Universidade do Minho

Escola de Direito

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Compliance and tax fraud - Risk management as a mechanism for collaboration between tax administration and taxpayers

abril de2022

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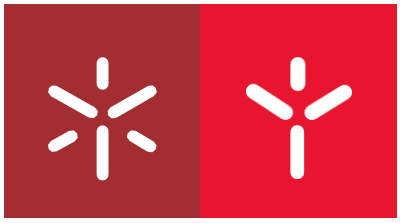
UMinho | 2022



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Compliance and tax fraud - Risk management as a mechanism for collaboration between tax administration and taxpayers

Master Dissertation
LL.M. in European and Transglobal Business Law

Work conducted under the guidance of
Professor PhD Andreia Isabel Dias Barbosa

abril 2022

ACKNOWLEDGMENTS

I always knew that a master's degree and thesis would not be so simple, but due to a sequence of events and facts, this journey became more difficult than expected. Fortunately, I have many to thank for helping me completing this phase.

I express my gratitude to my supervisor, Professor Dr. Andreia Isabel Dias Barbosa, who accepted guiding me in this project, and carried out the mission with patience and attention. Thank you for the careful guidance and dedication.

I would like to thank my parents Rosana and Wagner who ensured that I made it this far. Without their help this work would not exist. I also would like to thank my sister Bruna for all the emotional support. Even with an ocean away and many video calls, my family was able to support and love me. Thank you so much.

I also would like to thank my boyfriend Ricardo, who made this whole process much easier. The difficult days were always overcome thanks to his help. Thank you for always being my safe haven.

And thanks to all my friends who understood every time I said no to invitations and who always told me "you can do it".

Thanks to all of you mentioned here, I made it.

I dedicate this work to my grandmothers who gave me strength on this journey from other life plan, grandma Therezinha and grandma Gema, I hope you are proud.

STATEMENT OF INTEGRITY

I hereby declare having conducted this academic work with integrity. I confirm that I have not used plagiarism or any form of undue use of information or falsification of results along the process leading to its elaboration.

I further declare that I have fully acknowledged the Code of Ethical Conduct of the University of Minho.

Compliance and tax fraud - Risk management as a mechanism for collaboration between tax administration and taxpayers

RESUMO

São diversos os comportamentos fiscais abusivos, como a fraude fiscal, elisão fiscal e planeamento fiscal agressivo. Os casos de fraude fiscal são cada vez mais conhecidos e têm sido motivo de grande preocupação internacional - esse comportamento tributário abusivo é o principal para este trabalho, uma vez que suas práticas são consideradas crime e um grave problema para a economia de muitos países. Em um sistema tributário europeu quase inteiramente construído sobre sanções por fraude fiscal, uma nova estratégia começou a surgir: a prevenção por meio da gestão de riscos. A gestão de riscos assume várias formas, como governança corporativa, controle interno, *know your costumer* (KYC) e programas de compliance. Este trabalho concentra sua atenção em programas de compliance. Os programas de compliance surgiram da necessidade de combater a corrupção e foram desenvolvidos ao longo dos anos; adquiriram outras finalidades, ganharam diversas estruturas e profissionais competentes no assunto. A partir dessa evolução, percebeu-se a utilidade dos programas de compliance como redutores de fraude fiscal. O objetivo deste trabalho é demonstrar como a utilização de programas de compliance nas empresas pode ser um mecanismo de colaboração entre a administração fiscal e os contribuintes para reduzir a fraude fiscal e outros comportamentos fiscais abusivos.

Palavras-chave: Cumprimento de obrigações. Colaboração. Comportamentos fiscais abusivos. Gestão de riscos. Programas de compliance.

Compliance and tax fraud - Risk management as a mechanism for collaboration between tax administration and taxpayers

ABSTRACT

There are several abusive tax behaviours, such as tax fraud, tax avoidance and aggressive tax planning. Tax fraud cases are increasingly known and have been a matter of great international concern – this abusive tax behaviour is the main one for this work, because its practices are considered a crime and a serious problem for the economy of many countries. In a European tax system that has been almost entirely built on sanctions for tax fraud, a new strategy has begun to emerge: prevention through risk management. Risk management takes many forms, such as corporate governance, internal control, know your customer (KYC) and compliance programs. This work focuses its attention on compliance programs. Compliance programs emerged from the need to fight corruption and were developed over the years; they acquired other purposes, gained diverse structures and competent professionals in the subject. From this evolution, it was realized the usefulness of compliance programs as tax fraud reducers. The objective of this work is to demonstrate how the use of compliance programs in business can be a mechanism for collaboration between tax administration and taxpayers to reduce tax fraud and other abusive tax behaviours.

Key-words: Collaboration. Compliance. Compliance programs. Risk management. Tax fraud.

TABLE OF CONTENTS

LIST OF ABBREVIATIONS

APG	Asia/Pacific Group on Money Laundering
ATAD	Anti Tax Avoidance Directive
BEPS	Base erosion and profit shifting
BIS	Bank for International Settlements
CEO	Chief Executive Officer
CIAT	Inter-American Center of Tax Administrations
CJEU	Court of Justice of European Union
CRS	Corporate Social Responsibility
DOJ	United States Department of Justice
ECCHR	European Center for Constitutional and Human Rights
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
EU	European Union
FCPA	Foreign Corrupt Practices Act
IRS	Internal Revenue Service
IRC	Internal Revenue Code
KYC	Know Your Costumer
OECD	Organisation for Economic Co-operation and Development
SEC	Securities and Exchange Commission
SIGMA	Support for Improvement in Governance and Management in Central and Eastern European Countries
VAT	Value Added Tax

INTRODUCTION

Tax fraud cases have been on the headlines of newspapers for years, being the subject of research in the academy, and of general interest since everyone is affected by these practices. Associated with tax fraud, other abusive tax practices as tax avoidance and aggressive tax planning also stand out.

Combating tax fraud and other abusive tax behaviours through sanctions and punishments has not been enough, as new fraud strategies are quickly developed. The tax administration alone is also unable to legislate, execute and supervise - there is an increasing need for the taxpayer to be a figure of aid, and not just the figure of a payer.

It is not surprising that there are so many initiatives on ways to avoid tax fraud, and the urgent need to reduce this practice. In addition to domestic governments, international bodies such as the European Union and the OECD have allocated resources and efforts on this journey.

From this scenario arises the need to find solutions, to effectively understand what can be done to improve. One of the solutions that stood out in recommendations from international bodies and in academic studies is risk management. Corporate governance, audits, internal control, compliance programs, there are several terms that have been used. This work chooses as object of study compliance programs applied in business - the taxpayer - to reduce tax fraud (and consequently other abusive tax behaviours) supporting the tax administration. From this, the objective of this work is to demonstrate how the use of compliance programs in companies can be a collaboration mechanism between the tax administration and taxpayers to reduce tax fraud and other abusive tax behaviours.

