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**SOME EVIDENCE
ON THE IMPLEMENTATION
OF ENHANCED RELATIONSHIP**

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Abstract

Fostering an enhanced relationship between the tax administration and taxpayers is a promising approach for transforming traditional vertical relationships into a partnership based on trust and close, proactive cooperation. The article scrutinizes an example of such efforts, based on a pilot project in the Republic of Slovenia, called “Horizontal Monitoring”. After two years of operation, the project has justified its existence and represents a solid basis for an extension to a larger group of taxpayers.

Keywords: enhanced relationship, horizontal monitoring, pilot project, Slovenia, voluntary tax compliance

JEL classification: H11, H20, H26

1. Introduction

The typical relationship between the tax administration and a taxpayer involves a taxpayer who completes tax returns and discloses the minimum amount of information needed to administer the required tax. Yet the tax administration can demand additional information about the tax declaration and, if necessary, impose enforcement measures. In this relationship, tax intermediaries are not involved as direct parties, although they play an important role in influencing the taxpayer's behaviour (OECD, 2007). Due to aggressive tax planning, the OECD (2008) published a report, focussing on trilateral relationships among tax authorities, taxpayers and tax intermediaries. It recommends creating a cooperative, trust-based relationship with the taxpayers, whereby tax authorities need to demonstrate certain key attributes: understanding through commercial awareness, impartiality, proportionality, disclosure and transparency, and responsiveness. This approach should lead to cooperative, trust-based relationships between tax authorities and taxpayers, i.e. an "enhanced relationship".

In addition, in 2009 the OECD published a report that concentrates on the role of banks in aggressive tax planning and on identifying the benefits of including banks as large taxpayers in the process of an enhanced relationship (OECD, 2009a), while another study from the same year (OECD, 2009c) extends the coverage of a special relationship from large taxpayers and banks to professional associations, government bodies etc. Several tax administrations have thus recently started to launch special strategies and programmes aimed at managing tax compliance, especially in relation to large taxpayers (important with respect to tax revenue).

In enhanced relationship programmes, the tax administration's primary goal is to stimulate the taxpayer and tax intermediary to cooperate and increase voluntary tax compliance. Nevertheless, a high level of tax enforcement does not always increase tax compliance. On the other hand, tax systems with a low level of tax enforcement and, simultaneously, a low level of tax avoidance also exist. It is thus the key question for any tax administration how to balance out the use of tax enforcement with stimulation for voluntary tax compliance.

The OECD (2008) identified three basic mechanisms to adopt an enhanced relationship: (1) a unilateral statement of the tax administration, comprising the enhanced relationship process, and the consequences for taxpayers and tax intermediaries in the event of cooperation and non-cooperation; (2) a charter adopted by the tax administration, taxpayers and tax intermediaries, defining how they intend to work together and what are they expected to do, and setting out the consequences if they fail to do so; and (3) an agreement between the tax administration and a specific taxpayer, designed to meet their specific needs.

Supported by the OECD and other professional organisations, such as the European Commission (Fiscalis Risk Management Platform Group, 2010) and the Intra-European Organisation of Tax Administrations (IOTA, 2012), the enhanced relationship programmes

are thus largely based on a series of studies, devoted to the issues of tax avoidance and tax ethics¹. The literature on the topic of enhanced relationship, especially scientific research, has been very scarce so far. It is thus one of the purposes of this article to present an up-to-date and as comprehensive as possible an overview of the implementation of enhanced relationship worldwide.

Moreover, we present and analyze one of the pilot projects of enhanced relationship that was implemented in 2010 in Slovenia and is called “Horizontal Monitoring”. Horizontal monitoring is an example of enhanced relationship in line with the mechanism (3) of the OECD (2008) classification (given above). It was launched by the Tax Administration of the Republic of Slovenia (TARS) and includes 18 of the largest Slovenian corporate taxpayers². The main hypothesis of the article is that horizontal monitoring has proved to be successful, with implicit potential to be applied on a larger scale – throughout the taxpayers’ community. To support this idea, we introduce a survey among non-participating large taxpayers that was designed and conducted especially for this purpose. Based on the answers, we can conclude that the concept of enhanced relationship is widely supported, though further promotion is needed for the mechanisms to become established in practice. A discussion of incipient implementation of enhanced relationship and the analysis of non-participation in an enhanced relationship are thus two additional contributions of the present article.

