1.6. Outline of this study

Chapter 2 of this study focuses on the first sub-question. Chapter 2 provides a description of the background of this study, i.e. international cooperation in general, and intra-Community tax auditing in particular. First of all, I shall explain the laws and regulations that provide the legal basis for international cooperation. In this chapter, I also describe the way in which the concept of tax auditing was introduced in international cooperation, and what international and intra-Community tax audits should be understood to mean.

Chapter 3 elucidates the legal basis of tax auditing (sub-question 2). What is the notion of tax auditing to be understood to mean? What does it imply? What is the legal basis for conducting tax audits? In this chapter, the concept of "legal framework for tax auditing" will be described in more detail (sub-question 3). This more precise delineation and definition is necessary to be able to compare tax auditing practices in the various Member States. Here, stock is taken and an analysis is made of the laws and regulations, and the general competences of tax administrations will be discussed. With respect to taxpayers, I shall make a distinction between their obligations with respect to their own tax liability and to the liability of third parties. Chapter 3 will also discuss the restrictions which I was forced to observe in this study.

Chapter 4 makes the basic comparison between the legal frameworks for tax auditing of the 27 EU Member States. It will briefly discuss the characteristic elements of the procedural laws and regulations of each of the Member States. At this stage this evaluation will extend to two levels: similarities and differences between Member States will be charted and summarized in tables on the basis of Yes/No questions (analysis 1), and similarities and differences between Member States will be classified and each class will be elucidated separately (analysis 2). This chapter, thus, deals with sub-question 4 of this study.

After the analyses of levels 1 and 2, I want to provide insight into, and enhance the knowledge of the legal framework for tax auditing in the EU Member States. This will answer objective 1 of this study.

Next, in Chapter 5, I shall investigate whether any patterns can be distinguished (analysis of level 3) in order to establish the influence of the differences on the international cooperation during a tax audit, using testing criteria. This investigation of patterns will be made for each

research area that has emerged from the delineation and definition of the concept of "legal framework for tax auditing". This part thus covers sub-question 5. Following the conclusions of Chapter 5, I shall make some recommendations in Chapter 6; on the basis of the differences between the various jurisdictions some considerations will be presented as a starting point for harmonizing the legal frameworks for tax auditing, and thus for improving administrative cooperation. Finally, Chapter 7 summarizes this study.

1.7. Summary

This chapter has presented the reasons, the purpose and the structure of this comparative study. I have discussed the method of comparative law I have used for making comparisons. Moreover, this chapter has explained the methodology followed, as well as the structure of the study.

The purpose of this study is to provide comparative insight into the tax auditing competences of tax administrations, as well as into the rights and obligations of taxpayers during a tax audit in all Member States of the European Union. This requires elucidation of the legal rules concerned of all 27 Member States as they are provided by the laws and regulations governing tax auditing in the entire European Union, because international cooperation in tax auditing may be carried out between any conceivable combination of the 27 EU Member States.

The comparative study is made against the background of the necessity to conduct cross-border tax audits jointly. It appears that to be effective, a comparison of rules of law should be made using the *functional method* of comparative law. This comparative study will comprise an empirical part that investigates the laws and regulations of the EU Member States governing the conduct of a tax audit, and a supplementary part that studies the influence of differences in these laws and regulations on international cooperation.

Finally, this chapter has described the criteria for testing the differences in procedural laws and regulations, notably: effectiveness, efficiency, legal protection and materiality.

Chapter 2

European Cooperation

2.1. Introduction

The process of economic integration within the European Union has progressed steadily. The creation of a common market contributed substantially to this process. This common or internal market[73] is characterized by free movement of goods, services, persons and capital.[74] The introduction of the euro, as well as new digital techniques decidedly influenced this process, and it is expected that these factors will only accelerate the integration. As a consequence of these developments, the European market has become more accessible to an increasing group of companies. For example, the use of the internet in international trading offers major advantages to companies and, from an international perspective, results in shortening the distance from producer to consumer.[75] The internet, too, indisputably influences the customary flows of money and goods.