To provide an answer to this question, this work is carried out in three chapters. This work is focused on the European Union scenario, but without forgetting that tax fraud practices and their fight through compliance programs takes place all over the world, and while the abusive tax behaviours occur in one place, all will be affected.

The first chapter is responsible for introducing the object of study of this work - compliance programs applied in business. To this end a historical analysis of how compliance programs emerged, going back in time to when businesses were mostly family owned, is made. The expansion of business and subsequent globalization generated a wave of global corruption, and it was necessary to create some tool to stop it, it was the historical moment in which compliance officially emerged. The evolution of the

tool, its uses, and its characteristics are then reported. An analysis of the tool is made, developing the study of the ways that the programs can be applied in practice.

The second chapter is dedicated to the study of tax fraud and other abusive tax behaviours. It is necessary to know and understand the problem, so that it is possible to apply a solution. It is assumed that for a tax fraud to exist, a tax system must be violated. Thus, a small historical analysis is made of how taxes started and why they are paid, in order to understand the current functioning of the European tax system. In sequence, the meaning of tax fraud and other abusive tax behaviours as aggressive tax planning and tax avoidance is placed, followed by the impact of these practices; why tax fraud is also included in the criminal sphere; and which are the best-known tax fraud practices. The chapter ends with an exposition of some of the most relevant legislation in relation to tax fraud, mainly in the European Union and its members, but with a brief mention of other jurisdictions.

The last chapter is responsible for explaining how compliance programs applied in businesses (taxpayers) can effectively reduce tax fraud collaborating with tax administration. For this end the synergetic relationship between tax administration and taxpayers is exposed, demonstrating how the second can act as a partner of the first. The main ways in which compliance programs applied in business help to reduce tax fraud are highlighted, and some of the existing legislation in this area is presented.

With this set of three chapters, this work provides a broad view of the problem that tax fraud is, and the need to use effective solutions such as compliance programs applied in business.

CHAPTER I – COMPLIANCE

DIVISION I – CONCEPTUAL DIMENSION

The term compliance has been used for a long time, but its true definition as a risk management tool is not known or understood by many. The literal meaning of the word compliance is "the act of obeying an order, rule, or request"[1]. This means being in agreement with something - and when referring to compliance as a tool, the sense is to be in agreement with the internal rules of a company/business/corporation, that consequently must be in agreement with the applicable legislation. This is a basic concept, which becomes much more enriched when understood within a complete context.

1. The origin of compliance

The origin of compliance goes back years, and to several events; many were the factors that contributed to its creation and development. Therefore, for a full understanding of the tool, the chronological chain of related events is presented.

The business model as it is known today, full of partners, large companies and complex structures, was once very different. The structure of large corporations was supported by globalization and the second industrial revolution, because until then the predominant model was that of the family business.

During the first industrial revolution, family businesses were the majority[2]. These businesses were conducted in a simple and focused way, since all decisions taken were centred on a single person or a few. Consequently, "the power to appoint the chief executive and other board members brings the opportunity to manage the firm according to the family's values and culture"[3]. It was easy to control all actions, ensuring everything was working according to the expected rules.

With the second industrial revolution, in the middle of XIX Century, things started to change. At the same time changes in the production process took place and the possibility of production increased,

[1] CAMBRIDGE UNIVERSITY PRESS. Cambridge Dictionary. United Kingdom, Cambridge University Press, 2021.
[2] COLLI, Andrea. *The history of family business 1850-2000.* United Kingdom, Cambridge University Press, 2003.
[3] COLLI, Andrea; ROSE, Mary. Family business, in Geoffrey G. Jones and Jonathan Zeitlin (Ed.), *The Oxford Handbook of Business History*, United Kingdom, Oxford University Press, 2008, pp. 194-217, p. 197.

the movement of globalization intensified and with the greater quantity of product, large-scale trade was even more affordable. New business opportunities came along.

Dealing with all this volume only in a family environment became unfeasible, and it became necessary to delegate tasks, adding new people such as partners and managers. Basically, the fragmentation of control started a new era of partners, shareholders and managers.

> These management structures were crowded by salaried low, middle, top managers, more and more autonomous from the property and from the founder's family, according to the growing specialisation of their roles. [...] As the growth of the corporation demanded more investment and financial resources, the shift from personal, family capitalism to financial capitalism, where bankers and other financiers shared top management decisions, occurred.[4]

With the decentralization of power and complex structures, actions became much more susceptible to mistakes. Attached to this came the need for improvement, as competition increased and companies needed to find solutions to get ahead.

The automatic and natural reflex of entrepreneurs is to always seek to maintain the same status quo, with the same benefits, even in times of crisis. With this expectation, they were no longer concerned with the means, as long as the ends were reached, legally or illegally[5]. Thus, several were the businesses that found illicit alternatives as solutions, which went against what was established by law.

This way of conducting business generated a global wave of corruption. The involvement of companies operating in different territories in corruption schemes became commonplace, in order to gain access to foreign markets, contributing to the maintenance of governments with corrupt practices[6]. The most common practice was the bribery of public officials. For example, companies paid government employees to benefit from access to lucrative contracts, gaining an advantage over the competition[7]. In addition, tax fraud, unfair competition between competitors and other corrupt practices were increasingly widespread.

It is important to mention that when talking about corruption, although here we speak of the literal concept of corruption, it is about a broad context. Officially, the definition of corruption from the World

[4]COLLI, Andrea. *The history of family business 1850-2000*, op. cit., pp. 6-7.
[5]TONIN, Alexandre Baraldi. Compliance: a view of Compliance as a form of liability mitigation. *Revista dos Tribunais*, vol. 983/2017, p. 265 – 288, sep. 2017.
[6]FERREIRA, Fábia Duarte. A prática do compliance como um instrumento empresarial anticorrupção para preservação das empresas. *Revista de Direito Bancário e do Mercado de Capitais*, São Paulo, vol. 81/2018, p. 161.
[7]TANZI, Vito. *Corruption adorund the world:* Causes, consequences, scope and cures. France, International Monetary Found, 1998.

Bank is the use of public office for private gain[8], but within that there is much to be understood. Corruption is in all human social relations, in all simple everyday actions. When there is gain from a source that should not have made any gain possible, corruption exists.

Due to the actions of the companies, corruption was at an extremely harmful level. At the same time with the growing industrialization and globalization, governments, to accompany social needs, assumed a greater role. This trend began in 1960 and continued as demanded - there was a significant increase in regulation, fees and other requirements[9]. Logically, the more rules, the greater the incidence of non-compliance with them, and this implied that corrupt practices were increasingly identified. The accumulation of all these practices and situations resulted in the 1990s being the height of corruption[10].

