

**Inter-American Center of Tax Administrations – CIAT**

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**“THE ROLE OF TAX ADMINISTRATIONS IN THE GLOBAL CRISIS”**

**Topic 1.2**

**THE TAX ADMINISTRATIONS AND TAXPAYER’S SOCIAL RESPONSIBILITY:  
STRATEGIES FOR COMBATING HARMFUL TAX PLANNING**

**State Agency of Tax Administration  
Spain**

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## **I. THE TAX ADMINISTRATION-TAXPAYER RELATIONSHIP**

The tax systems of developed countries are increasingly complex, as a reflection of the social, economic and financial reality in which they operate.

Tax administrations must perform their task in an environment characterized by the globalization of companies' performance, demographic changes, the international mobility of capital and labor factors, the constant innovations in corporate structures and the offer of financial products, the advancements in information technologies or the increasing concern for environmental issues. The concurrence of these factors calls for Tax Administrations to formulate new strategies in the field of both tax default prevention or control, and taxpayer information and assistance.

In light of such environment, the analysis should focus, on the one hand, on the position of taxpayers and how they approach the new economic situation; and on the other hand, the position of Tax Administrations to approach the new challenges described.

### **Factors influencing taxpayers**

Over the last years, taxation has taken on an increasingly ethical, social and economic relevance. The issues of business management associated with tax matters have turned more complicated, risky and changing. A corporate attitude that presupposes the assumption that the tax environment has a secondary role may fail to provide the company with the transparency required by these times of increased sensitivity to corporate social responsibility. In addition, the lack of tax revision systems may deprive entities of the access to benefits and incentives created by the tax authorities and shared by countries which design their tax systems to attract and retain the corporate investment. Therefore, the entities' tax and risk management policies should be as sophisticated, consistent and transparent as are the policies for the rest of the areas that involve multiple stakeholders, such as suppliers, clients or investors.

Historically, the tax departments of companies have been inclined to work isolately from both the advisors and the business units, and have on occasions not received the same importance as have other business areas. This implies that, in many companies, the fiscal risks are the target of attention only with relation to financial aspects.

The old barriers between the tax departments and the rest of the areas of a business are being toppled more by external influences than by internal actions. Regulations such as the US' Sarbanes-Oxley Act or the new compliance programs in different countries are compelling the change.

The companies may adopt two positions regarding the fiscal strategy vision:

- They may consider that the entity should act and provide services to the society, emphasizing compliance with the regulations and its contributions to the society.
- They may act exclusively for the sake of its stakeholders by reducing costs to a minimum within the legal boundaries (or on the borders of it) and perceiving taxation as a cost; in fact, as one of the main costs of the business.

To discuss the fiscal policy of choice, companies should ponder two main issues:

- How aggressive should the fiscal policy be?
- What is the acceptable level of risk it can assume?

In any case, whichever the adopted position may be, advisors should be aware that any tax planning that implies a forced interpretation of the regulation may create value for the stakeholders in the short term, but may destroy value in the long term upon damaging the entity's image in the eyes of interested third parties. This damage to its reputation may in turn lead to considerable damages in the economic results.

Hence, among the key factors that determine the decision-making processes of companies, as well as the interaction with the Tax Administrations, are the **Corporate Social Responsibility** and the **reputation risk**. Taxpayers, especially big-sized companies, have become very sensitive to the negative publicity related to a number of aspects, among them fiscal supervision. The Boards of Directors should assume that the current debates over good governance, corporate social responsibility and ethics suggest that the bet on a strict tax reduction policy, even within the legal boundaries, could have such effect on image that could lead to potential financial losses, loss of opportunities or even the failure of the company's strategies.

On the other hand, the companies should consider that fiscal risk management cannot be performed isolately from the supervising departments, but should rather climb up to the management layers which must make the necessary choices to increase transparency of financial reporting and become responsible for the relationship with the Tax Administration, facilitated by the incorporation of fiscal matters into the principles of Corporate Social Responsibility. The companies that have advanced most regarding responsibility matters have a formal structure and a perfectly designed fiscal risk management that are applied strictly and on a regular basis. This structure should be supplemented with the design of a periodical development evaluation system, the results of which should be known by the company's decision makers. All this allows the internal audit to perfectly identify the risks faced by the company, to prepare tools that facilitate decision making and provide the required information to the stakeholders (shareholders, clients, suppliers).