The article proceeds as follows. In Section 2, we provide an international overview of the implementation of enhanced relationship. In Section 3, we describe and discuss the elements of introduction of enhanced relationship in the case of Slovenia, where we focus on the agreement with taxpayers, the implementation issues, and evaluation. In Section 4, we analyze the non-participation in the enhanced relationship process based on our survey. The final section concludes with the main findings.

¹ Namely, besides the economic factors, several other sociological and psychological factors determine the complex individual’s attitude to taxes (*cf.* Allingham and Sandmo, 1972; Torgler, 2003).

² In 2011, these 18 taxpayers employed 20.1% of employees in large corporate taxpayers and 7.9% of all employees in the Republic of Slovenia (AJPES, 2012).

2. An International Overview of the Implementation of Enhanced Relationship

Among the early initiators of enhanced relationship were the Netherlands, Ireland, and the UK. The Netherlands started with an enhanced relationship programme called “Horizontal Monitoring” in 2005, initially including 20 large corporate taxpayers³. The programme represents an attempt of the Netherlands Tax and Customs Administration (NTCA) to build greater trust in relation to taxpayers, as a mechanism to encourage greater disclosure of tax uncertainties and risks. It is based on transparency, understanding, and trust. The NTCA and participating taxpayers signed a non-binding agreement, obliging taxpayers to notify the NTCA of any issues entailing a potential and significant tax risk. The basic requirement is that agreements are concluded with taxpayers whose tax control frameworks are solid. In exchange, the NTCA assures tax certainty. The agreement covers the uncertain tax positions, taken by the taxpayer in the past, as well as those contemplating in the future (OECD, 2007).

In 2007, the programme was extended to medium- and small-size companies, tax intermediaries (financial and tax advisors, accountants etc.), and different professional trade and industry organisations. The next phase in the programme introduces horizontal monitoring to software producers, in order to enable reliable reporting and controlling in the whole chain from business transaction to tax return. The NTCA emphasises the importance of attitude of participating taxpayers’ top management to horizontal monitoring (the so-called “tone-at-the-top” principle), as this is crucial for increasing taxpayers’ willingness to adopt voluntary tax compliance and for improving the internal tax control framework. From the point of view of tax administration, it is essential for the employees to have excellent knowledge not only of the particular taxpayer’s business, but also of its specific branch of industry, in order to work with a particular taxpayer (NTCA, 2008). The Slovenian programme of “Horizontal Monitoring”, introduced in 2010, is based on the Dutch experience and is being implemented with support from the NTCA.

Ireland introduced its enhanced relationship programme called “Cooperative compliance programme” in 2005 (Revenue – Irish Tax and Customs, 2005; Griffin, 2006). It aims to include large taxpayers that exceed certain turnover and asset thresholds. This programme includes comprehensive supervision of all cases related to tax compliance issues. For this purpose, a special department inside the tax administration has been established. Each participating taxpayer is assigned to a particular employee of this unit in order to enable a prompt reaction.

³ In the Netherlands, as early as 2002, the Scientific Council for Government Policy recommended changing the relationship between the government and citizens from vertical to horizontal, i.e. a move towards more equal relationships, as a consequence of international and social development (*cf.* NTCA, 2008). The government included the recommendations in the “Andere Overheid” programme. These principles were also a basis for NTCA pilot projects for the development of new forms of cooperation with taxpayers and tax intermediaries; one of these was “Horizontal Monitoring” in 2005.

The UK started its enhanced relationship programme called “High Risk Corporates Programme” in 2006, based on a unilateral approach, i.e. the relationship arises from an assessment of the risk connected with a particular taxpayer (Freedman *et al.*, 2012; HMRC, 2012). The High Risk Corporates Programme has three strategic aims: (1) to influence corporate customers to take a less aggressive approach to tax mitigation and tax filing positions; (2) to increase the openness, with which they disclose transactions, and their tax impact; and (3) to collect as effectively as possible the correct amount of tax from their transactions and profits – if necessary, determining this by litigation (OECD, 2009b). In 2009, the UK also introduced a “Code of Practice on Taxation for Banks”. As of 30 June 2010, over 100 banks had adopted this code and many more, including most of the largest banks, were actively working towards the adoption (OECD, 2010).

In the EU, a form of enhanced relationship is currently being implemented also in Belgium, Denmark, Germany, Austria, Spain, and Sweden (*cf.* Stevens *et al.*, 2012). The concept is also known in Switzerland (Bugnon, 2012), while in South-East Europe the Former Yugoslav Republic of Macedonia introduced a programme of horizontal monitoring (European Commission, 2011), and the Croatian tax administration has been preparing to introduce a pilot enhanced relationship programme, funded by the “Matra-flex” short-term programme (Government of the Republic of Croatia, 2012). As in Slovenia, both South-East European projects are being supported by the NTCA.

