

# Cooperation in Voluntary Tax Compliance and International Compliance Assurance Programme (ICAP)

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## Abstract

The problem of taxpayers' tax compliance has existed since taxes first appeared on the historical stage. Tax compliance, which can be expressed in the most general sense as the fulfillment of taxpayers' obligations, is an important factor that should be evaluated in the background of tax losses and evasion. Since almost all states rely heavily on taxes as a source of public revenue, they have consistently sought to find measures to guarantee this compliance. Studies that focus at the responses of taxpayers to taxes and research into the underlying causes of tax incompatibility in this context. Based on this research, the concept of taxpayers' voluntary compliance has recently gained attention as a means of assuring tax compliance. It may be claimed that the International Compliance Assurance Programme (ICAP) developed by the Organization for Economic Cooperation and Development (OECD) is one of the most recent among several concepts and strategies to secure voluntary compliance. ICAP was developed utilising experience gained from "cooperative compliance" programs that have been in place for a while in some countries, focusing on the increase of cooperation between the taxpayer and the tax administration to ensure taxpayers' voluntary compliance with taxes. On the other hand, it represents the first effort and varies from the aforementioned domestic practices in that it brings compliance and cooperation to the international scale. In this respect, examining the background and current practice of ICAP, which is still in the pilot stage, together with its theoretical background is of great importance in terms of evaluating the future of the concept of cooperative compliance and making predictions about its development in the international arena.

**Keywords:** tax compliance, cooperative compliance, tax evasion, tax avoidance

**JEL Classification** K34, H26, K33

## 1. Introduction

Although taxes, which are perhaps the most important source of revenue for states, are collected for the financing of public expenditures, in other words, for the provision of public services, they are not embraced by all taxpayers. In almost all countries, the taxation relationship symbolizes the taxpayers' "obligation" to pay taxes and is a reflection of the state's ability to impose penalties. Taxes that are imposed as a duty, by laws and under force are collected in a relationship where not every taxpayer is voluntarily involved in this regard, and it is even seen that taxpayers sometimes resort to various alternative ways to avoid paying taxes.

Taxpayers' reactions to taxes and their underlying attitudes are not always in accordance with the law; sometimes, illegal responses may also be given. Taxpayers' responses, both legal and illegal, demonstrate their desire to reduce their tax liability as much as feasible. Instead, the government seeks to maximize its tax revenues or, at the very least, to generate income consistent with its taxing authority. By focusing on how to assure taxpayers' compliance with taxes, this type of disagreement has given rise to the idea of developing a solution proposal.

With the development of these ideas, it is clear that two different types of measures have been

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taken to guarantee taxpayer compliance. The first category of measures is taken to raise the costs associated with taxpayers' reactions regarding non-compliance. Measures like the legal provisions relating to tax penalties and adjustments in instances of some tax avoidance or aggressive tax planning are addressed in this context. Instead of eliminating taxpayers' tax non-compliance, the second category of measures focuses on assuring tax compliance. In this regard, positive steps are taken by the state. Instead of eliminating taxpayers' tax non-compliance, the second category of measures focuses on assuring tax compliance. The state has made a good decision in this regard. It is evident that certain countries have implemented strategies that emphasize communication and trust over time in order to establish a positive relationship between taxpayers and tax administrations that would guarantee tax compliance. As a result of the OECD's review of these practices, the notion of "enhanced relationship," which is based on collaboration between taxpayers and the administration, was later proposed. This concept, which serves as the forerunner of the concept of "cooperative compliance," was not only expanded upon subsequently, but also brought to a global scale with ICAP.

## 2. Literature Review

ICAP is a relatively new program that was formed in 2016-2017 and initially implemented as a pilot in 2018. There is relatively little research in the literature regarding this programme. Before mentioning these studies, it is vital to explain the literature on tax compliance, in order to better comprehend the context of the discussion.

In order to explain taxpayers' behaviour emerges as non-compliance, economists have relied on deterrence theories. Based on this, rational individuals are expected to abide by norms when the expected utility of compliance exceeds that of non-compliance and as a result, the likelihood and severity of sanctions and punishments for deviants are crucial elements to explain the levels of norm conformity that have been observed (Noguera, et al. 2014: 765). The main proponent of this theory was Becker (1968). In his study titled "Crime and Punishment: An Economic Approach," the author analyzes the impact of punishment on the decrease of crime rates from an economic point of view and claims that it can be modified to assure tax compliance. According to Becker (1968: 180), if the only purpose were deterrence, the probability of conviction could be boosted and penalties could be increased beyond what would be gained, which would allow the number of offenses to be almost arbitrarily decreased. In parallel with this, taxpayers are viewed as being reasonable in Allingham and Sandmo's (1972) analysis. According to them; the tax rates themselves, the penalty rates, and the total expenditure on investigations, which determines the possibility of being caught, are the policy measures at the government's disposal to combat the tendency to evade taxes (Allingham & Sandmo, 1972: 338). Srinivasan (1973) also adopted a similar approach.

