

# Some evidence for implementing an enhanced relationship in Slovenia

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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. This article examines an example of such efforts, based on a pilot project in Slovenia called Horizontal Monitoring. After two years of operation, the project has justified its existence and represents a solid basis for extension to a larger group of taxpayers.*

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

## 1 INTRODUCTION

The typical relationship between a tax administration and a taxpayer involves a taxpayer that completes tax returns and discloses the minimum amount of information needed to administer the required tax. However, 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 behavior (OECD, 2007). Because of the prevalence of aggressive tax planning, the OECD (2008) published a report focusing on the trilateral relationships among tax authorities, taxpayers, and tax intermediaries. It recommends creating a cooperative, trust-based relationship with 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; that is, an "enhanced relationship."

In addition, in 2009 the OECD published a report that focuses 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), and another study from the same year (OECD, 2009b) extends the coverage of a special relationship from large taxpayers and banks to professional associations and government bodies. Several tax administrations have thus recently started to launch special strategies and programs aimed at managing tax compliance, especially in relation to large taxpayers (important with respect to tax revenue).

In enhanced relationship programs, the tax administration's primary goal is to stimulate the taxpayer and tax intermediary to cooperate and increase voluntary tax compliance. A high level of tax enforcement does not always increase tax compliance. In contrast, there are tax systems with a low level of tax enforcement and, simultaneously, a low level of tax avoidance. The key question for any tax administration is thus how to balance out the use of tax enforcement with stimulation for voluntary tax compliance.

The OECD (2008) has identified three basic mechanisms applicable in the adoption of 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 they are 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 organizations, such as the European Commission (Fiscalis Risk Management Platform Group, 2010) and the Intra-European Organization of Tax Administrations (IOTA, 2012), the enhanced relationship programs are largely based on a series of studies devoted to tax avoidance and tax ethics.<sup>1</sup> The literature on enhanced relationships, especially research, has been very scant so far. One of the purposes of this article is therefore to present an overview of the implementation of enhanced relationships worldwide, with an emphasis on the case of Slovenia.

We also present and analyze an enhanced relationship pilot project that was implemented in 2010 in Slovenia called Horizontal Monitoring. Horizontal monitoring is an example of an enhanced relationship in line with the third mechanism of the OECD (2008) classification (given above). It was launched by the Tax Administration of the Republic of Slovenia (DURS) and includes eighteen of the largest Slovenian corporate taxpayers.<sup>2</sup> 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 taxpayer community. To support this idea, we introduce a survey among non-participating large taxpayers that was designed and conducted especially for this purpose. In accordance with the findings, we can conclude that the concept of an enhanced relationship is widely supported, although further promotion is needed for the mechanisms to become established in practice. A discussion of the initial implementation of an enhanced relationship and the analysis of non-participation in an enhanced relationship are thus two additional contributions from this article.

The article proceeds as follows. Section two provides an overview of the implementation of enhanced relationships around the world. Section three describes and discusses the elements involved in an introduction of an enhanced relationship in the case of Slovenia, where we focus on the agreement with taxpayers, implementation issues, and evaluation. Section four analyzes non-participation in the en-

<sup>1</sup> In addition to the economic factors, several other sociological and psychological factors determine the complex individual attitude toward taxes (Allingham and Sandmo, 1972; Torgler, 2003).

<sup>2</sup> In 2011, these eighteen taxpayers employed 20.1% of employees in large corporate taxpayers and 7.9% of all employees in Slovenia (AJPES, 2012).

hanced relationship process based on our survey. The final section concludes with the main findings.

## 2 OVERVIEW OF IMPLEMENTING AN ENHANCED RELATIONSHIP AROUND THE WORLD

Among the initiators of an enhanced relationship were the Netherlands, Ireland, and the UK. The Netherlands started an enhanced relationship program called Horizontal Monitoring in 2005, initially including twenty large corporate taxpayers.<sup>3</sup> The program represents an attempt by the Dutch Tax and Customs Administration (TCA) 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 TCA and participating taxpayers signed a non-binding agreement obliging taxpayers to notify the TCA 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 TCA assures tax certainty (OECD, 2007).