The damage that corruption causes to the government is immense, not only economically but also in the areas of health, education, employability, and security[11]. In 2012, the frauds in health systems (constituted basically in fiscal matters for tax evasion, accompanied by the crime of falsifying receipts for consultations, exams and surgeries) in the United States alone, represented an annual loss of US$ 100 billion[12]. In 2013, the German company Siemens denounced fraud and cartel in bids for the purchase of trains, which may have generated 30% more spending in Brazil for the states of São Paulo and the Federal District in contracts in the railway sector[13]. These examples demonstrate how corruption can have an impact in a wide range of areas, and consequently affect the lives of all individuals.

Returning to the timeline, the consequences of corruption in the 1990s have seen governments toppled, promising politicians losing their positions, entire political classes disappearing from the map[14] and by all means, instability. The risk possibilities were much greater with the new business structures and new legislation.

With all of that, some action was needed. If everything continued as it was, it would become impossible to maintain honest business relationships. The subject began to be debated, and many devoted themselves to studying how to deal with the situation. Solving the problem was the first and most obvious solution: dealing with known cases of corruption and sanctioning accordingly. However, in addition to being difficult to identify all corrupt practices, it would be unfeasible to deal with all illegalities

[8]HUTHER, Jeff; SHAH, Anwar. *Anti-corruption Policies and Programs*: A Framework for Evaluation. Washington, DC, The World Bank, 2000.
[9]TANZI, Vito. *Corruption adorund the world:* Causes, consequences, scope and cures, op. cit.
[10]*Idem, ibidem.*
[11]FERREIRA, Fábia Duarte. A prática do compliance como um instrumento empresarial anticorrupção para preservação das empresas, op. cit.
[12]NEGRÃO, Célia Lima; PONTELO, Juliana de Fátima. *Compliance, controles internos e riscos*: a importância da área de gestão de pessoas. Brasília: Senac, 2014.
[13]*Idem, ibidem.*
[14]TANZI, Vito. *Corruption adorund the world:* Causes, consequences, scope and cures, op. cit.

after they happen. What was perceived was that the prevention of corrupt practices could be the best strategy, as it would guarantee a reduction in the incidence and would make it possible to deal with the cases that still happened.

This understanding and the movement to prevent corruption had started in a timid way years before the outbreak of corruption and the idea itself had been going on for quite some time. It is worth taking a historical look back at the events that paved the way for the current compliance tool to exist.

In 1913, the intention of regulation was already observed with the creation of the Federal Reserve Act - the central bank of the United States. The reason for creating the Federal Reserve System was to set out "the purposes, structure, and functions of the System as well as outlines aspects of its operations and accountability"[15].

With the famous New York Stock Market Crash in 1929 - the year that also marks the beginning of the great depression - many were the economic losses that resulted in the deterioration of all aspects in every-day life. This moment of crisis "triggered a sea-change in economic theory and policy"[16]. Companies were forced to start controlling their data and finances in a way they didn't do before, which contributed in a very positive way to the subsequent implementation of compliance.

In 1930 the Bank for International Settlements (BIS) was established with objectives as promoting central bank cooperation and providing additional facilities for international financial operation[17]. Over time, BIS' objectives adopted a guidance character, as it can be seen from the creation of the Basel Committee in 1974. The Committee was responsible for publishing in 1998 thirteen principles for internal control through the Framework for Internal Control Systems in Banking Organisations[18] - the publication of this document contributed to 1998 being the beginning of the popularly called 'Age of Internal Controls'.

Following the historical line, the years of 1950 and 1960 were very relevant. 1950 drew attention because, for the first time that it is known, lawyers were hired with the exclusive function of following and monitoring the securities sector to avoid breaches. 1960 by its turn was marked by the Securities and

[15]BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM. Federal Reserve Act. *Board of Governors of the Federal Reserve System*, March 10, 2017. Available at: <https://www.federalreserve.gov/aboutthefed/fract.htm>.

[16]KONZELMANN, Suzanne J.; WILKINSON, F.; FOVARGUE-DAVIES, M.; SANKEY, D. Governance, regulation and financial market instability: the implications for policy. *Cambridge Journal of Economics*, 34 (5), 2010, pp. 929-954, p. 3.

[17]BANK FOR INTERNATIONAL SETTLEMENTS. *Introductory note on the Bank for International Settlements 1930 – 1945*. Basle, 1997, p. 1.

[18]BASLE COMMITTEE ON BANKING SUPERVISION. *Framework for Internal Control Systems in Banking Organisations*. Basle, 1998. Available at: <https://www.bis.org/publ/bcbs40.pdf>.

Exchange Commission (SEC) deciding that hiring compliance officers to create the internal rules of companies and carry out personal management should be mandatory[19].

Although the movement started in the United States, the same trend was observed worldwide, even in extra-continental organizations. In 1975 the United Nations General Assembly for the first time dealt with the issue of corruption related to international business transactions, in Resolution 3514. The resolution was very direct in condemning all corrupt practices by transnational and other corporations[20]. In 1997 the Organisation for Economic Co-operation and Development (OECD) published the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The Convention aims to establish rules that criminalize the bribery of foreign public officials in international business transactions and provides several measures that can do so[21]. In short, this instrument determines that member states must penalize acts of corruption, from the conduct of public officers to companies.

At the local level, also on the European continent, in sequence of the BIS creation, the Core Principles for Effective Banking Supervision were published by the Basel Committee on Banking Supervision in 1997, which consisted in the standard that banks should adhere to prudential regulation and supervision[22]. In the same year, the Asia/Pacific Group on Money Laundering (APG) was created "as an autonomous regional anti-money laundering body"[23], therefore, this act is the landmark that paved the way for compliance in Asia. Two years later in 1999 Africa started dealing with the same type of regulation, with the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). The group "is a Regional Body subscribing to global standards to combat money laundering and financing of terrorism and proliferation"[24]. Central and Latin American countries in general only had official regulations and groups later, such as Brazil, which only had its Compliance Law published in 2013[25].

The perception of prevention as a solution was already widespread and extremely well accepted. With all this movement and events, laws were emerging and at the same time becoming a guide to

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[19] NEGRÃO, Célia Lima; PONTELO, Juliana de Fátima. *Compliance, controles internos e riscos*: a importância da área de gestão de pessoas, op. cit.

[20] UNITED NATIONS GENERAL ASSEMBLY. Resolution 3514. *United Nations General Assembly*, 1975. Available at: <https://digitallibrary.un.org/record/189574>.

[21] OECD. *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*. Paris, 1997. Available at: <https://www.oecd.org/daf/anti-bribery/ConvCombatBribery_ENG.pdf>.