Among the OECD countries, Australia, Canada, New Zealand, and the USA have also introduced such programmes (*cf.* Stevens *et al.*, 2012). For example, the “Compliance Assurance Process” (CAP) in the USA started in 2005 and represents a real-time, year-by-year audit programme, devoted to large companies. The 73 participating taxpayers at the time of its introduction expanded to 160 participants by 2012. The programme starts at the beginning of a taxpayer’s financial year and finishes after its tax return is submitted. The taxpayer discloses in real-time all transactions and connected tax positions, and any open issues are resolved with the tax administration before the tax return is filled in (OECD, 2007; IRS, 2012).

3. Enhanced Relationship in Slovenia: The Process of Horizontal Monitoring

In Slovenia, an enhanced relationship project started in 2010 under the title “Horizontal Monitoring” as a consequence of establishing the strategic business plan of the TARS for the 2010–2013 period (TARS, 2010). It became obvious during the preparation of the strategic business plan that a small tax administration with limited resources needs an alternative approach to the classic vertical relationship with taxpayers and tax intermediaries, especially in the context of a complex environment of the ongoing (late-2000s) economic and financial crisis.

The new business strategy has therefore set increased voluntary tax compliance as the first strategic objective (TARS, 2010). Its implementation requires the services of the TARS to be provided in such a way that (Šinkovec, 2012b): (1) procedures are simplified for those taxpayers, who are willing to comply; (2) all necessary assistance is given to those taxpayers, who strive for compliance, but are not always successful; (3) taxpayers, who are not willing to comply, are deterred from doing so with fast and effective identification of the evasion and avoidance of their tax obligations; and (4) all possible enforcement measures, provided by law, are applied to taxpayers determined not to comply.

Besides the new business strategy, the initiation of the horizontal monitoring project was based on a series of studies and guidelines of the relevant international organisations, such as the already mentioned IOTA, EC/Fiscalis Risk Management Platform Group, and OECD, as well as some domestic analyses (Filipović, 2009; Centa-Debeljak, 2010). The latter revealed an already high level of voluntary tax compliance among the largest taxpayers. As a result, it was decided to commence a two-year pilot enhanced relationship project. From the outset, the NTCA actively cooperated through the transfer of experiences and know-how, resulting in many similarities between the Slovenian and the Dutch enhanced relationship processes.

3.1. Agreement with the Taxpayers

In March 2010, the first public presentation of horizontal monitoring was organised in cooperation with the NTCA, followed by a public call to all large corporate taxpayers⁴ that have already established a system of internal tax control (Centa-Debeljak, 2011), in order to join the pilot project in May 2010. At this stage, organisations of professions were involved, such as the Bank Association of Slovenia, to inform and motivate large corporate taxpayers to participate. In the introductory phase of an enhanced relationship project, the tax administration usually approaches large corporate taxpayers first, as they are typically low-risk taxpayers with a series of external advisors, who indirectly also become part of this process. In this way, all three participant groups become involved. As a result, the starting number of participating taxpayers was fairly small; out of 721 large corporate taxpayers in 2010, 18 responded and were included in the pilot project of horizontal monitoring⁵. In Table 1, we present the structure by industry of large corporate taxpayers in Slovenia in 2010.

⁴ There were 721 large corporate taxpayers in Slovenia in 2010, representing 1.3% of all companies. They were very important from the viewpoint of public revenues, contributing 53% of the whole amount of collected corporate income tax, 54% of generated revenue, and 40% of all employees (Šinkovec, 2012b).

⁵ In 2011, there were 695 large corporate taxpayers, their share in total turnover amounting to 54.4% and employing 39.2% of all employees in the Republic of Slovenia (AJPEŠ, 2012). Of the 18 large corporate taxpayers that responded to the public call, 13 were financial and/or insurance companies with 11,427 employees, two were pharmaceutical companies with 6,136 employees, and three were other companies with 17,774 employees altogether (Šinkovec, 2012c).

Table 1. Structure of large corporate taxpayers by industry in Slovenia, 2010

Industry	All large corporate taxpayers		Included in horizontal monitoring	
	Number	Percent	Number	Percent
Finance and insurance	90	12.5%	13	72.2%
Pharmaceuticals	2	0.3%	2	11.1%
Others	629	87.2%	3	16.7%
Total	721	100.0%	18	100.0%

Source: Own calculations.