In 2007, the program was extended to medium- and small-sized companies, tax intermediaries (such as financial and tax advisors or accountants), and various professional trade and industry organizations. The next phase in the program introduces horizontal monitoring to software producers, in order to enable reliable reporting and monitoring in the entire chain from business transaction to tax return. The TCA emphasizes the importance of the attitude of participating taxpayers' top management to horizontal monitoring (the "tone-at-the-top" principle) because 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 a tax administration, it is essential for 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 (TCA, 2008). The Slovenian Horizontal Monitoring program, introduced in 2010, is based on the Dutch experience and is being implemented with support from the TCA.

Ireland introduced its enhanced relationship program, called the 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 program includes comprehensive supervision of all cases related to tax compliance issues. For this purpose, a special department has been established inside the tax administration. Each participating taxpayer is assigned to a particular employee of this unit in order to enable prompt reactions.

<sup>3</sup> 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; that is, a move towards more equal relationships, as a consequence of international and social development (TCA, 2008). The government included the recommendations in the Other Government (Andere Overheid) program. These principles were also a basis for TCA pilot projects for developing new forms of cooperation with taxpayers and tax intermediaries; one of these was Horizontal Monitoring in 2005.

The UK started its enhanced relationship program, called the High Risk Corporates Programme, in 2006 based on a unilateral approach; that is, 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 induce 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 the correct amount of tax from their transactions and profits as effectively as possible — if necessary, determining this through litigation (OECD, 2009c). 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 adopting it (OECD, 2010).

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

Among the OECD countries, Australia, Canada, New Zealand, and the U.S. have also introduced such programs (Stevens et al., 2012). For example, the Compliance Assurance Process (CAP) in the U.S. started in 2005 and represents a real-time, year-by-year audit program devoted to large companies. The seventy-three taxpayers participating at the time of its introduction turned into 160 participants by 2012. The program starts at the beginning of a taxpayer's financial year and finishes after its tax return is submitted. The taxpayer discloses all transactions and connected tax positions in real time, and any open issues are resolved with the tax administration before the tax return is completed (OECD, 2007; IRS, 2012).

However, there are several theoretical and practical concerns related to the enhanced relationship, deriving from constitutional (legal) and practicability issues (Burton and Dabner, 2008; Druen, 2012; Stevens et al., 2012), such as conflicts of interest or unequal treatment of taxpayers. Freedman et al. (2012) found that the enhanced relationship program overall has been successful in achieving some aims (such as better allocation of resources within the tax authority), but not others (such as moderating the tax planning of certain types of corporate taxpayers). In a similar way, Burton and Dabner's (2012) analysis of enhanced relationships in Australia, New Zealand, and the UK summarizes the difficulties in implementing the enhanced relationship as ideological tensions, legislative constraints, institutional and internal constraints, and international pressures.

### 3 THE ENHANCED RELATIONSHIP IN SLOVENIA: THE HORIZONTAL MONITORING PROCESS

In Slovenia, an enhanced relationship project started in 2010 under the title Horizontal Monitoring as a consequence of establishing the DURS strategic business plan for 2010-2013 (DURS, 2010). It became obvious while preparing the strategic business plan that a small tax administration with limited resources needs an alternative approach to the standard vertical relationship with taxpayers and tax intermediaries, especially in the context of the 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 (DURS, 2010). Its implementation requires the services of DURS to be provided in such a way that (Šinkovec, 2012a): (1) procedures are simplified for taxpayers that are willing to comply, (2) all necessary assistance is given to taxpayers that strive for compliance but are not always successful, (3) taxpayers that 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.

In addition to the new business strategy, the initiation of the horizontal monitoring project was based on a series of studies and guidelines of relevant international organizations, such as the IOTA mentioned above, the EC/Fiscalis Risk Management Platform Group, and the OECD, as well as some domestic analyses (Filipović, 2009; Centa-Debeljak, 2010). These analyses 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 TCA actively cooperated through the transfer of experience and know-how, resulting in many similarities between the Slovenian and Dutch enhanced relationship processes.