[22] BASLE COMMITTEE ON BANKING SUPERVISION. *Core Principles for Effective Banking Supervision*. Basle, 2012. Available at: <https://www.bis.org/publ/bcbs230.pdf>.

[23] ASIA/PACIFIC GROUP ON MONEY LAUNDERING. APG history and background. Asia/Pacific Group on Money Laundering, n.d. Available at: <http://www.apgml.org/about-us/page.aspx?p=91ce25ec-db8a-424c-9018-8bd1f6869162>.

[24] EASTERN AND SOUTHERN AFRICA ANTI-MONEY LAUNDERING GROUP. Who we are. *Eastern and Southern Africa Anti-Money Laundering Group*, 2018. Available at: <https://www.esaamlg.org/index.php/about>.

[25] BRASIL. *Lei nº 12.846, de 1º de agosto de 2013*. Brasília, DF, 2013. Available at: <http://www.planalto.gov.br/ccivil_03/_ato2011-2014/2013/lei/l12846.htm>.

establish norms for preventing corruption in all its spheres – and one of these laws is considered the global compliance framework and has served as the basis for many other laws around the world.

In 1997, in the United States, the Watergate Scandal was in all first pages for being a major public corruption scandal involving the then President Richard Nixon, which eventually led to his resignation from office. As a reflection of the scandal, there was a great impact on the population and government, with the second being obliged to act. If there was already legislation being prepared in the scope of combating corruption, social pressure and government needs were the triggers that drove to the publication of some code. Thus, the famous Foreign Corrupt Practices Act (FCPA) was created.

In short, the FCPA prohibits the offering and actual making of improper payments to foreign officials[26]. The scope of the Law is wide, guaranteeing the effective application individual and legal person level. Furthermore, the FCPA reaches beyond the internal field of action: the external field, by reaching its agents outside the territory of the United States.

Another strong law that has influence around the world is the United Kingdom Bribery Act. The UK has started corruption prevention regulations since 1988, through the Prevention of Corrupt Acts 1889 to 1916. The year 2010 saw the Bribery Act, which is the most complete anti-corruption law today, and was created as an improved reflection of the FCPA. Two relevant points of this Law are the provision of punishment for failure to prevent corruption, and the provision of civil and criminal punishment for individuals and legal entities[27].

It is interesting to note that in general, all these initiatives and laws focus not only on the public sector, but directly on the legal persons. It was noticed that a law more directed towards the starting point of corrupt actions, especially regarding prevention, would be more effective than directed towards the public sphere. The already mentioned OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions was the first international instrument that adopted this approach[28].

It was precisely the set of all initiatives, laws and this direct approach to the legal person that made it possible to establish the compliance tool in the fight against corruption. Each of the exposed historical milestones was relevant and responsible for structuring the anti-corruption system with an emphasis on risk prevention and management.

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[26]UNITED STATES OF AMERICA. *Foreign Corrupt Practcices Act*. Washington, 1997. Available at: <https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2012/08/29/corruptrpt-95-213.pdf>.

[27]UNITED KINGDOM. *Bribery Act*. England, 2010. Available at: <https://www.legislation.gov.uk/ukpga/2010/23/pdfs/ukpga_20100023_en.pdf>.

[28]OECD. OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. *OECD.org*, n.d. Available at: <https://www.oecd.org/corruption/oecdantibriberyconvention.htm>.

1.1 Risk management and related behaviours

Considering that the compliance tool revolves around the concept of risk management, it is worth highlighting what risk management is. And within the risk management dimensions, there are several tools that stand out, side by side with compliance.

The origin of risk concept comes from ancient Italy, when the journeys in unknown waters could represent the loss of vessels and cargo – and this combination of uncertainty and loss gave rise to risk[29].

Risk is associated with uncertain possibilities, which may or may not happen. Risk comprises consequences assumed when performing or not a certain act (and in most cases these consequences are unknown due to ignorance or lack of interest).

The figure of risk cannot claim pre-determined preventive public control, as the uncertainty and lack of knowledge that characterize it make it impossible to construct preventive public normative schemes[30].

> Risks are events or circumstances that could or will result in problems for the organisation. Risks should be defined to a level such that the risk and causes are understandable and can be accurately assessed. Risk covering all of the following:
> • Hazard - bad things are happening
> • Uncertainty - things are not occurring as expected
> • Opportunity - good things are not happening.[31]

Also, risk cannot be confused with danger - they are different legal figures. Danger, as it corresponds to known realities, presupposes the construction of preventive public regulatory schemes, that is, the subordination of certain activities, behaviours or juridical-private assets to public control, as a rule there is a proper administrative control[32].

As the name suggests, risk management is risk analysis; it consists in evaluating what the risks mean. As mentioned, prevention through risk management was highlighted as an effective way to fight corruption, but in practice it also represents an effective way of doing business. Basically, all corporate

[29] EUROPEAN COMMISSION. *Risk management guide for tax administrations.* Brussels, 2006. Available at: <https://ec.europa.eu/taxation_customs/system/files/2016-09/risk_management_guide_for_tax_administrations_en.pdf>, p. 13.
[30] SILVA, Suzana Tavares da. A "linha maginot" da sustentabilidade financeira: perigo, risco, responsabilidade e compensação de sacrifícios: uma revisão da dogmática a pretexto da gestão do litoral. *RevCEDOUA*, vol. 12, nº 23, 2009, p. 30.
[31] EUROPEAN COMMISSION. *Risk management guide for tax administrations,* op, cit., p. 13.
[32] *Idem, ibidem*, p. 29.

decisions are based on financial returns, so predicting the possibility of risk in any decision is extremely relevant. So many of investors' decisions are based on the level of risk an investment can pose.

The risk management process gives the means to identify, assess and plan the risks; and all levels of an organization must be included when managing risks[33]. The key to predicting all risks is to ensure attention to all these levels, interactions between them and the particularities of each one (subsequently it will be addressed that the ideals of compliance programs place a lot of emphasis on this philosophy).

However, to understand what the risks can mean – the harm if the risk is not managed and the consequences on the legal entity – a great deal of anticipation work is needed (tax planning is a very good example of anticipating the risks). It is precisely in this work of anticipating that the preventive nature of risk management lies. It is in this aspect that compliance programs are structured.

> The risk definition makes it clear that the organisation's objectives are the starting point for identifying risks. Without an understanding of the objectives, it is not possible to identify risks. The identification of risks has to start with high-level objectives and continue with other objectives on different levels. The risk is the events or circumstances that could result in a bad outcome (not reaching the objectives). These events or circumstances must be identified.[34]

When looking to implement risk management on legal entities, the search for some way to do so began. As a starting point, it was realized that ethics was the key factor, as ethical decisions mean correct and not illegal conduct. As the study of ethics as a basis for compliance is very thorough, it will be discussed later. Based on this starting factor, some tools were implemented as a form of risk management.