Once the responses were obtained, meetings between the top management of those taxpayers and the management of tax administration took place, where details of the project were presented. From the very beginning, the project was based on the following grounds: (1) taxpayers joined the programme with the expectation that horizontal monitoring would increase tax certainty, required for everyday business; (2) the tax administration made it clear from the outset that during the programme it would not perform tax advising in the sense of optimising tax liabilities; and (3) existing rights and obligations, deriving from existing regulations, would remain unchanged.

Based on these initial meetings, cooperation agreements were signed with the participating taxpayers. The taxpayers thus committed themselves to inform the tax administration about the issues related to their operations that may involve tax risks. On the other hand, the tax administration offered to provide prompt opinions based on existing regulations, and to monitor internal control mechanisms of the participants.

The agreements do not interfere with the ongoing tasks of the tax administration⁶. However, the horizontal monitoring pilot project may lead to potential amendments to the tax regulation, enabling the project's permanent implementation. Compared to tax audits, which are retrospective by nature and concentrate on irregularities in already submitted tax returns, the horizontal monitoring is focused on the present and future operations of taxpayers, and their interactions with the tax administration. The horizontal monitoring is derived from business processes and ongoing transactions; it examines the existence and efficiency of internal tax controls and focuses on risks that appear before taxpayers submit their tax returns. Current issues, related to the project, are resolved at meetings with members of working groups. Where such topics are relevant to other taxpayers, the results are published on the tax administration's website.

Operating in a complex environment that is subject to changes, these issues are especially significant for large corporate taxpayers. They have to operate internationally and face complex financial and fiscal structures, related to tax risks in areas such as transfer prices,

⁶ During the horizontal monitoring project, the tax administration performs all its ordinary services, such as supervision procedures, interpretation of tax legislation etc. Should the tax administration and taxpayer disagree about the interpretation of tax laws, a supervision procedure can be carried out according to the provisions of the Tax Procedure Act.

permanent establishments, and offshore activities. They encounter constant amendments to the legislation, which they should comply with and adjust to by changing their business processes, computer software, or even complex information systems. Due to these ongoing changes, possible subsequent audits, performed by the TARS, represent a great burden on taxpayers that are generally willing to voluntarily comply with tax regulations.

Time-consuming search of documentation, a reconsideration of the legislation that was valid at some point in the past, and access to certain data may not be possible due to changes in information systems. All of this may pose a burden on employees in charge for taxes that also have to perform their regular work obligations. Therefore, following the introduction of horizontal monitoring, taxpayers expect a (limited) tax audit, primarily based on a review of the operations of internal tax controls. Instead of extensive and time-consuming audits, covering several years in the past, accuracy controls should be performed to a small extent, based on sampling.

Based on the results of horizontal monitoring process so far, the advantages that the taxpayers perceive in the enhanced relationship are: (1) a reduction of time-consuming components of tax compliance, (2) the updating and upgrading of their knowledge, and (3) greater tax certainty. Taxpayers expect better responsiveness from the TARS to their questions and a confirmation of having accurately understood explanations of the legislation, which holds consequences for management's decisions regarding the financial and tax statements of their companies. They also expect proposals for the improvement of processes and internal control systems. They are willing to participate in the preparation of proposed amendments to the legislation and would like to play an active role in the formulation of tax standards and legal bases.

3.2. Implementation Issues of Horizontal Monitoring

Agreements, signed between the TARS and the participating taxpayers, represented a basis for the organisation of three working groups for implementing the horizontal monitoring in the tax administration (Šinkovec, 2012b): (1) the finance and insurance companies group; (2) the pharmaceutical companies group; and (3) the other large companies group.

Finance and insurance institutions were selected as the first target group based on already mentioned studies of international organizations, as they form the most appropriate group for the pilot project. The mandatory application of International Financial Reporting Standards, the supervision of the Bank of Slovenia, membership in the Bank Association of Slovenia, and statutory internal audits provide for a high level of tax transparency. This was backed by the analysis of the TARS for tax audit in banks from 2005 onwards (Centa-Debeljak, 2010), where in comparison to other industries relatively low number of tax irregularities emerged. The selection of pharmaceutical companies to participate in the pilot project is due to their international status regarding taxation and associated risks (presence on the global market, transfer pricing, residency status etc.), while the third

group includes the remaining large corporate taxpayers, including Mercator⁷, the biggest retailer in Slovenia.