## **The position of Tax Administrations: risk management and cooperative relationship.**

Broadly speaking, the strategic long-term objective of Tax Administrations is the promotion of taxpayers' voluntary compliance with their fiscal obligations through two lines of action: on the one hand, the provision of information and assistance services in order to cut down overhead costs tied to the performance of tax obligations; and on the other hand, the detection and regularization of tax defaults by way of control actions.

In light of the great amount of work implied in the management of mass tax systems, the Tax Administrations have to make a rigorous allocation of resources to the diverse procedures and, in this scenario, risk management becomes an essential tool to allocate resources efficiently. To summarize the most relevant benefits, we could say that risk management provides tax administrations with:

- a structured base of strategic planning that comprises the allocation of resources;
- a process of identification of risks that affect the whole tax system;
- a compilation of evidence that allows determining the response to the risk; and
- a defensible criterion to manage taxpayers' compliance

Furthermore, risk management may also carry with it benefits to taxpayers, which implies not initiating unnecessary controls, minimizing compliance costs and generating greater certainty on their situation.

In any case, in order to make effective risk valuations, tax administrations need to have updated, apropos and reliable information. The valuation of risk implies that the tax administration has to consider, overall, the data available on each taxpayer and their different tax obligations, and draw on the compiled information in order to make an objective estimation of the risk. Besides, this valuation should make it possible for the Tax Administration to fix priorities or respond to taxpayer's conduct.

This new approach entails the construction of new relationship channels, bridging communication between the Tax administration and taxpayers, fostering relationships based on cooperation and trust; that is, establishing a **cooperative relationship**.

It is within the frame of risk management where the establishment of a **cooperative relationship**, based on the mutual confidence between taxpayers and tax administrations, can develop its full potential, in allowing, on the one hand, that tax administrations should identify "low-risk profile" taxpayers, and, on the other hand, that companies should cooperate in identifying the risks that affect taxation activities.

To be able to build a cooperative relationship as that previously described, tax administrations need to display, in their treatment of taxpayers, their knowledge of the

situation based on the understanding of the business world, their objectivity and technical strictness, proportionality, transparency and responsiveness.

As a consequence, the adoption of a cooperative relationship in the sense described above may carry with it important improvements in the **risk management** of tax administrations that organize their control activities in consideration of the existence of taxpayer groups that respond to a relationship of trust and cooperation.

## **II.- THE SPANISH CASE: FORUM OF LARGE COMPANIES**

In an environment such as the one described so far, the State Agency of Tax Administrations is immersed in the process of developing a new form of relationship with Large Companies, a process which has consisted of two stages: the creation of a central unit as a single interlocutor with large taxpayers, and the implementation of a cooperative relationship.

### **The Central Delegation of Large Taxpayers**

The Tax Fraud Prevention Plan of 2005 proposed, among its organizational and internal coordination and functional integration measures, the creation of a Central Delegation that would allow a coordinated control of large taxpayers, within the frame of a strong bet on the coordination and integration among the functional areas of the Tax administration, aimed at, in some cases, a greater integration between the inspection controls performed by the financial and tax inspection bodies, and the customs and special tax inspection in the case of taxpayers subject to the payment of such taxes, in order to avoid the performance of independent and uncoordinated actions. And, in other cases, the reinforcement of the coordination between liquidation and collection areas, so that control actions may be targeted from the very start at not only regularizing tax non-performance but also the effective collection of the debt bound to be liquidated.

So, the Central Delegation of Large Taxpayers was created as the single interlocutor with large-sized companies subscribed to it. This has brought about a change in organization and culture, upon overcoming the functional structure present in the rest of the organization and attaining a more direct relationship frame with large-sized companies.

The objective is to contribute with added value to the Tax Agency's actions. Hence, some functions are integrated which are in other delegations distributed along different bodies and divisions, as is the case of, for example, financial control and customs control, or the activity of liquidation and collection bodies.