All these changes will obviously have consequences for the operations of tax administrations which are confronted by the challenge of ensuring that companies comply with their fiscal obligations in each of the countries in which they are active. Induced by international developments, cooperation between tax administrations seems inevitable. A number of factors contribute to this trend. As business becomes global, it transcends national borders. Companies establish residency in whichever country is preferred. As a result of this globalization, multinational companies grow and capital markets integrate, creating a need for harmonization of laws and regulations. The international accounting scandals have been another factor.[76] These events

73. In the Single European Act, Official Journal EC of 29 June 1987, No. L 169, which came into force in July 1987, to the concept of the common market in the Treaty of Rome has been added the concept of the "internal market". This concept is defined as follows: The internal market of the European Union is a single market in which the free movement of goods, services, capital and persons is ensured and in which European citizens are free to live, work, study and do business.
74. Art. 2 of the Treaty establishing the European Economic Community (1957).
75. Council Directive 2002/38/EC of 7 May 2002 amending and amending temporarily Directive 77/388/EEC of 7 May 2002 (Official Journal of the European Communities of 15 May 2002).
76. It is still uncertain what the impact of the global credit crisis will be. But without any doubt this, too, will lead to new laws and regulation.

have undermined public confidence in the management of companies, as well as in public (i.e. private sector) auditors, and have caused an increase in laws and regulations in the field of corporate governance and financial reporting (IFRS).[77] In addition, the attention paid to the fiscal aspects of risk management of companies intensifies, as is apparent from, amongst other things, specific legislation in this area.[78] As a consequence, companies and governmental regulators including tax authorities, seek to achieve an "enhanced relationship".[79] A final factor prompting the necessity of intergovernmental cooperation is the fight against fraud, such as laundering money and carrousel fraud. Fraudsters are not inhibited by national borders; to the contrary, they try to turn them to their advantage. Cooperation between tax administrations is called for in order to combat fraud effectively and efficiently.

For the purpose of enforcing the law tax, administrations need fiscally relevant data on and from taxpayers, including those who operate internationally. Increasing internationalization of business compels them to intensify the exchange of information and to extend their cooperation in the field of tax auditing. Thus, this chapter focuses upon the first sub-question: "How did (substantive) cooperation in the field of intra-Community tax audits evolve within the European Union?" Substantive cooperation I understand to mean cooperation in which two or more tax administrations

77 An example is the US Sarbanes-Oxley Act (2002, which imposes strict requirements on corporate governance of companies listed at any stock exchange in the United States of America. (Pub.L.107–204, 116 Stat. 745, enacted 2002–07–30, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 and commonly called SOX or Sarbox).See http://www.sarbanes-oxley.com/.
From 2005 onwards, all companies listed at a stock exchange in the European Union are required to apply the International Financial Reporting Standards (IFRS) when preparing their consolidated annual accounts. In addition, non-listed Dutch companies are permitted to opt for applying these standards. (Regulation (EC) 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards).

78. Examples are the specific guidelines for financial reporting in the International Accounting Standards (IAS 12) (http://www.iasb.org/Home.htm) and the code Tabaksblatt (Dutch) (Para. III.5.4.e.). (http://www.commissiecorporategovernance.nl).

79. "Revenue bodies can achieve a more effective and efficient relationship in their dealings with taxpayers and tax intermediaries if their actions are based upon the following attributes (understanding based on commercial awareness, impartiality, proportionality, openness and responsiveness). If revenue bodies demonstrate these five attributes and have effective risk-management processes in place, large corporate taxpayers would be more likely to engage in a relationship with revenue bodies based on co-operation and trust, what is described in the report as an *enhanced relationship*."
Fourth meeting of the OECD Forum on Tax Administration, *Cape Town Communiqué*, 10–11 January, 2008 (OECD), Centre for Tax Policy and Administration, p. 3.

carry out intra-Community tax audits as if they were one "national" tax administration operating under unambiguous rules and concepts.

2.2. The internal market and taxation

The (economic) cooperation within the European Union rests on the creation of a single, internal market.[80] Art. 3 of the Treaty establishing the European Economic Community, the precursor of the Treaty on European Union, states a number of activities in the field of taxation that should contribute to the realization of that internal market.[81] Art. 3 provides, amongst other things:

(1) For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein:
   (a) the prohibition, as between Member States, of customs duties and quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect;
   (c) an internal market characterized by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital;
   (g) a system ensuring that competition in the internal market is not distorted;
   (h) the approximation of the laws of Member States to the extent required for the functioning of the common market.