Each working group consists of tax administration staff members, who are tax auditors with long-term experience in working with large taxpayers. On the other hand, participating taxpayers also appoint a contact person to communicate with the relevant working group. These working groups perform the project in four steps: (1) they prepare and permanently update the taxpayer's profile, (2) they conduct the introductory interview, (3) they monitor the taxpayer's internal tax controls, and (4) they are in charge of continuous monitoring of each participant taxpayer.

The purpose of a *taxpayer's profile* is to inform working group members about the taxpayer's business and tax compliance records. It includes data from tax administration databases (register of taxpayers, tax returns, control data for the assessment of personal income tax, implemented audit procedures and controls etc.), data from other supervisory authorities, publicly available data about the taxpayer (annual reports, newspaper articles, websites etc.), and data submitted by the taxpayer itself. This last element is particularly important, as in the cooperation agreement the taxpayer accepts the responsibility to substantially and timely inform the tax administration about all potential tax risk activities. The taxpayer's profile is used by the working group's members to define the critical segments of the taxpayer's activities, at which their attention should be focused.

Equipped with the taxpayer's profile, the working group organises the *introductory interview* in order to establish personal contact with the taxpayer's representatives and to obtain additional internal data on business details, strategic goals, existing external and internal control mechanisms, so as to further extend its profile. Based on the NTCA experience, the introductory interview opens a discussion in five crucial areas: (1) the strategic goals of the taxpayer, (2) the internal tax control framework, (3) the information system, (4) tax functions, and (5) external supervision.

The key topic, related to strategic goals, is the participant's long-term commitment to voluntarily comply with the tax legislation. At this stage, the top management of the taxpayer is usually included. It turns out that only a few participants (banks) officially accepted the internal tax policy act as an independent document devoted to tax activity (Šinkovec, 2012a). Discussions about the internal tax control framework seek to find out how the taxpayer administers its tax risks. Here the condition that the tax administration had set out in the first public call becomes relevant, namely that the taxpayers must have had the appropriate internal tax control framework in place. It turns out that companies that are subsidiaries of multinational

⁷ Mercator d.d. is one of the largest Slovenian companies with 12,000 employees in 2010 (AJPES, 2012). In October 2010, Mercator signed an agreement with the TARS to take part in the pilot project of horizontal monitoring. The company's participation in the pilot project started on 1 January 2011 and will presumably last for two years. The main benefit the company expects from taking part in the project is greater certainty regarding taxation. In 2011, the operation of internal controls was reviewed in the field of value-added tax accounting. In addition, the TARS responded instantly and professionally to questions submitted by the company, and thus contributed to the mitigation of tax risks regarding major business decisions. For 2012, the audit of internal controls is planned in the fields of personal taxes and corporate income tax (Mercator, 2012).

corporations generally have a professional approach to tax policy. Several multinationals have introduced Codes of Conduct and demanded from all members of the group (including Slovenian subsidiaries) to comply with specific standards and models (COSO, the Sarbanes-Oxley Act, the Savings Law etc.). The information system represents the technical basis and as such plays an important role in exercising tax functions within a taxpayer. Emphasis is thus given to controlling mechanisms of the information system (level of risk regarding data loss, accessibility of the information system etc.).

At the introductory interview, the organisation of tax functions is also presented (organisations, people in charge, role of external experts etc.). It may be organised in many different ways, depending on the taxpayer's size and the complexity of its tax obligations, and is usually implemented in several organisational units (accounting, HRM, sales etc.). It turns out that almost all participants employ at least one tax specialist. During the interview, there is an emphasis on how the company transfers knowledge of tax changes and the tax strategy among its employees, along with how tax risks are recognised and controlled for. It is thus important to find out how tax returns for different taxes are filled in.

Another integral part of the introductory interview is obtaining information on the roles of external auditors, advisors and supervisors in the process of monitoring and facilitating tax compliance at the taxpayer level. This includes information about the frequency of their services (regularly *vs.* occasionally – only in the case of difficulties); about the supervision of their performance, and what their attitude is to the taxpayer's participation in the horizontal monitoring programme.

The *analysis of a taxpayers' internal tax controls* is the most important step in the horizontal monitoring process, since its key principle is that the tax administration shall rely to the greatest extent possible on the internal tax controls, established by the taxpayer. It includes the examination and testing of already established tax control mechanisms within a particular taxpayer, definition of potential risks regarding these mechanisms, and their evaluation. Internal tax controls are evaluated with respect to their accuracy, timely tax reporting, and tax payments, and focus on the following issues (Šinkovec, 2011): (1) who is responsible for different internal controls in the company (including tax controls); (2) how the company examines implementation of the internal control procedures; (3) what is the level of cooperation among internal "controllers", i.e. the tax specialist, the accountant, and the internal auditor; (4) what is the approach to tax risks (how often does the company discuss them etc.); (5) what is the relationship between tax compliance and ethics (tax morale); and (6) what is the degree of tax transparency within the company.