#### 3.1 AGREEMENT WITH TAXPAYERS

In March 2010, the first public presentation of horizontal monitoring was organized in cooperation with the TCA, followed by a public call to all large corporate taxpayers<sup>4</sup> that had already established a system of internal tax control (Centa-Debeljak, 2011) to join the pilot project in May 2010. At this stage, organizations 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 because they are typically low-risk taxpayers with a series of external advisors that also indirectly become part of this process. In this

<sup>4</sup> 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 entire amount of corporate income tax collected, 54% of revenue generated, and involving 40% of all employees (Šinkovec, 2012b).

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, eighteen responded and were included in the pilot project of horizontal monitoring.<sup>5</sup> Table 1 presents the structure by industry of large corporate taxpayers in Slovenia in 2010.

**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 took place between the top management of those taxpayers and the management of the tax administration, where details of the project were presented. From the very beginning, the project was based on the following grounds: (1) taxpayers joined the program with the expectation that horizontal monitoring would increase tax certainty, which is required for everyday business; (2) the tax administration made it clear from the outset that during the program it would not perform tax advising in the sense of optimizing tax liabilities; and (3) 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 thereby committed themselves to informing the tax administration about 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 administration.<sup>6</sup> However, the Horizontal Monitoring pilot project may lead to potential amendments to the tax regulation, enabling the project's permanent implementation.

<sup>5</sup>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 Slovenia (AJPEŠ, 2012). Of the eighteen large corporate taxpayers that responded to the public call, thirteen 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).

<sup>6</sup>During the Horizontal Monitoring project, the tax administration performs all of its ordinary services, such as supervision procedures or interpretation of tax legislation. 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.

Compared to tax audits, which are retrospective in nature and concentrate on irregularities in tax returns already submitted, Horizontal Monitoring focuses on the present and future operations of taxpayers and their interactions with the tax administration. 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, permanent establishments, and offshore activities. They encounter constant amendments to legislation, which they need to 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 DURS represent a great burden on taxpayers that are generally willing to voluntarily comply with tax regulations.

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 the horizontal monitoring process so far, the advantages that taxpayers perceive in the enhanced relationship are: (1) a reduction of time-consuming components of tax compliance, (2) updated and improved knowledge, and (3) greater tax certainty. Taxpayers expect better responsiveness from DURS 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 preparing proposed amendments to legislation and would like to play an active role in formulating tax standards and legal bases.

### 3.2 IMPLEMENTATION ISSUES OF HORIZONTAL MONITORING

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



Finance and insurance institutions were selected as the first target group based on the studies of international organizations already mentioned because 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 DURS analysis for tax audits in banks from 2005 onwards (Centa-Debeljak, 2010), where a relatively low number of tax irregularities emerged in comparison to other industries. 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, and residency status), and the third group includes the remaining large corporate taxpayers, including Mercator,<sup>7</sup> 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 continue to 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 assessing personal income tax, implemented audit procedures and controls), data from other supervisory authorities, publicly available data about the taxpayer (i.e. from annual reports, newspaper articles, websites), and data submitted by the taxpayer itself. This last element is particularly important because in the cooperation agreement the taxpayer accepts the responsibility to inform the tax administration about all potential tax risk activities substantially and in a timely manner. The taxpayer's profile is used by the working group's members to define the critical segments of the taxpayer's activities that their attention should focus on.

Equipped with the taxpayer's profile, the working group organizes an introductory interview in order to establish personal contact with the taxpayer's representatives and obtain additional internal data on business details, strategic goals, and existing

<sup>7</sup>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 DURS to take part in the Horizontal Monitoring pilot project. 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 value-added tax accounting. In addition, DURS responded instantly and professionally to questions submitted by the company, and thus contributed to mitigating tax risks regarding major business decisions. For 2012, an audit of internal controls is planned in personal taxes and corporate income tax (Mercator, 2012).