The effects of the creation of the Central Delegation of Large Taxpayers since its creation to date may be discussed in light of the following figures:

- More than 3,200 taxpayers are enrolled. Nearly all of them are large economic groups (over 80%), and a minority is composed of individuals.
- It has a payroll of over 900 persons.
- It provides over 80 percent of the information records received by the Tax Agency.
- It contributes with over 40% of the annual collection.
- Their taxpayers' activities account for 39% of the GDP, outperforming the entire public sector.
- It has liquidated certificates of control actions for over 4,200 million euros.

### **Creation of the Forum of Large Companies**

The opinion of large companies regarding the creation of the Central Delegation of Large Taxpayers has been very positive, for the centralization of an interlocutor has allowed greater simplification, clarity and professionalism in the relationship with the Tax Agency as well as a greater legal certainty.

In 2008, the AEAT conducted a survey to know the degree of satisfaction of large taxpayers regarding the task performed by the Central Delegation of Large Taxpayers. In general terms, the valuation was very positive, mostly regarding aspects related with the Management area (with an excellent reputation, high information technology, qualified and professional staff). Alternatively, the control procedures were questioned, mostly due to the existing legislation, the duration of procedures and the volume of information that taxpayers must provide.

In this state of things, the update of the Tax Fraud Prevention Plan conducted within the Tax Agency in 2008 implies a step forward in the relationship between the Tax Agency and large taxpayers, through the implementation of a new type of **cooperative relationship** with a reduced number of large companies, in two phases:

1<sup>st</sup> PHASE. The creation of a discussion forum with taxpayers intended to discuss, through joint or sector meetings, the main problems arising from the relationship between large-sized companies and the Tax administration and the valuation of the extension of the cooperative relationship model.

2<sup>nd</sup> PHASE. The possible implantation of a special framework whereby the Tax administration would provide, in terms suitable to the needs of companies, a criterion regarding the tax consequences of business operations, in exchange for a total transparency of such operations, provided that companies that voluntarily abide by this special framework should offer any information required by the Tax administration to establish its criterion.

To apply the first of the proposals, the Forum of Large Companies was constituted on July 10 of 2009 as a cooperative relationship body between the AEAT

and a total of 27 large Spanish companies, with a view to promoting a greater cooperation based on the principles of transparency and mutual trust, through the knowledge and sharing of problems that could arise in the application of the tax system.

The selection of companies that would participate in the Forum considered factors such as turnover volume, tax debt volume, the volume of information provided to the Tax administration, number of employees, activity sector and geographical distribution; choosing the companies considered representative and easily accessible for these purposes.

Among the represented economic sectors are:

- Automotion (2 entities).
- Integrated trade (1 entity).
- Construction (2 entities).
- Financial (4 entities).
- Insurance (2 entities).
- Large surfaces (3 entities).
- Transformation industry (1 entity).
- Electrical industry (1 entity).
- Textile industry (1 entity).
- Petroleum (2 entities).
- Communication (2 entities).
- Transportation (1 entity).
- Electronics (2 entities).
- Electricity (2 entities).
- Gas (1 entity).

The initial participation of a reduced group of companies should not be interpreted in any way as a sign of privilege to these participants with respect to the other taxpayers, because, in any case, the agreements adopted in the Forum will be applied generally to all affected taxpayers.

At the session of incorporation of the Forum of Large Companies, the Functional Rules of such forum were approved, which regulate, among others, the following matters:

- Regarding the **Forum's functions**, any matter proposed by any of the participants may be brought forth, which should be related to taxation and be of interest to all participants.

Among others, the following issues may be subject to knowledge and discussion at the Forum:

- a) Improvement of the relationship between the State Tax Administration and the companies, and the establishment of fluid communication channels. In particular:
- Dissemination of the structure of tax application bodies and the practice of such application.
  - Suggestions for improvement of tax management.
  - Improvement of the current communication channels between the Tax administration and the companies, and the establishment of new ones.
  - Dissemination of specific interpretation criteria of the competent bodies (administrative, economic-administrative and judicial) that are of general concern.
- b) Simplification and facilitation of tax obligation compliance through the analysis of:
- Possible improvements to be introduced in tax application procedures.
  - Tax control actions: duration, costs of assistance, etc.
  - Formal obligations with relation to the supervision of tax groups (Corporations and VAT), related operations, etc.
  - The criteria and the frequency for forwarding tax information to the Administration.
  - The incorporation and modification of reporting and assistance software for fulfilling tax returns. Anticipated information on them.
  - The promotion of electronic billing.
  - The establishment of information channels that may generate greater security of corporate actions, minimizing litigation costs and penalty risks.
  - Taxation of certain operation that are of general concern.
- c) Study of regulation changes and how to adapt to them:
- Anticipated knowledge of regulation projects of general concern.
  - Proposals for changes in regulations of general concern.
- d) Evaluation of the internal actions of companies with regard to the tax system application:
- Spreading of tax management relevance in management education programs of companies.
  - Responsibility of the Boards of Directors as to task matters, as a sign of Corporate Social Responsibility.
  - Creation of a Code of good tax practices.
  - Possible improvements to be introduced in internal control procedures to detect and manage fiscal contingencies in companies.
- As to the **Forum's functioning**, the functional regulations establish Plenary work and Group work:



