. Taxes used to be accounted based on manual calculations and audited based on detailed testing. The internal controls were not considered in tax accounting. The co-operative compliance initiative has obliged companies to change the approach on tax accounting. National tax administrations have published their perspective on tax controlling. Tax controlling is a basic requirement for participating in co-operative compliance.

Co-operative compliance is a new form of legal tax compliance. Companies give early insight to the tax authorities about their tax strategy and tax procedures. The tax authorities are required to give their opinion about the tax structure soon after the company has presented their tax structure. For the tax authorities, this should lead to better allocation of resources as they can put the most attention on the companies with the largest legal tax risk.

For companies the benefit is the real-time insight in tax positions and therefore creating more certainty. For legal security, legal knowledge is required. Legal knowledge could stem from laws (including cases) and regulations. When a new phenomenon is started the relevant laws and regulation have still to be developed or could be extracted partly from existing laws and regulations. Co-operative compliance is a new legal phenomenon. The implemented laws and regulations are still very recent.

Despite the initiation by the OECD countries could still develop their own form of co-operative compliance . The OECD has created very limited guidance for the co-operative compliance initiative. One of the countries implementing co-operative compliance in an early stage is the United Kingdom. With this paper the OECD guidelines are used to create guidance on legally comparing co-operative compliance approaches. This framework is applied on the situation in the United Kingdom.

II. OECD

The OECD notes has been discussed in this research. In these notes it has mentioned basics. The first basic is the compliance pyramid. This pyramid is applied in this research. The basic idea of the compliance pyramid is that companies willing to comply has less severe tax audits and pressure. For co-operative compliance it is essential that there is a clear separation between companies willing to comply and companies not willing to comply. Companies require insight in the activities required to be in a certain category of co-operative compliance. Clarity is a basic condition for legal security.

The OECD also mentioned some operational basics required for sufficient co-operative compliance. These are the basics mentioned in the "Right from the start" note. These basics are researched by this research. Together with the clarity basic general condition the basics forming the framework for this section are as follows:

- Companies have clarity about how to comply with co-operative compliance (Clarity).
- Looking forward and real-time action to ensure that tax uncertainties are prevented or detected when they occur (timely).
- Put effort on the operations related to taxes (non-tax).
- Make it easy to comply and hard to not comply with laws and regulations (enforcement).
- Involve actively the tax payers, their representatives and other stakeholders with the purpose of better understanding and cooperation between parties (involvement).

III. THE UNITED KINGDOM

In the United Kingdom co-operative compliance is guided by the HMRC internal manual "Tax Compliance Risk Management". In this manual the different steps for determining the level of tax risk is defined. The high-level process is as follows: 1. Assessing inherent risk 2. Assessing risk mitigation 3. Conclusions on residual risk. For the process of cooperation between the HMRC and the tax payer are different articles starting with "TCRM" followed by the number of the article. In this section the relevant articles are elaborated.

TCRM 3320**:** The HMRC identified different levels of inherent risk. Three general categories are defined for inherent risk identification: complexity, boundary (internationality) and change. For all these categories the level of inherent risk is identified and scored major, significant, moderate or low risk. The HMRC defined the levels of risk in more detail in TCRM 3320.

TCRM 3330: The HMRC identified different levels of behavioural indicators. Three general categories are defined for inherent risk identification: governance, delivery and tax strategy. For all these categories the level of behavioural indicators is identified and scored low risk, tends to reduce risk, tends to increase risk and increases risk. The HMRC defined the levels of risk in more detail in TCRM 3330.

TCRM 3360: According to the HMRC a decision for low risk need to be "as transparent and consistent as possible". The HMRC defined several examples which are indicators for low risk companies. Among others the indicators for low risk are:

- The customer is open with HMRC in real time about how they manage tax compliance risk across all relevant taxes and duties (1.1).
- The customer is aware of their obligations across all taxes and duties, seeks assistance as necessary and provides appropriate resources to deal with those obligations (1.4).
- The customer has clear accountabilities up to and including the Board for the management of tax compliance risk and tax planning (1.5).
- The customer has a history of accurate and timely returns, declarations, claims and payments across all relevant taxes and duties (2.1).
- The customer is not involved in tax planning other than that which supports genuine commercial activity (3.1).
- The customer tells us about significant transactions involving innovative interpretation of tax law and fully discloses any legal uncertainty (3.3).
- The customer is not involved with illicit trades (3.4).