Internal tax control mechanisms are examined for all tax types. Due to its relevance among government revenues, its complexity and the numerous taxpayer questions about its implementation, value added tax (VAT) was covered for all participants as the first tax in this step. The examination includes checking of internal control mechanisms for sales and purchase of goods and services (resulting in output and input VAT), verification of the VAT documentation and, finally, the accuracy of the VAT returns. The selection of documentation

for testing purposes is performed with the help of Audit Command Language (ACL) software, such that standard verifications are performed and documents with risks detected are submitted to the taxpayer. Internal controls in the area of VAT go hand in hand with the information system due to the volume of VAT transactions.

Following the analysis and testing, final reports are prepared by the working groups. Apart from findings of discovered irregularities and insufficiencies that may influence tax compliance, final reports include recommendations to the taxpayer's management in areas that may influence tax compliance.

The last step in the implementation of horizontal monitoring is the ongoing process of *continuous monitoring* of a taxpayer, based on the already established and updated taxpayer's profile and on the access to its internal tax control mechanisms. It includes checking whether the recommendations have been adopted (e.g. establishing additional control points). The scale of continuous monitoring, performed by the working group, thus mostly depends on the level of internal and external control mechanisms, provided by the taxpayer. The more it is able to control its processes, the less intensive is the tax administration's activity.

In line with these steps, the tax administration provides tax certainty to the participating companies, as the cooperation agreement binds the tax administration to promptly respond to every question regarding the current legislation. From 1 January 2011 until 30 September 2012, the TARS provided 131 answers to the 18 participating taxpayers, with the majority covering the area of VAT (42.7%), followed by personal income tax (24.4%), and corporate income tax (16.8%), as shown in Table 2. During the project, regular meetings between the management of the tax administration and the management of taxpayers are organised to promptly review and assess already performed phases of the project.

Table 2. Answers provided by the TARS to the participating taxpayers, 2011–2012

Area of interest	Number	Percent
Value added tax	56	42.7%
Personal income tax	32	24.4%
Corporate income tax	22	16.8%
Tax procedure	8	6.1%
Double taxation avoidance	8	6.1%
Financial instruments	1	0.8%
Interests directive	1	0.8%
Insurance contracts tax	1	0.8%
Pension insurance	1	0.8%
Real property transaction tax	1	0.8%
Total	131	100.0%

Source: Šinkovec (2012c); own calculations.

3.3. Evaluation of Horizontal Monitoring

Following the OECD's Tax Intermediaries Study team requirements for the successful engagement of taxpayers within enhanced relationship programmes (OECD, 2007), we can perform a qualitative evaluation of the Slovenian horizontal monitoring project.

Regarding the first requirement, i.e. commercial awareness, we can conclude that the TARS has made its best efforts to achieve it first by dividing taxpayers in the pilot project into three groups – finance and insurance, pharmaceuticals, and others, and then by appointing the most experienced tax auditors as members of each of the aforementioned working groups. In so doing, the tax administration increased its ability to understand the business, the major characteristics of taxpayer's industry, and its risk appetites. However, the need for additional knowledge and experience, which refers mainly to particularities of individual industries, still increases.

The second requirement is an impartial approach to the resolution of potential disputes. This is reflected in the reasonable expectation of the participant taxpayer in case of disagreements that arise as a result of voluntarily disclosed information in the course of the programme that the tax authority will act objectively and fairly, and exercise its discretion in a considered, revenue-detached and proportionate manner. The next requirement, connected to the previous one, is proportionality, aiming to assess whether the total amount of tax declared in the participant's tax return accords with the tax authority's understanding of the underlying tax regulations. Since the enhanced communication is an important tool for reducing potential uncertainties and miss-understandings of the tax duties imposed, though the results are difficult to measure, the programme is believed to have been successful in these respects.

Disclosure and transparency are also essential elements of the reciprocity of the relationship. As stated above, the increased number of questions from taxpayers and opinions, answered by the TARS in the course of the pilot project, reflect a mutual readiness to open discussions, a higher level of mutual trust, and to some extent an influence on drafting of amendments to the existing tax regulations. The last requirement on the OECD's (2007) list is responsiveness. Notwithstanding its limited resources, the TARS is taking important steps to improve its promptness and efficiency, as well as the professional level of its operations during the programme, partially due to the incorporation of the experiences of other European tax authorities, and the more focused, hands-on approach and communication with individual participants.