- a) The Plenary acts with the presence of the members of the Board of Directors of the companies or the members of the companies expressly appointed by the Board to represent them at the Forum, together with the Directors of the functional departments of the Tax Agency.

One of the main objectives of the Forum is that the maximum responsible for the companies have a direct participation in the supervision area, so their presence is required at the Forum's Plenary.

The Plenary meets under the direction of the Chairman of the Forum, a position that is exercised by the President of the Tax Agency.

The Plenary will hold regular meetings at least once every semester, and a special meeting called either by the President or at the request of the representatives of at least five of the member companies.

The decisions at the Plenary are always adopted by the consensus of the attendees and will be formalized in reports or recommendations regarding the issues transacted thereat, which shall have no binding legal effects.

- b) At the Working Groups, the representatives have a more technical profile regarding tax matters. The Forum's Plenary is the body authorized to agree to the creation or suppression of Working Groups, and will set forth their commitments, competences and functioning system.

Currently, there are three working groups operating:

- The preparation of a Code of Good Tax Practices
- The analysis and rationalization of Indirect Tax Burdens, and
- Transfer prices.

- c) The Forum has a Technical Secretariat headed by an officer of the AEAT. Also collaborating on a rotating basis with the Technical Secretariat are the representatives of member companies of the Forum who wish to do so.

### **Actions of the Forum of Large Companies**

There are three Working Groups operating currently at the Forum of Large Companies: The preparation of a Code of Good Tax Practices, The analysis and rationalization of Indirect Tax Burdens and Transfer Prices.

These Working Groups held a first constitutional meeting by late July of 2009, and continue pursuing their commitments, despite the fact that the Forum may have

already arrived at certain conclusions or have adopted certain decisions as a result of the work of the Groups.

### Working Group on Transfer Prices

The work carried out by this group is intended to discuss the different matters relative to transfer prices, such as:

- Prior valuation agreements.
- Documentation to be presented within the context of transfer prices.
- Secondary adjustment and relationship with third-country jurisdictions.
- Penalty system.

So far, an agreement has been reached for the preparation of a series of criteria for AEAT's actions on different matters, in which preparation the experience contributed by the companies themselves will constitute key data.

### Working Group on Analysis and Rationalization of Indirect Tax Burdens

The Spanish model of tax system application is based on an intensive use of information and new technologies. Notwithstanding the success of the model in terms of the implementation of a modern tax system apt to raise the necessary resources, the model implies a series of formal obligations that taxpayers must fulfill, with the resulting cost of physical and human resources. Nowadays, Tax Administrations, both on an internal and international level, are immersed in the process of reducing, as much as practically possible, the complexity of tax regulations and simplifying the formal obligations that fall upon taxpayers, while assuring the adequate compliance with tax regulations. In the process of transposing the European regulation<sup>1</sup>, the Spanish Government has raised the objective of reducing the administrative burdens borne by taxpayers as a consequence of the national legislation, from 25% proposed by the European Commission, to 30% for 2012 (Agreement of the Council of Ministers of June 20, 2008).

Therefore, this Working Group allows obtaining information directly from taxpayers, thus facilitating decision making in the process of simplification of formal obligations.

As for the conclusions, for example, one of the Working Group's proposals has been incorporated into a draft bill.

Besides other commitments, the AEAT is working with this Group to spread to other Public Administrations the matters that motivate a special concern to companies.

### Working Group on the preparation of a Code of Good Tax Practices

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<sup>1</sup> Directive 2006/123/CE of the European Parliament and the Council, December 12 of 2006, relative to services in the local market.