Until this day some of the concepts of these risk management tools are still confounded. One of the most common misconceptions occurs between the concept of internal audit and compliance. Auditors, as a rule, are independent, and their job is to verify that what should be done was done and if it was done properly[35]. Auditing is often primarily about numbers and accounting. Also, the audition happens after the facts, that is, despite being a tool of risk management it happens as a remedy and not as a prevention. Compliance, in turn, acts before the facts, acting as a preventive tool. In short, in the

[33]MERNA, Tony; AL-THANI, Faisal. *Corporate risk management*. United Kingdom: John Wiley & Sons, Ltd, 2008.
[34]EUROPEAN COMMISSION. *Risk management guide for tax administrations,* op. cit., pp. 13-14.
[35]CHIMAL, Mónica Ramírez. So different and so alike: Internal audit and compliance. *CEP Magazine*, Ed. February, 2019.

audits, a raw analysis of the data is carried out, without understanding what causes the negative results and without proposing improvement and correction plans, dealing more with the analysis and reporting of inaccuracies.

Another common misconception is between corporate governance and compliance. Corporate governance is more about a way of managing legal entities, it is about managing a company in the long-term following certain ethical values and established conduct. According the OECD, the main points of corporate governance are transparency and accountability to support stronger growth and more inclusive societies[36]. Also, corporate governance can be responsible for distributing rights and responsibilities between the legal entity members[37]. And this tool is an important form of risk management, as poor corporate governance can mean the loss of investment[38].

Corporate governance works as a guide for investors, ensuring that they are making smart choices investing in a transparent and trustable company. It makes it easier to prevent problems, and to anticipate future results. It is important to mention that in many cases corporate governance and compliance are used as synonymous, especially in legislation, where the described features for corporate governance are the same of compliance.

One more concept of a risk management tool is internal control. “An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of a company”[39]. Internal control is thus a process, a means and not an end. Internal control is a system that can help with the most diverse control tools, such as "all material controls, including financial, operational and compliance controls..."[40].

Another term, which is also not the same as compliance, but operates within the tool's concepts, is the tool called know your costumer (KYC). KYC “refers to the requirement for banks and other financial institutions to monitor, audit, collect, and analyse relevant information about their costumers (or potential

[36]OECD. *G20/OECD Principles of Corporate Governance*. Paris, 2015. Available at: <https://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015_9789264236882-en>.

[37]ISAKSON, Mats. Investment, financing and corporate governance: the role and structure of corporate governance arrangements in OECD countries. *OECD Seminar on Corporate Governance in the Baltics*, Oct., 1999. Available at: <https://www.oecd.org/corporate/ca/corporategovernanceprinciples/1931532.pdf>.

[38]FUNG, Benjamin. The Demand and Need for Transparency and Disclosure in Corporate Governance. *Universal Journal of Management,* 2(2): p. 72-80, 2014. Available at: <https://www.hrpub.org/download/20140105/UJM3-12101630.pdf>.

[39]THE FINANCIAL REPORTING COUNCIL. *Internal Control*: Guidance for Directors on the Combined Code. London, 2005, p. 7. Available at: <https://www.frc.org.uk/getattachment/fe1ba51a-578d-4467-a00c-f287825aced9/Revised-Turnbull-Guidance-October-2005.pdf>.

[40]*Idem, ibidem*, p. 4.

costumers) before engaging in financial business with them"[41]. This tool is part of the compliance application, being within banks and financial institutions associated with the compliance sector.

It is evident that there are different forms of risk management, and each one is effective and necessary in its own way. All these tools can coexist, complement each other, or be part of each other's strategy. In practice, actions end up merging, as they are all risk management tools. What happens is that usually compliance programs are well defined as a single tool, which can fit into the coexistence described above. It then remains to understand what compliance is and why this tool is so special. This subject will then be addressed in the next section.

2 Compliance as a polysemic concept

The compliance tool was born, in a brief recap, of the need to fight corruption. It was realized that risk management was the most effective way, and tools were developed from that. One of these tools is called compliance, and it is currently considered essential for business. Large companies to close contracts require contractors to have compliance programs, some governments reduce penalties for companies that prove to have effective compliance programs, books and articles on the subject are published in large numbers. The importance and relevance of compliance is undeniable.

Even so, there is no single definition of compliance. There are harmonized concepts that revolve around the same thoughts, but a single concept is not possible. The reason, is because there is no single form to apply it, this tool needs to be applied in different jurisdictions and companies that have specific aspects. There is no universal way of applying it; compliance is a subjective tool that must consider all the individualities of its place of application. The best way to understand what compliance means is to analyse different concepts, and thus understand what the tool intends to do and how it works.

For Siqueira and Francischetto, compliance is linked to business management, which aims to promote the exercise of economic activity in an ethical, transparent and in accordance with legal rules and codes of ethics[42]. Abboud and Menezes expose the tool as a mechanism and structure for the

[41]BILALI, Genci. Know your costumer – or not. *University of Toledo Law Review 319*, 2012, p. 319.
[42]SIQUEIRA, Vitor da Costa Honorato de; FRANCISCHETTO, Gilsilene Passon Picoretti. The emergency of compliance programs and their application in the labor context in the light of the company's social function. *Revista dos Tribunais*, vol. 1019/2020, p. 319 – 332, sep., 2020.

fulfilment of laws and prevention of harmful acts[43]. These are the most traditional and most widespread definitions, in which compliance is seen as conformity with legal rules.

Ferreira sees compliance as a business practice, to guarantee conformity with established normative standards, obedience and conformity with legal parameters, the impositions of regulatory bodies, as well as established internal procedures regarding business policy, in all spheres: financial, environmental, ethics, labour, social security, tax, accounting[44].

Rodrigues explains that compliance is inseparable from the new actors in the economy – corporations; and with that compliance is presented as the centre of 'regulatory self-regulation', a strategy developed through public intervention in which the company is a collaborator of the state in executing laws[45]. This point of view deserves attention, as the compliance tool allows the company to be an ally of the public administration. By ensuring compliance with laws that are proposed by the State or other bodies, the company collaborates directly with these, acquiring an agent role.

Tonin understands that compliance is split into two strands, with slightly different goals, corporate compliance, and criminal compliance; criminal compliance is the tool to prevent corruption-related offenses, while corporate compliance would be associated with measures that guide compliance in the corporation[46]. The author adds that both, although different, are complementary.

Considering the evidence in this thesis, compliance was created with the objective of combating corruption (which would refer to criminal compliance), but its mode of operation is just to lead the corporation to avoid non-compliance - whether criminal or not (which would refer to the corporate compliance). If this division is made when understanding the risk management tool, it is in fact necessary to be aware that they are inseparable. It is impossible to enforce criminal compliance without using corporate compliance. The sentence "corporate compliance programs are internal mechanisms implemented by companies to prevent and detect criminal conducts within the corporation"[47] accurately represents the impossibility of dissociation.