It should be emphasized that throughout time, this approach has been criticized for not taking into account the social behavior aspect of tax compliance. Within this context, recent research instead focuses on topics such as taxpayers' tax morale (their tolerance for tax fraud), social norms, the consequences of social interaction, ethical principles, perceptions of justice, tax system knowledge, or attitudes toward government and public expenditures (Noguera et al. 2014: 766). For instance, Torgler (2007: 205) argues that social and institutional factors systematically such as the moral constraint matter in tax compliance. Wenzel's study (2002: 640) discovered, among other factors, that when taxpayers believe that tax officials are treating them fairly and with respect, they are more likely to comply with the law. Similar with this, Murphy (2004: 203-204) highlighted that taxpayers' willingness to comply can be impacted by a decline in trust, and it may even inspire outright hostility towards a regulating authority. Further, some authors (Taylor, 2003; Wenzel, 2005) contend that spreading social norms at a collective level will encourage voluntary tax compliance (Kirchler et al., 2008: 218).

These studies had an impact on the OECD, which in 2008 created the idea of "improved relationship" in an effort to boost tax compliance (OECD, 2008). This study promoted the development of a reliable and cooperative interaction between taxpayers and revenue authorities. This concept was replaced with "cooperative compliance" in with the OECD's study dated 2013, claiming to be a more accurate expression. In this period, the concept of "cooperative compliance" has been discussed in the literature specifically for the countries that have implemented programs for this purpose. Within this regard, Bronżewska (2016) and addressed the topic broadly, while Huiskers-Stoop and Gribnau (2019) focused on the Netherlands and Björklund Larsen (2016) examined Sweden specifically. On the other hand, De Widt and Oats (2017) compared practices in the UK and the Netherlands.

Since ICAP, which reflects the application of the concept of "cooperative compliance" in the international arena, is a relatively new practice, there are not many studies on this subject in the literature. In this context, research on ICAP includes Hein and Russo (2020), Majdanska (2021), Marcovici and Noked (2021) and Martini and Russo (2019 and 2021) as studies which consider ICAP in a broader context. On the other hand, ICAP has been looked at in certain studies in terms of nations. Within this regard, Christians and Diniz (2020) focused on Canada's experience with ICAP, while Martini (2022) studied the Brazilian approach.

### **3. ICAP As A Cooperative Compliance Programme in the International Arena**

ICAP, which was developed after domestic applications on cooperative compliance were evaluated with the goal of fostering trust and collaboration between the administration and the taxpayer to ensure tax compliance—which is crucial for the states—was not implemented immediately, although it was considered for a long time.

When the OECD first proposed the concept of "cooperative compliance" in 2013, it was stressed that this concept should also be developed on an international level. This is due to the increased possibility of aggressive tax planning and other actions that result in tax non-compliance in an increasingly globalized society. Particularly, the accessibility to mobility and tax expertise by MNE firms encourages certain taxpayers to develop a wide range of tax avoidance strategies by exploiting weak monitoring and harmonization in the global setting.

In addition to the fact that the risk of tax avoidance is high in the international arena, the idea of cooperative compliance is thought to be preferable in this field as a logical requirement. Since there is not an international supreme authority with the capacity to impose sanctions and is accepted by all nations, and since it is clear that each country has taxation sovereignty, there will inevitably be variations in tax systems. It would be beneficial to try to find a solution in cooperation and communication with taxpayers in addition to preventing the abuse of this circumstance. In the absence of an absolute authority, it is highly advantageous to improve contact with taxpayers to guarantee tax compliance. In order to foster trust and cooperation between MNE groups and member countries of the OECD's Forum on Tax Administration (FTA), ICAP was established with these objectives in mind. It is important to evaluate the two ICAP pilot implementations in this context.

#### **3.1 ICAP Pilots: ICAP 1.0 and 2.0**

ICAP comprises assessing how tax administrations from other countries would approach these risks and exchanging ideas in an effort to give taxpayers tax certainty against some tax risks on a voluntary basis. Within this framework, only FTA member countries and MNE groups established or operating in these countries can participate in the programme. In this process, MNE groups themselves submit specific documents with tax administrations, such as Country-by-country reports (CbCR) or master files, and the administrations review them. As a result, the taxpayer is given some level of the assurance that the tax risks under consideration constitute low risk.