The provision in sentence h of Art. 3 of the Treaty in particular is important to this study; bringing closer together national laws and regulations in the field of tax auditing may prove to be relevant to, or perhaps even necessary for effectively and efficiently executing an intra-Community tax audit (see Chapter 5).

The internal market can function properly only if it is shielded against inhibiting factors. A harmonization process, as well as prohibitive rules, provides such protection. In its Art. 90, the Treaty on establishing the European Union lays down a prohibition of fiscal discrimination: "No Member State shall impose, directly or indirectly, on the products of other

80. Art. 2 of the Treaty establishing the European Union.
81. Art. 3 of the Treaty establishing the European Union, Para. 1, sentences a, c, g and h.

Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products."[82]

Art. 93 of the same Treaty refers to harmonization of legislation in the field of indirect taxes: "to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market." Art. 94 lays the basis for harmonizing legislation in the field of direct taxation.[83] The Treaty, though, does not lay down any specific provisions concerning the harmonization of direct taxes.

With respect to indirect taxes, the differences between national systems had given rise to fiscal boundaries that hampered the free traffic. Harmonization had to ensure that (fiscal) borders could be eliminated. This was achieved with effect from 1 January 1993 when physical (customs) borders were abolished.[84] At the same date an EC Regulation on administrative cooperation in the field of indirect taxation came into force.[85] This cooperation is coordinated by a Standing Committee on Administrative Cooperation (SCAC) in the field of indirect taxation, consisting of representatives of Member States, and presided over by a representative of the European Commission.[86] In addition the Commission has implemented a wide array of measures in order to further harmonize indirect taxes. The duty of the SCAC is to permanently supervise developments in administrative cooperation.

In recent years "Brussels" has extended its attention to direct taxation. Harmonization of taxation systems had already been discussed within the European Union for years. Taking practical measures, however, appears to be arrested by all sorts of objections. Since 1990, the European Commission has been focused on eliminating obstacles that hamper the functioning of the internal market. Among these is "harmful tax competition" upon which the European Commission has expressed its concern that it will undermine the tax base and thus structurally reduce the tax yield through a so-called "race to the bottom". The EU's reaction has been to implement several

82. Treaty on establishing the European Union (EU Treaty), Part III, Title VI, Chapter 2.
83. To the extent the Treaty on establishing the European Union should not provide this competence, Art. 308 of the Treaty on establishing the European Union provides it for unforeseen matters.
84. Single European Act, Official Journal EC, 29 June 1987, L 169.
85. Council Regulation (EEC) 218/92 of 27 January 1992 on administrative cooperation in the field of indirect taxation (VAT.
86. Art. 10 of the Regulation (EEC) 218/92 of the Council of 27 January.

measures and to enact Directives that should eliminate impediments to cross-border cooperation and activities.[87] While these Directives have substantially mitigated the obstacles to cross-border activities, they fail to keep pace with the increasing integration of the internal market.[88]

Until now, internationally operating companies have had to pay corporate tax in accordance with the rules of each of the countries in which they are active. This causes companies to incur additional accounting costs. In December 2006 the European Union put forward proposals to consolidate company tax in order to arrive at a "Common Consolidated Corporate Tax Base (CCCTB)".[89] Proposals to this effect are being drawn up by a European working group in which both the European Commission and the 27 Member States are represented.[90] The advantages of a CCCTB include a reduction of the administrative burden and mitigation of the interfering effects of existing differences between national company tax systems.[91]

Another point of attention is the investment climate policy of Member States concerning internationally operating companies. In many countries this policy goes back to their fiscal climate. After years of talk, the Ecofin Council reached an agreement on a taxation package in its meeting of 3 June 2003 in Luxembourg.[92] This package consists of three parts: the Saving

87. Council Directive 90/434/EEC of 23 July 1990 on the Common System of Taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (Directive on mergers); Council Directive 90/435/EEC of 23 July 1990 on the Common System of Taxation applicable in the case of parent companies and subsidiaries of different Member States (Parent/Subsidiary Directive); Council Directive 69/335/EEC of 17 July 1969 concerning indirect taxes on the raising of capital; Convention 90/436 of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

88. Commission of the European Communities, 23 October 2001, Brussels, COM(2001) 582, final.

89. The term "Consolidated" refers to the fiscal profits of an entire company or group of companies, (thus including all its subsidiaries) being established according to an EU-wide taxable base for company profits still to be drafted. These consolidated profits are to be apportioned to the Member States concerned on the basis of a formula to be established. Each Member State can then apply its national company tax rate to the apportioned company profit. Companies operating in two or more Member States have to submit one company tax return only for all their establishments within the European Union.