external and internal control mechanisms so as to further extend its profile. Based on the TCA 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 compliance with 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, 2012b). Discussions about the internal tax control framework seek to determine how the taxpayer administers its tax risks. Here the condition that the tax administration set out in the first public call becomes relevant, that is, that taxpayers must already have an appropriate internal tax control framework in place. It turns out that companies that are subsidiaries of multinational corporations generally have a professional approach to tax policy. Several multinationals have introduced codes of conduct and demanded that all members of the group (including Slovenian subsidiaries) comply with specific standards and models (COSO, the Sarbanes-Oxley Act, and the Savings Law). The information system represents the technical basis and as such plays an important role in exercising tax functions within a taxpayer. Emphasis is thus placed on controlling mechanisms of the information system such as level of risk regarding data loss or accessibility of the information system.

In the introductory interview, the organization of tax functions is also presented. It may be organized in many different ways, depending on the taxpayer's size and the complexity of its tax obligations, and is usually implemented in several organizational units (accounting, HRM, or sales). 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 recognized and controlled for. It is thus important to find out how tax returns for different taxes are completed.

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, or 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 program.

The analysis of a taxpayer's internal tax controls is the most important step in the horizontal monitoring process because its key principle is that the tax administration will rely to the greatest extent possible on the internal tax controls established by the taxpayer. It includes the examination and testing of tax control mechanisms

already established 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 various internal controls in the company (including tax controls), (2) how the company examines implementation of the internal control procedures, (3) the level of cooperation among internal “controllers”, i.e. the tax specialist, the accountant, and the internal auditor, (4) the approach to tax risks (how often the company discusses them), (5) the relationship between tax compliance and ethics (tax morality), and (6) 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 internal control mechanisms for sales and purchase of goods and services (resulting in output and input VAT), verification of 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 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 irregularities and deficiencies 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 implementing horizontal monitoring is the ongoing process of the continuous monitoring of a taxpayer, based on the taxpayer’s profile already established and updated, and on 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 monitor its processes, the less intensive the tax administration’s activity.

In line with these steps, the tax administration provides tax certainty to the participating companies because the cooperation agreement obligates the tax administration to respond promptly to every question regarding current legislation. From 1 January 2011 to 30 September 2012, DURS provided 131 answers to the eighteen participating taxpayers, with the majority referring to 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 organized to promptly review and assess phases of the project already performed.

**TABLE 2**

*Answers provided by DURS to 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 of team requirements for successfully engaging taxpayers within enhanced relationship programs (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 DURS has made its best efforts to achieve this 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 these working groups. In so doing, the tax administration increased its ability to understand the given business, the major characteristics of the taxpayer's industry, and its risk appetites. However, the need for additional knowledge and experience, which mainly refers to particular features 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 that, if disagreements arise as a result of voluntarily disclosed information in the course of the program, 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 is in line with the tax authority's understanding of the underlying tax regulations. Because enhanced communication is an important tool for reducing potential uncer-

tainties and misunderstandings of the tax duties imposed, the program is believed to have been successful in these respects, although the results are difficult to measure.

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 DURS in the course of the pilot project reflect a mutual readiness for open discussions, a higher level of mutual trust, and to some extent an influence on drafting amendments to the existing tax regulations. The last requirement on the OECD (2007) list is responsiveness. Notwithstanding its limited resources, DURS is taking important steps to improve its promptness and efficiency, as well as the professional level of its operations during the program, partially due to the incorporation of the experiences of other European tax authorities and a 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 ended, and the eighteen 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 TCA with implementing the enhanced relationship, the survey was addressed to the senior management of a company, and this was verified in the questionnaire<sup>8</sup> with a question on the position in the company of the actual respondent to the survey. Due to questions on willingness to fulfill tax liabilities and to cooperate with the tax administration, the anonymity of the respondent was ensured by a return envelope being enclosed.