One of the main projects discussed at the Forum of Large Companies is the approval of a Code of Good Tax Practices. The purpose of the Code is to encourage a reciprocal cooperative relationship between the Tax Agency and the companies that subscribe to it, a relationship based on the principles of transparency and mutual trust, which should lead to the development thereof under the principles of good faith and loyalty between the parties, which would result in an increase in the efficiency of the controls of the Tax Administration and reduce the legal uncertainty that companies could be exposed to and the amount of litigations arising between them.

On the other hand, the principles of good faith and legitimate trust that legally govern the functioning of Public Administrations gain special relevance within this taxation framework. Not only because of a greater strictness of the legislation, but also because the economic systems require from companies, and especially from those with an international component, an increased complexity of their operations.

And all the most when one of the two large lines of action of the Tax Agency, under its governing regulation, consists in the provision of information and taxpayers assistance services. In effect, a modern Tax Administration is required to stand closer to the companies, considering them both as main taxpayers and their valuable contribution as tax collaborators. This closeness should be characterized not only by a better and more detailed knowledge of taxpayers' actions, but also by procuring the maximum publicity and consistency of their interpretation criteria and actions. All things considered, it is this commitment of the Tax Administration which should provide taxpayers with the necessary legal certainty and allow a better and more effective compliance with tax obligations.

Hence, the main task of this Working Group is the formulation of a series of recommendations that sum up the measures or practices of good governance of corporations regarding tax matters, with relative and flexible character, allowing companies to adapt them to their own characteristics. Among the matters subject to debate are:

- The Board of Directors' actions regarding tax matters.
- The reduction by companies of significant fiscal risks.
- The transparency in the actions of companies and the Tax Agency.
- The cooperation in the fight against tax fraud.
- The establishment of a procedure for consultations with the Tax Agency.
- The increase in the information provided by companies.

### **III.- FORUM OF FISCAL ADVISORS**

As stated at the beginning of this paper, the tax systems are becoming increasingly complex as a reflection of the social and economic reality in which they operate. In this environment, the task carried out by the fiscal advisors as offerors of tax planning mechanisms and assistants of taxpayers for the understanding and fulfillment of tax obligations should not go unnoticed. Therefore, Tax administrations must design coordinated and consistent relationships with taxpayers and fiscal advisors.

Under the Spanish model, the tax advisory services are provided by diverse professional entities with very different levels of services as well. So, between the large tax advisory firms and the individual advisor lies a whole universe of advisory formulas performed by experts (lawyers, economists, business agents, etc). It is sector with a high segmentation.

Among the diverse forms whereby the AEAT may intensify its relationship with fiscal advisors, one of them, of innovative character, is the creation of a Forum with representation of both parties, intended for the discussion of tax matters of general concern.

In order to be able to value the alternative relationships of the AEAT with the fiscal advisors, firstly the most representative interlocutors of the sector should be identified. For this purpose, we may classify the sector under two big groups: large tax advisory firms and the different entities representative of small and medium-sized advisory firms.

On ruling out large tax advisory companies, represented by the companies with highest turnover, the sector is composed of professionals of diverse origins and different corporates (from small or medium-sized companies, to individual advisors).

The best option seems to be a relationship with large advisory firms and the association of fiscal advisors existing in our country. A direct relationship with these associations, as well as with a representative of the profession (as recommended by the associations themselves) presupposes a significant representation of the sector. However, it should be noted that since these are not organizations such as the Professional Association, the membership of a fiscal advisory professional to any of the associations is purely voluntary, with the consequences that this has in the involvement of these professionals in future agreements.

Secondly, it is necessary to determine the objective of the Forum, both by the AEAT and the advisors' representatives.

Today, fiscal advisors are vital figures for the functioning of tax systems, helping taxpayers understand their tax obligations and fulfill them. In addition, in some cases

they play a relevant role in large investment projects of multinational companies, so a fluent and stable relationship with them is of great importance to provide legal certainty to taxpayers and attract investments.

The cooperative relationships between tax administrations and fiscal advisors offer potential benefits to all parties involved and favor a better understanding by tax administrations of their work and their role in the economy.