This need for the two notions to always walk together is also because both share their characteristics in common almost completely. Corporate compliance and criminal compliance work with

[43]ABBOUD, Georges; MENEZES, Paulo Roberto Brasil Teles de. Compliance programs and market protection: combating corruption and competitive disloyalty. *Revista dos Tribunais*, vol. 1007/2019, p. 37 – 64, sep., 2019.
[44]FERREIRA, Fábia Duarte. A prática do compliance como um instrumento empresarial anticorrupção para preservação das empresas, op. cit.
[45]RODRIGUES, Anabela Miranda. Compliance programs and corporate criminal compliance. *Revista Brasileira de Ciências Criminais*, vol. 149/2018, p. 17 – 28, nov. 2018.
[46]TONIN, Alexandre Baraldi. Compliance: a view of Compliance as a form of liability mitigation, op. cit.
[47]RODRIGUES, Anabela Miranda. Compliance programs and corporate criminal compliance, op. cit, p. 2.

the prevention of risk and in application they share the same structures of compliance programs. The classification exists and is recognized in doctrine, always emphasizing the common face of the two aspects.

Kingsbury challenges the traditional concepts of compliance; for the author "compliance with law does not have, and cannot have, any meaning except as a function of prior theories of the nature and operation of the law to which it pertains"[48]. This interpretation goes in the direction of the above mentioned here, that it is impossible to have an exact concept. Although all concepts emphasize the need to comply with the law, compliance is much more than that.

Ribeiro and Diniz also share this point of view. For the authors, compliance refers to the tool to implement a company's mission, vision and values, and in this way, compliance cannot be confused with mere compliance with formal and informal rules, with its scope being much broader[49].

Thus, when asked what compliance is, compliance is indeed ensuring the enforcement of law, but this is part of compliance, not the concept. Compliance is so much bigger; it is the means and the end, is the desire to apply the best intentions in everyday life in the corporate world, is the opportunity to avoid problems, it is the solution. Compliance is such a precise tool that it adapts to the needs and particularities of each environment where it will be used, considering the details of all employees involved. There is no way to present a concept of compliance, but to enable the individual construction of a polysemic concept of what the tool is.

2.1 The dimensions of compliance

Since compliance is a multifaceted concept, it is natural that the dimensions reached take place in different spheres. From the different areas of application to the nature of the application, there are some points to be highlighted.

Regardless of the interpretation of what compliance is, in all contexts, the interaction of compliance with the internal part is evident, being the tool applied inside legal entities, as well as with the

[48]KINGSBURY, Benedict. The Concept of Compliance as a Function of Competing Conceptions of International Law. *Michigan Journal of International Law*, 345, 1998.

[49]RIBEIRO, Marcia Carla Pereira; DINIZ, Patrícia Dittrich Ferreira. Compliance e Lei Anticorrupção nas Empresas. *Revista de Informação Legislativa*, Ano 52, nº 205 jan./mar. 2015.

external part, as it aims to comply with the applicable legislation. Therefore, it is worth noting whether the tool has an internal or external character.

In general, compliance has internal character, as it is an internal form of risk management, constantly associated with internal control practices. This internal character is subjective, as its application is done in a way that the chief compliance officer (the designation of compliance professionals) deems correct. Despite the subjective character having internal as its name, it does not mean that it applies only into the internal environment.

From this point of view, regulations are internal but can have an impact on the external environment (which is not to be confused with the external character). As well mentioned by Gabardo, Morettini and Castella, the subjective/internal character comprises internal regulations, such as the implementation of good practices inside and outside the company and the application of mechanisms in accordance with the legislation relevant to its area of operation[50]. This is the main feature of compliance, being internal and subjective.

Despite this, the tool, which is incredibly nuanced, also has an external and objective character. Since compliance programs are structured based on complying with laws that are outside the 'internal bubble' of legal entities, it is in direct contact with the external character, ensuring an objective character to the tool.

These two features always coexist, as they are directly connected. The laws are objective, and must be complied with, as established, so the chosen way to guarantee this is subjective and internal. As will be discussed in greater detail below, compliance programs have as base foundation reporting criminal practices (such as corruption, tax evasion, unfair competition...) to the responsible authorities. This communication bridges the internal with the external.

Another factor that reinforces the external character of compliance is that it also has a great impact on the company's social function, the corporate social responsibility (CSR). Clearly, the main function of every business is to generate profit, and the way of conducting it is designed considering this purpose. However, the company assumes a social responsibility when producing profit, and this is increasingly noticed, especially when considering the social agendas currently discussed (sustainability, equality, decent work, quality of life...).

[50] GABARDO, Emerson; MORETTINI E CASTELLA, Gabriel. A nova lei anticorrupção e a importância do compliance para as empresas que se relacionam com a Administração Pública. *Revista de Direito Administrativo & Constitucional*, Belo Horizonte, n. 60, p. 129-147, apr./jun., 2015.

The CRS started with pressure from the people and government. The negative impact in the environment, human rights, labour, among other aspects forced companies to be more responsible[51]. These pressures also ended up creating another side of the coin, with companies realizing an economic advantage in complying with socially required topics. By meeting the requirements, and sometimes surpassing expectations with good proposals for social responsibility, consumption increased.

In a general context, the company fulfils its social function when it generates jobs, taxes and wealth, contributing positively to the economic, social and cultural development of the region or country in which it operates by adopting sustainable business practices in order to protect the environment, respecting society[52].

Compliance programs working with risk prevention have an impact on all these aspects, contributing to the due taxes being paid, employment contracts being fair and dignified, company operations being as sustainable as possible, no underpaid women and no sexism on workplaces, among all CRS target points. As compliance deals with all these aspects, it respects the principles of public administration in dealing with the government, and is an effective tool in the search for the company's fulfilment of its social function[53].

Another facet of compliance is that with its application, the principles of public administration are brought to the private sphere - there is a need for the private company to apply public ethics internally and practice internal ethics in public[54]. Therefore, the external character of compliance is reinforced.

The joint initiative of the OECD and the European Union 'Support for Improvement in Governance and Management in Central and Eastern European Countries' (SIGMA), lists the principles of public administration, which are reliability and predictability; openness and transparency; accountability; and efficiency and effectiveness[55]. All these characteristics can be observed in compliance programs and are inherent to ethical actions - that is, inherent to compliance.

As the tool focuses on several points, it can be used in many different areas. Within the business area, as mentioned above, it has a strong focus on the criminal sphere, and on the corporate sphere.