90. Commission Service Document on CCCTB\WP\057.

91. Commission of the European Communities of May 2007 on Implementing the Community Programme for improved growth and employment and the enhanced competitiveness of European business, COM(2007) 223, final.

92. Report of the Eurogroup and the Ecofin Council of 2 and 3 June 2003 in Luxembourg (Letter of the Minister of Finance to the Speakers of the First and Second Chamber of the Parliament of the Netherlands, ref. BFB 2003/744 M).

Directive, a Code of Conduct and the Interest and Royalties Directive.[93] A major obstacle on the path to this agreement was the Savings Directive.[94]

The Member States could not agree on the system to be implemented with regard to the taxation of Member States on interest from savings: should it be a system for a levy at source or a system for the exchange of interest information. Ultimately, they decided on a system of automatic exchange of information on cross-border interest payments.[95] Three Member States, having banking confidentiality have been granted a transitional period of seven years during which they will levy a tax at source, and after which they, too, should have a system for the exchange of information in place.[96] The agreement reached on 3 June 2003 is a milestone in the history of taxation of Europe, as it marks progress towards harmonization in the area of direct taxation.

In order to adequately settle the tax matters of internationally operating taxpayers, Member States must exchange information. Such cooperation can be at various levels of intensity, one of the most far-reaching forms of cooperation being the simultaneous (multilateral) tax examination (multilateral tax control). The exchange of information takes place at the level of the "competent authorities", and is based on a network of treaties.[97] The customary concept of the exchange of information is bilateral and uses written requests and answers to requests between countries.[98] The next paragraph will discuss the legal basis of the international exchange of information.

93. Resolution of the Council and the representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation (OJ EC 1998, C/2/5, the purpose of which is to have Member States abstain from implementing beneficial tax provisions that are considered to be harmful for other Member States.
94. Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments.
95. Under the "Savings Interest Directive", with effect from 1 July 2005, EU Member States and their dependencies and associated territories are obliged to automatically exchange information on interest payments.
96. Belgium, Luxembourg and Austria, as well as some dependent and associated territories.
97. Competent authorities are centrally located officials and bodies that have been especially appointed by Member States for the purpose of mutual assistance in fiscal matters. They are appointed under the legislation of the individual Member State concerned.
98. A. Wisselink, "International exchange of information between European and other countries", *EC Tax Review*, 1997/2.

2.3. Legal basis of the international exchange of information[99]

Bilateral treaties

For decades, bilateral treaties for the prevention of double taxation have been concluded in order to enable international cooperation in the area of taxation. Generally, these treaties are based on the OECD Model Tax Convention which, however, does not lay down any binding prescriptions. It is as its name says, a model, that countries may depart from if they so wish.[100] To the Model Tax Convention a Commentary has been issued which also does not contain any binding provisions, and thus can only serve as a source of information, inspiration and interpretation.[101] A large proportion of the currently existing bilateral tax treaties include an article concerning exchange of information analogous to Art. 26 of the OECD Model Tax Convention.[102]

Art. 26 Exchange of information

(1) The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation there under is not contrary to the Convention. The exchange of information is not restricted by Arts. 1 and 2.[103]

(2) Any information received under Para. 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies)

99. Most international regulations use the term "exchange of information", which is understood to include the exchange of facts and data. I, therefore, have adapted this term with this meaning.
100. OECD Model Tax Convention on Income and on Capital of 1963, 1977 and 1992 (as amended in 1994, 1995, 1997, 2000, 2003 and 2008), formerly the OECD Model Tax Treaty.
101. C. van Raad, *Teksten International & EG Belastingrecht*, Kluwer, Deventer (2005/2006).
102. The phrasing in Dutch of Art. 27 of the standard treaty of the Netherlands is virtually the same as Art. 26 of the OECD Model Treaty.
103. Art. 26 of the OECD Model Treaty uses the term information. This term also include intelligence, facts and data.