4. Non-participation in the Enhanced Relationship

After the public call to all 721 large corporate taxpayers, initiated in May 2010, had ended, and the 18 large corporate taxpayers that responded to the call were included in the pilot project of horizontal monitoring, the remaining 703 large corporate taxpayers were subject to a survey of non-participation, designed and implemented in order to determine the reasons for non-participation, the attitude towards horizontal monitoring, and willingness to participate in the future. In line with the experience of NTCA with implementation of the enhanced relationship, the survey was addressed to the senior management of a company, and this was verified in the questionnaire⁸ with a question on the position in the company of the actual respondent to the survey. Due to questions on willingness to fulfil tax liabilities and to cooperate with the tax administration, anonymity of the respondent was assured by enclosing a return envelope.

In order to minimize the costs of the survey, 20% of the non-participating large corporate taxpayers were randomly selected, resulting in 140 large corporate taxpayers⁹, whom the questionnaires were sent. Out of 140 companies, 51 responded, with a response rate of 36.4% and covering 7.3% of all non-participating large corporate taxpayers in Slovenia. In Table 3, we present the structure of the sample of non-participating large corporate taxpayers by industry. The information on industry of a large corporate taxpayer that responded to the survey was gathered by introducing a corresponding question in the survey questionnaire.

Table 3. Structure of the sample of non-participating large corporate Slovenian taxpayers by industry, 2010

Industry	Included in the sample		Responded to the survey	
	Number	Percent	Number	Percent
Finance and insurance	11	7.9%	6	11.8%
Pharmaceuticals	0	0.0%	0	0.0%
Others	129	92.1%	45	88.2%
Total	140	100.0%	51	100.0%

Source: Own calculations.

Structure of the actual respondents according to position in a particular company was as follows: 27.5% of respondents belonged to the top management (CEO, chairman of the board, or general manager), 31.4% were members of the board, CEO, or deputy CEO, while 41.2% were from the lesser positions (assistant director, director of finance and accounting, CFO, administration assistant, accounting manager, head of controlling, tax specialist, or accountant). We can thus observe that many CEOs still transferred the questionnaire to subordinates, who cover the tax field in their companies, at least in the non-participating large

⁸ Due to obvious spatial limitations, the survey questionnaire is not included in the article, but is available upon request. In the present article, only the results of the most relevant questions are addressed.

⁹ In 2011, the 140 large corporate taxpayers from the survey sample had a 10.6% share in total turnover and employed 7.6% of all employees in the Republic of Slovenia (AJPES, 2012).

corporate taxpayers. There is probably still room (and need) for awareness rising in Slovenian companies with respect to horizontal monitoring, although this could also be a sign of trust of the senior management to their subordinates.

The survey included questions related to familiarity of companies with horizontal monitoring in the Netherlands and Slovenia, and to the mode of acquaintance with the pilot project in Slovenia. Only 33.3% of respondents were aware that the NTCA enters into agreements with taxpayers on mutual cooperation, and only 23.5% of the non-participating large corporate taxpayers knew that a similar pilot project was introduced in 2010 by the TARS. Most of the latter got information on the TARS website, followed by the media, organisations of professions, and various workshops and seminars. These responses support our previous finding that more and better-targeted effort should have been invested in the promotion of the project.

Irrespective of whether the company was familiar with the pilot project, the process of horizontal monitoring in Slovenia was then presented in brief. The respondents were asked whether they would be willing to participate in the future, should the pilot project of horizontal monitoring prove to be successful. Some 86.3% of the currently non-participating large corporate taxpayers responded affirmatively, stating as main reasons for doing so: (1) tax certainty (26 respondents), (2) support of the tax administration in the introduction of internal tax controls (22 respondents), and (3) reduced possibilities of tax inspections (16 respondents). The seven respondents that would not like to participate in the project justified their response with: (1) existence of distrust of the TARS (three respondents), (2) possible costs related to the introduction of internal tax controls (two respondents), (3) insufficient information about the project (five respondents), and (4) lack of resources in general (two respondents).

There was also a question in the survey questionnaire about the importance of internal tax controls. Some 35.3% of respondents found them important and quoted that they are already established in their companies, while another 41.2% thought that internal tax controls are important and would like to receive support from the TARS in order to establish them. Moreover, an additional 11.8% of non-participating large corporate taxpayers deem internal tax controls important, although they would like to establish them with the support of external experts. The responses demonstrate a high level of readiness of taxpayers to establish a system of internal tax controls, which is an important condition for voluntary exercise of tax liabilities.