Revisiting: The tax compliance risk management can change over the years. The level of tax control can therefore change over the years. The HMRC decides periodically whether the tax audit plan requires adjustment. The revisiting plan depends on the category of the customer (low risk or not). Revisiting a low risk company is based on a three-year cycle (TCRM 3410). Revisiting a non-low risk company will generally appears annually (TCRM 3420).

Other: Other relevant guidance numbers which are not discussed in detail are the requirement to collect evidence (TCRM 3370), to have a sufficient audit trail (TCRM 3380), the method for applying a risk assessment (TCRM 4000) and the action plan for mitigating significant risks (TCRM 5000).

IV. ANALYSIS

Clarity. In the UK the tax administration has put great effort in defining the circumstances for low risk and the situation of having not low risk (refer to chapter 3). As much as possible considerations and examples are defined to guide the taxpayer. Moreover, the approach for tax audits is defined. The taxpayer can understand the co-operative compliance approach without contacting the tax administration. All relevant information is publicly available. To conclude, the clarity of the co-operative compliance regime is sufficient.

Timely. In the UK the timely response of the tax administration on tax issues is less clear (refer to chapter 3). The HMRC has safeguards for ensuring the accuracy of decisions on, for example, the decision whether a company qualifies as a low risk company. More procedures generally mean more time consumption. This is an influencing the timely aspect negatively. To conclude, the timely handling in co-operative compliance is insufficient.

Non-tax. The use of non-tax processes is integrated in the aspect that the company is obliged to prove the efficiency of the tax compliance risk management (refer to chapter 3). This creates an incentive to apply the tax risk management also over the non-tax processes. The non-tax processes are not mentioned specifically in the HMRC guidance. However, as it is such an evident aspect of tax controlling, it is assumed that the non-operating processes are inherent on the HMRC guide for tax compliance risk management. To conclude, the use of non-tax processes in the co-operative compliance regime is sufficient.

Enforcement. The UK has a clear approach on co-operative compliance (refer to chapter 3). Companies can consult the guidance on co-operative compliance to apply for a low risk company. Also, there is no pressure on companies to apply for the co-operative compliance regime. The group of companies is questionable considering enforcement. The tax administration focuses only on large companies. Other companies are not in the scope of co-operative compliance. Therefore, not all companies are stimulated to participate in co-operative compliance. As the OECD did not mention that the co-operative compliance regime should be for all companies in a country, this seems not a problem if the relevant group is stimulated to participate: the benefits of becoming a low risk company are clear. To conclude, the enforcement of the co-operative compliance regime is sufficient.

Involvement. In the UK the focus is on large companies (refer to chapter 3). This seems to limit the involvement of different groups. In 2015 the HMRC revised its compliance tax risk management policy. Before revising the policy a consultation document was published. The HMRC requested the opinion of business, individuals, tax advisers, professional bodies and any other interested parties. This signals that the tax administration considers it important to have as many as possible parties involved in the design of the tax compliance risk management policy, even though the tax administration doesn’t focus on all companies. To concluded, the involvement of different parties is sufficient in the co-operative compliance approach.

Analysis. The UK policy is elaborated based on five OECD principles. Four of these principles are sufficient and one principle is insufficient in the co-operative compliance regime. The benefit of the UK approach is clarity. Taxpayers are given a thorough understanding of the expectations of HMRC. Taxpayers can read in detail the process of determining tax risks and examples create inspiration for taxpayers on the design of the internal tax control environment. Over the years companies can rely on the co-operative compliance regime. When a company has low risk it knows that without changes the HMRC relies in the tax internal control environment and the resources allocated for the contact with the tax administration can be lowered for at least three years. Consistency in the HMRC handling is ensured for three years. The downside of the co-operative compliance regime is that timely reaction is not part of the HMRC policy. There are no procedures in place that ensure the timely response. A counterargument is that low risk companies require limited contact with HMRC. However, the current co-operative compliance form has the risk of letting taxpayers wait for a long time once they have uncertain tax positions.

V. CONCLUSION

In this paper the legal framework for considering co-operative compliance is created. This is an important starting point for comparing co-operative compliance approaches between countries. The framework is beneficial for both scholars and practitioners as it is an easy but through legal framework to understand different co-operative compliance approaches. This paper is therefore a call for scholars globally to conduct research with the legal framework introduced in this paper to make tax controlling understandable. Limitation of this paper is the subjectivity in the framework created. However, the framework is based on the OECD papers and should therefore be an internationally accepted basis for conducting research.

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