In order to minimize the costs of the survey, 20% of the non-participating large corporate taxpayers were randomly selected, resulting in a sample of 140 large corporate taxpayers<sup>9</sup> to whom the questionnaires were sent. Out of 140 companies, fifty-one responded, with a response rate of 36.4% and covering 7.3% of all non-participating large corporate taxpayers in Slovenia. Table 3 presents the structure of the sample of non-participating large corporate taxpayers by industry. The information on the industry of a large corporate taxpayer that responded to the survey was gathered by introducing a corresponding question in the survey questionnaire.

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

<sup>9</sup>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 Slovenia (AJPES, 2012).

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.*

The 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), and 41.2% were from the lower positions (assistant director, director of finance and accounting, CFO, administration assistant, accounting manager, head of auditing, tax specialist, or accountant). We can thus observe that many CEOs still transferred the questionnaire to subordinates that cover tax in their companies, at least in the non-participating large corporate taxpayers. There is probably still room (and need) for awareness-raising in Slovenian companies with respect to horizontal monitoring, although this could also be a sign of senior management's trust in its subordinates.

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

Regardless of whether the company was familiar with the pilot project, the process of horizontal monitoring in Slovenia was then briefly presented. 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 the main reasons for doing so as: (1) tax certainty (26 respondents), (2) support of the tax administration in introducing internal tax controls (22 respondents), and (3) reduced likelihood of tax inspections (16 respondents). The seven

respondents that would not like to participate in the project justified their response with: (1) distrust of DURS (three respondents), (2) possible costs related to introducing 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 about the importance of internal tax controls. Some 35.3% of respondents found them important and stated that they are already established in their companies, and another 41.2% thought that internal tax controls are important and would like to receive support from DURS in order to establish them. Moreover, an additional 11.8% of non-participating large corporate taxpayers deemed 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 by the tax authorities with respect to horizontal monitoring. Alongside more and better-targeted promotion of the project in the future, DURS should probably place more emphasis on the particular benefits of participating in horizontal monitoring, with demonstrations of existing good practices in Slovenia.<sup>10</sup>

## 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 it 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 the cooperation of the TCA, in 2010 DURS launched 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, horizontal monitoring has proved to be successful. Based on experience and evidence to date, taxpayers are showing greater willingness to cooperate with DURS and disclose their operations related to tax risks. They benefit from greater tax certainty through prompt and regular two-way communication with DURS. Both parties thus benefit from experience and mutually recognized know-how because the project has already induced additional training of employees in charge

<sup>10</sup> The outlook is nevertheless encouraging because DURS has been receiving many inquiries, especially in 2012, from companies for inclusion in the project (Šinkovec, 2012c).



of individual tax procedures. DURS 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 TCA. In addition, the results of the project have already enabled improvement of the system of internal tax controls for some participating taxpayers. In the long term, DURS expects to spend fewer resources supervising taxpayers, and thus be able to direct resources to other areas of its work.

Nonetheless, the project has also revealed some shortcomings. The greatest challenge for the participating taxpayers is the implementation of internal tax controls, because this is a time-consuming and expensive process. Some participating taxpayers might also understand horizontal monitoring as a free “tax optimization service” provided by DURS, 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 have 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 DURS should improve promotion of the project in the future, and place more emphasis on particular benefits of participating in horizontal monitoring.

The key elements of the pilot project – transparency, trust, and understanding – have nevertheless been fulfilled, and the project represents the right direction for further development of DURS. Because the final phase of the incipient implementation of enhanced relationship has passed (December 2012), the tax administration must 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 the large-scale introduction of horizontal monitoring, and even amended legislation cannot cover all taxpayers, although it could definitely include additional groups of suitable and motivated companies. Based on existing Slovenian experience and following the TCA approach, serious long-term candidates include consulting and accounting companies. It is also planned that at the end of the pilot project DURS 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 increasing the international tax attractiveness of the country.



However, despite our best efforts to analyze and evaluate the process of horizontal monitoring, these conclusions are still based on mostly qualitative findings. The literature on the topic, especially research, has been very scant so far, and quantitative measurement of the project effectiveness is still lacking. This is nevertheless an issue related to horizontal monitoring in general (Stevens et al., 2012). This article is thus only an attempt to narrow the gap between ongoing practical implementation and research on horizontal monitoring, and 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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