As mentioned above, ICAP was not applied for a long time, although the idea of an international cooperative compliance model was suggested in 2013. The long-developed concept was only put into practice as a pilot in 2018. Eight FTA member countries and MNE groups that were already established in those countries voluntarily participated in this pilot (Kim, 2020: 14). In this first application, it is decided to examine transfer pricing and permanent establishment (PE) risks in general. Administrations and MNE groups joined together in this framework, tax administrations acquired about one another's methods, and it became clear that MNE groups could also reduce the risk of double taxation and obtain some assurance of tax certainty. In response to the favorable feedbacks, ICAP 2.0 took place in 2019.

Seventeen FTA member countries and more MNE groups took part in the second pilot, entitled ICAP 2.0. The first application's success and the good attitudes about the programme also contributed to an increase in participants. There are various differences from the second pilot to the first pilot. First of all, the number of stages involved in the application has been reduced, and a substantially larger range of tax risk is addressed, including hybrid mismatch arrangements rather than just transfer pricing and PE.

### **3.2 Analysis of the Two ICAP Pilots**

As a pre-audit "multilateral cooperative risk assessment and assurance method" that aims to give MNEs "greater tax certainty" over a portion of their operations and transactions (Kim, 2020: 17), ICAP is a promising initiative. Both countries and MNE groups widely anticipated the presence of both pilots. With regard to this, there are currently twenty-two states that join to ICAP. The MNE groups' positive attitude toward the initiative has also been based on giving taxpayers such a level of certainty, and the ability of tax administrations to comprehend the complex corporate structures of enormously large firms like Shell has also been helpful to these taxpayers.

It may be possible to lower the risk of tax audits and hence decrease administrative costs if such communication and cooperation are accomplished before tax audit has even begun. In addition, another positive outcome is that the ICAP process is relatively shorter than tax audits and also other bilateral applications such as the Mutual Agreement Procedure (MAP) or Advanced Pricing Arrangements (APA), which are based on the consent of the tax administration and the taxpayers. Similarly, ICAP covers a wider range of tax risks than other applications such as MAP or APA (Kim, 2020: 19). Similar to tax risks, ICAP differs from other applications due to the large number of tax administrations as participants. ICAP is a multilateral practice, in contrast to other international dispute resolution procedures, which are often bilateral. ICAP is considered as a wider process as a result of this.

### **5. Conclusion**

Throughout history, efforts to ensure tax compliance have progressed beyond the notion of punishing non-compliance and have given rise to the idea of creating a conducive atmosphere of communication and trust to ensure compliance. The social and psychological aspects of the problem have also been looked into in response to criticism that economic approaches to understanding how taxpayers react to taxes fall short of reality. In this context, the idea of cooperative compliance for promoting cooperation between taxpayers and the administration and domestic practices that concentrate on it have emerged.

The OECD, which focuses on tax compliance and the concept of tax certainty, has carefully considered these country practices, stressed that these experiences can be useful, and even stressed the need to build an international practice for the idea of cooperative compliance. In order to combat aggressive tax planning strategies used by MNE groups, which have greater international mobility and can easily transfer their profits to jurisdictions with no or low taxes, the OECD has argued that an example of cooperative compliance applied internationally can produce positive

results.

Based on these motives, the aforementioned desire, which was revealed in 2013, could only be realized in 2018 with ICAP. ICAP, which created a voluntary compliance program that progressed in two pilot programs in 2018 and 2019, is an application where FTA member countries and MNE groups operating in these countries can come together to discuss certain tax risks and provide some assurance to the MNE group if these risks pose a low risk. With this practice, certain risks can be eliminated before a dispute arises, thus reducing administrative costs and establishing a good taxpayer-administration relationship. Thus, ICAP becomes a powerful component for tax administrations when they meet with other administrations to share ideas about similar taxpayers, observe other administrations' approaches, and get in touch with the taxpayer. On the other hand, ICAP does not create additional burden for taxpayers, since it covers documents already issued to countries such as CbCR or master file. Moreover, it offers a unique environment where they can directly come together with multiple tax administrations to explain complex structures.

The fact that more countries joined the program between and after the two pilots and the positive outputs from the MNE groups together with the positive outputs show that ICAP is extremely promising for enhancing tax compliance, which is highly challenging to achieve in an international environment where governments are sovereign equals and there is a form of tax competition, and on the other hand, taxpayers have great opportunities for tax avoidance. In this way, cooperation, communication, trust and working together will be realized in order to ensure tax compliance of taxpayers.

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