The results, presented in this section, provide important information for future decision-making of the tax authorities with respect to horizontal monitoring. Alongside more and better-targeted promotion of the project in the future, the TARS should probably put more emphasis on particular benefits of participating in horizontal monitoring, with demonstrations of existing good practices in Slovenia¹⁰.

¹⁰ The promises are nevertheless encouraging, as the TARS has been receiving a great deal of inquiries, especially in 2012, from companies for inclusion into the project (Šinkovec, 2012c).

5. Concluding Remarks

The enhanced relationship represents a modern approach of the tax administration to taxpayers and tax intermediaries. Even though this concept is relatively new, it has already proven successful in several countries, and is leading to improved cooperation between tax administrations and taxpayers. It is resulting in better supervision and a higher level of voluntary tax compliance. With cooperation of the NTCA, the TARS has launched in 2010 a pilot version of an enhanced relationship project, called “Horizontal Monitoring”, with the main purpose of improving the relationship with a selected group of large taxpayers that are willing to comply voluntarily. The key characteristic of such an enhanced relationship is that it transforms the standard methods of vertical taxpayer supervision into a horizontal partnership.

So far, the horizontal monitoring has proved to be successful. Namely, based on experience and evidence to date, the taxpayers are showing greater willingness to cooperate with the TARS and disclose their operations related to tax risks. They benefit from greater tax certainty through prompt and regular two-way communication with the TARS. Both parties thus benefit from experience and mutually recognised know-how, as the project has already induced additional training of employees in charge of individual tax procedures. The TARS employees are benefiting not only from the new type of relations with taxpayers that are more willing to openly discuss sensitive tax issues, but also from cooperation with the NTCA. Additionally, the results of the project have already enabled an upgrade of the system of internal tax controls at some participating taxpayers. In the long term, the TARS expects to spend fewer resources on the supervision of taxpayers, and thus to direct resources to other areas of its work.

Nonetheless, the project has also revealed some shortcomings. The biggest challenge for the participating taxpayers is the implementation of internal tax controls, as it is a time-consuming and expensive process. Some participating taxpayers might also understand horizontal monitoring as a free “tax optimisation service”, provided by the TARS, without implementing the disclosure of tax risks. Others are concerned about the disclosure of sensitive data, related to their day-to-day business. In addition, some concerns emerged that participation in the project may violate the principle of equality with respect to tax authorities’ treatment of participating and non-participating taxpayers (Hauptman, 2011). The results of the survey revealed that the TARS should improve promotion of the project in the future, and put more emphasis on particular benefits of participating in horizontal monitoring.

The key elements of the pilot project, namely transparency, trust, and understanding, have nevertheless been fulfilled, and the project represents the right direction for further development of the TARS. Since the final phase of the incipient implementation of enhanced relationship is approaching (December 2012), the tax administration has to determine whether the Slovenian tax environment is sufficiently developed to allow the general introduction of

such an approach, whereby all taxpayers that are willing to comply voluntarily, disclose their risks, and establish an effective system of internal tax controls. Given the experience and evidence from the pilot project to date, it would be reasonable to include (at least) other appropriate large taxpayers.

However, several legal amendments would be necessary for a large-scale introduction of horizontal monitoring, and even an amended legislation cannot cover all taxpayers, although it definitely could include additional groups of suitable and motivated companies. Based on existing Slovenian experience and following the NTCA approach, serious long-term candidates include consultancy and accountancy companies. It is also planned that at the end of the pilot project the TARS will publish new recommendations for taxation standards, in cooperation with external experts. In the long run, the project is contributing to an improved tax culture and to the tax system in general, and is thereby fostering the international tax attractiveness of the country.

It needs to be emphasized, though, that despite our best efforts to analyze and evaluate the process of horizontal monitoring, the conclusions are still based on mostly qualitative findings. The literature on the topic, especially scientific research, has been very scarce so far, and the quantitative measurement of the project effectiveness is still lacking to date. This is, nevertheless, an issue related to horizontal monitoring in general (*cf.* Stevens *et al.*, 2012). The present article is thus only an attempt to narrow the gap between ongoing practical implementation and scientific treatment of horizontal monitoring, while for the long-term success of this concept, first and foremost, a set of well-founded measures (performance indicators) should be designed and enforced.

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