[51]UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION. *Corporate social responsibility for market integration*. N.d. Available at: <https://www.unido.org/our-focus/advancing-economic-competitiveness/competitive-trade-capacities-and-corporate-responsibility/corporate-social-responsibility-market-integration>.

[52]SIQUEIRA, Vitor da Costa Honorato de; FRANCISCHETTO, Gilsilene Passon Picoretti. The emergency of compliance programs and their application in the labour context in the light of the company's social function, op. cit.

[53]SANTOS, Douglas de Oliveira; TORRES, Rafael Lima; RODRIGUES, Maria Lúcia de Barros. A regulamentação do programa de compliance pelo direito brasileiro, como ferramenta capaz de auxiliar as empresas no cumprimento de sua função social. *Revista Percurso*, Curitiba, v. 2, n. 17, p. 333 – 349, 2015.

[54]GABARDO, Emerson; MORETTINI E CASTELLA, Gabriel. A nova lei anticorrupção e a importância do compliance para as empresas que se relacionam com a Administração Pública, op. cit.

[55]OECD. European Principles for Public Administration. *SIGMA Papers No. 27*. Paris: OECD Publishing, 1999.

Furthermore, the tool is widely used in public administration to fight corruption. When compliance programs are applied within the government, there is a greater probability of bids, contracts and decisions being carried out correctly. Likewise, the area of health and education is also already using the tool to carry out their activities in a lawful manner.

This is the true meaning of compliance, a tool with many faces, useful and important for the most diverse areas. Even though the meaning already demonstrates its effectiveness, the spread and application of compliance needs legal help to be implemented to a greater extent. The next section will demonstrate how diffusion took place through hard law and soft law.

3 Dissemination of compliance – from hard to soft law

As governments and public entities realized that the more compliance programs were applied the less corruption and the incidence of various crimes occurred, they sought to transform the introduction of compliance through legislation. This application took place in two ways, through hard law and soft law.

Hard law and soft law are terms that come from international law, as this field of law is full of treaties and directives that need to be framed in some type of law. Although mostly used in this area, in this work they have the function of demonstrating the two different types of legal instruments that approach compliance (even more considering that most of the compliance legal instruments are of international scope).

Hard law, according to the European Center for Constitutional and Human Rights (ECCHR) are "legal obligations that are binding on the parties involved and which can be legally enforced before a court"[56]. The ECCHR refers to soft law, by its turn, as being used to "agreements, principles and declarations that are not legally binding. Soft law instruments are predominantly found in the international sphere. UN General Assembly resolutions are an example of soft law"[57]. This means that when a company is subject to hard law regulations it will be obliged to comply, and when it is soft law, it is only recommended to follow the suggested.

[56]EUROPEAN CENTER FOR CONSTITUTIONAL AND HUMAN RIGHTS. Hard law/soft law. *European Center for Constitutional and Human Rights Glossary,* n. d. Available at: <https://www.ecchr.eu/en/glossary/hard-law-soft-law/>.

[57]*Idem, ibidem.*

Soft law has its origins in the need to create a bridge between the moral, the political and the legal, having as its causes the economic and social needs of flexibility, adaptability and communicability of economic agents[58]. And this need is the same that explains most compliance regulations being soft law.

Soft law is a response to the regulatory needs of the current rapidly changing global scenario. The soft law negotiation process is less costly, less time consuming and less politically and legally risky than the negotiation of true international treaties. Soft law has been used as a tool to reach consensus and compromise texts that would otherwise never exist. Contributing to this conjuncture is the dispensability of the rigor of textualism, as these instruments are intended for a global analysis rather than an autonomous interpretation of its components.[59]

Considering that compliance is a recent tool, much of soft law addresses the issue only with the term corporate governance. However, if the context in which the term is used is observed, soft law also aims to apply compliance programs. In hard law, the same occurs, but as the formal laws that approach the tool are more recent, the term compliance is already found in some.

The way that internal control policies were put into practice in the beginning (and prevails to this day despite the increasing insertion of compliance in legislation) was through soft law. As the need to apply compliance increased, that is, as the social characteristics were changing, it was necessary to encourage adherence. Encouraging is always easier and generates less resistance to the target than forcing.

This was confirmed in a 2010 study in which the conclusion, after analysing corporate governance in 202 Colombian companies, was that it is desirable to improve corporate governance standards by adopting the recommended practices in soft law, which in most cases are more rigorous than hard law[60].

The result is somewhat curious, as the general idea is that the hard law is more effective because it is mandatory. But precisely because it is mandatory the demands made cannot be so high, while in soft law if they are high so there is no 'complaint'.

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[58]PIRES, Rita Calçada. Consensualismo Fiscal. Notas para reflexão. *Revista FISCO*, Ano XVII, n.º 122/123- 124/125, nov. Lisboa: Lex - Edições Jurídicas, Lda, 2007.

[59]PIRES, Rita Calçada, et. al. Um olhar ao actual direito internacional fiscal: Magic mirror on the wall, who is the fairest one of all?. *Cadernos de Justiça Tributária*, Braga, n. 31, jan. - mar., 2021, p. 19-50.

[60]RAMIREZ, Jose Bernardo Betancourt; BETANCOURT, Gonzalo Eduardo Gómez; CORTÉS, Diógenes Lagos. Normas vinculantes y no vinculantes en gobierno corporativo: un análisis para la asamblea de accionistas. *Entramado,* vol.15, nº 2 jul.-dec., 2019, p. 28-44.

> We argue, in contrast, that international actors often deliberately choose softer forms of legalization as superior institutional arrangements. To be sure, soft law is sometimes designed as a way station to harder legalization, but often it is preferable on its own terms. Soft law offers many of the advantages of hard law, avoids some of the costs of hard law, and has certain independent advantages of its own.[61]

Creating a law that entirely forces the application of compliance programs is not feasible, and this can be seen from the fact that to date no law - worldwide - defines a compliance program. This is due to the aforementioned difficulty in defining a concept as a function of the particularity of each program. What several laws do is encourage the use of compliance, mentioning some characteristics and principles of risk prevention programs and granting benefits to those who use them.

Also, soft law has an additional benefit. Because of its flexibility it handles uncertainty better and considering that risk management is about uncertain probabilities that may or may not happen, the fit is ideal. “It offers more effective ways to deal with uncertainty, especially when it initiates processes that allow actors to learn about the impact of agreements over time”[62].

There are counterpoints to soft law. First, soft law not being mandatory, it may have no adherence. It so happens that a large part of the compliance function is to create an ethical culture in companies, which will naturally make use of soft law (this point is further discussed in the following section). Also, as already discussed, the company's social function is increasingly demanded by its consumers, so adhering to soft law is a solution for correct practices.