The adoption of a cooperative relationship with fiscal advisors may bring about important improvements in the **risk management** of Tax administrations. Risk management has become an essential tool to detect risk taxpayers or behavior. Hence, the fiscal advisors themselves may provide information on behaviors or operations with fiscal risk, while the Administration will adapt its control actions taking into account the existence of taxpayer groups that are responsive to a relationship of trust and cooperation.

Likewise, it would be beneficial to the fiscal advisors to know certain criteria of the Administration's actions, for this will allow them to stand in a better position to give advice to companies.

The fiscal advisors, together with the tax advisory tasks, perform an important task as collaborators in the application of taxes. This brings about, among others, two relevant consequences: the adaptation to regulations changes in tax matters, which occur rapidly, and the obligation to assume the compliance with formal burdens implied in the fulfillment of tax obligations, for which they should be the first interlocutors in the process of preparing development rules and concrete measures associated with these changes.

Regarding indirect tax burdens, the Spanish tax system application model is based on an intensive use of information and new technologies. Notwithstanding the success of the model in terms of the implementation of a modern tax system apt to raise the necessary resources, the model implies a series of formal obligations that taxpayers must fulfill, with the resulting cost of physical and human resources. However, and within the environment created by the European regulation and the Government's directives, the AEAT is immersed in the process of rationalization of the formal obligations that fall upon taxpayers, but assuring in all cases the control of the adequate compliance with the fiscal rules. In this process, the group of fiscal advisors should not be kept aside, because to a large extent, and through the mechanisms of social cooperation, it is them who, in many cases, maintain a direct relationship with the Tax administration on behalf of third parties.

Finally, the aspect of the fight against aggressive tax planning should not be disregarded, to which the Tax administration should respond. The maintenance of a cooperative relationship between the tax administrations and the fiscal advisors will

allow the aggressive tax planning to be a less attractive option for taxpayers, and will reduce the demand thereof and, consequently, the offer of these products.

Therefore, within such frame, the Tax Agency has designed as one of its future projects in the short term the creation of a Forum of Fiscal Advisors, with the following guidelines:

- **Creation of a specific Forum of Fiscal Advisors** to discuss the main issues of interest in their relationship with the AEAT. A particular characteristic is the heterogeneity of the participants (small advisors and large advisory firms), so the Forum would function through Sections and Working Groups.

The territorial units will take part in this Forum by way of periodical meetings with fiscal advisors' associations of their territorial jurisdiction. At these meetings, the issues dealt with at the Forum will be informed and the territorial associations will be able to put issues for debate or make suggestions or comments on the issues discussed at the Forum.

- Among the **objectives of the Forum of Fiscal Advisors** is the pursuance of a better relationship between the AEAT and the fiscal advisors, and, specifically, an increased mutual knowledge between the parties, through the search of actions that facilitate the voluntary compliance of taxpayers and the transparency of the information, allowing for an improvement of the advisors' work as well as the facilitation of tax compliance. In addition, this Forum will make it possible to increase parties' interaction for the purposes of social collaboration tasks.

From its creation, two Sections were formed within the Forum having clearly differentiated tasks:

- o Section on specific or especially complex issues.
- o Section on operating issues.

On the one hand, as far as the work contents are concerned, the following proposals have been subject to consideration:

- Permanent information on issues discussed at the Forum of Large Companies, allowing for an interaction between both Forums, without duplication of Working Groups.
- Definition of the relationship frame between the AEAT and the fiscal advisors (regulation of responsibility, etc.).
- Analysis of formal tax obligations.
- Study and application of mechanisms for the communication of information and the registration of doubtful operations or operations performed exclusively for fiscal reasons.

- As for the **composition of the Forum of Fiscal Advisors**, it will be composed of as follows:
  - On behalf of the AEAT: members of the Tax Agency Directorate.
  - On behalf of the fiscal advisories:
    - The main fiscal advisory firms in Spain.
    - The remaining fiscal advisors, represented by business and professional associations:
  
- Despite the existence of meetings with the totality of the members of the National Forum of Fiscal Advisors, an important part of the work will be performed through the **Working Groups**. Each group will identify the problems and establish guidelines for the Groups' activities. The decisions will be made by the Plenary of the National Forum or, in the cases of delegation, by the relevant Working Group, in order to learn in more detail about the technical matters brought forth.