Second, hard law can facilitate international interactions, such as "the demand for hard law should be especially strong when the risks of opportunism are high and compliance is difficult to monitor"[63]. And in fact, this legislative security cannot be fulfilled by soft law.

Another point is that the hard law can more easily reach small and medium-sized companies, as it is mandatory, they will have to comply. Soft law is usually appointed by international bodies, so a small family business is less likely to seek the advice and decide to apply. The simple fact of looking for a compliance officer to create a program is not so common in these smaller companies, so the law forcing to do so would be the way to go.

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[61] ABBOTT, Kenneth Wayne; SNIDAL, Duncan. Hard and Soft Law in International Governance. *International Organization*, Vol. 54, p. 421-456, 2000, p. 423.
[62] *Idem, ibidem.*
[63] *Idem, ibidem*, p. 451.

Even with these issues and the limitations that soft law may present, it can be preferable them solutions consisting solely of hard law, as its flexibility allows companies to adapt to best practices[64]. Ideally, when companies plan their compliance programs, they should use the best of hard law (which are mandatory) together with the best of soft law - only then compliance can be applied with maximum effectiveness.

Some laws from different years and geographic locations can be analysed, for an understanding of how compliance has been approached in soft law. The Bribery Act, the British law already mentioned, does not oblige the insertion of the compliance tool, but since it punishes the failure to prevent corruption, the encouragement for companies to make use of compliance is much greater. Furthermore, the compliance enforcement ensures that the company's liability is mitigated in the event of a future conviction[65].

The FCPA, the law from the United States, understands compliance as essential to detecting and preventing FCPA violations. The tool has an extremely important role in the decision of criminal sentences, as having a compliance program can influence the form of resolution or prosecution, the monetary penalty, and the compliance obligations to be included in any corporate criminal resolution[66].

The decrease in penalties is justified by the fact that "a company's failure to prevent every single violation does not necessarily mean that a particular company's compliance program was not generally effective"[67]. This means that having a compliance program is rewarded, even if there are problems, the compliance program was there.

In Portugal, the *Lei* nº 83/2017 requires the effective application of policies, procedures and controls that are shown to be adequate. The Law requires the definition of an effective risk management model, with practices adequate to the identification, assessment and mitigation of the risks of money laundering and terrorist financing to which the obligated entity is or will be exposed[68]. The Law also requires the designation, when applicable, of a person responsible for monitoring compliance with the applicable regulatory framework - and this person can be understood as a chief compliance officer.

[64]EFIGÉNIA, Ana Sílvia Falcão Mestre. The "comply or explain" principle and the "soft law*". Revista electrónica de direito*, feb., 2015, n.º 1. Available at: <https://cije.up.pt//client/files/0000000001/5_666.pdf>.
[65]UNITED KINGDOM. *Bribery Act*, op. cit.
[66]DEPARTMENT OF JUSTICE AND SECURITIES AND EXCHANGE COMMISSION. *A Resource Guide to the FCPA U.S. Foreign Corrupt Practices Act. Second Edition.* United States: Department of Justice, 2020.
[67]*Idem, ibidem.*
[68]PORTUGAL. *Lei nº 83/2017.* Lisboa, 2017. Available at: <https://dre.pt/dre/detalhe/lei/83-2017-108021178>.

The *Lei* nº 12.846 of 2013, in Brazil, provides that in the application of civil sanctions it will take into account the existence of internal mechanisms and procedures of integrity, auditing and incentive for reporting irregularities; and the effective application of codes of ethics and of conduct within the scope of the legal entity[69]. This means that if companies with compliance programs are sanctioned for some wrongdoing, the sanctions can be reduced.

In general, the hard law that addresses compliance is like that, including guidelines and principles for risk management, benefits for those who apply them, punishments for those who do not use them to prevent corruption, among other details. Soft law doesn't stray too far from this - as it would not be something constitutionally allowed.

For example, the 2007 Commission Communication A Europe of results – Applying Community Law, sees scope for improvement in prevention, efficient and effective response, improving working methods and enhancing dialogue and transparency - "All of these measures should contribute to a reduction in the number of infringement procedures and improved efficiency in managing them"[70]. The Communication presents the measures to be taken, justifies why, but it is not mandatory.

The Commission Recommendation (EU) 2019/1318, which deals with internal compliance programs for dual-use trade controls is extremely accurate in establishing how to conduct internal compliance controls: "All compliance related functions, duties and responsibilities are defined, assigned and connected to each other in an order that ensures the management that the company conducts overall compliance"[71]. If this recommendation were binding, it would be unfeasible because it establishes exactly how to structure a compliance program. But because it's soft law, it serves as a guide that can be extremely helpful for programs that come to be created - it's flexible.

Likewise, the Commission Recommendation (EU) 2021/1700 sets out the parameters for risk assessment. The guidelines presented are excellent and allow the construction of a very complete risk program. But again, luckily it is soft law, because if it was mandatory to implement exactly these features, they would not be universally adequate.

[69]BRASIL. *Lei nº 12.846, de 1º de agosto de 2013,* op. cit.

[70]COMMISSION OF THE EUROPEAN COMMUNITIES. *A Europe of results – Applying Community Law*. Brussels, 2007. Available at: <https://eur-lex.europa.eu/resource.html?uri=cellar:6fc1ad14-7018-485f-bceb-ab767b5c5927.0003.02/DOC_3&format=PDF>.

[71]EUROPEAN COMMISSION. *Commission recommendation (EU) 2019/1318 of 30 July 2019 on internal compliance programmes for dual-use trade controls under Council Regulation (EC) No 428/2009*. Brussels, 2019. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019H1318&rid=8>.

The Guidelines Manual from the United States Sentencing Commission provides guidelines on the assessment of compliance programs and is used by the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) - which are the bodies that implement the FCPA.

The already mentioned G20/OECD Principles of Corporate Governance are another good example of soft law, and this example demonstrates how soft law has adherence, as the principles

> [...] have become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. They have also been adopted as one of the Financial Stability Board's Key Standards for Sound Financial Systems and form the basis for the World Bank Reports on the Observance of Standards and Codes (ROSC) in the area of corporate governance.[72]

Between soft and hard law, compliance officers have the material necessary to build a compliance program that is in conformity with the appropriate laws, and that, if correctly applied with ethical basis, has its effectiveness enhanced.

4 Ethics as an essential factor for compliance

Ethics should be present in every human action, every decision taken should have an ethical charge and its consequences depend on it. The use of ethics is so important that it has become part of all compliance programs, being the foundation of the tool. Each compliance program must be built on this.

Ethics can be understood as "the systematic study of the generally-held (or conventional) morality of a society aimed at determining the rules which ought to govern human behaviour, the rules that a society ought to enforce, and the virtues worth developing in human life"[73].

As seen through out the history and concept of compliance, it has an economic character. Its very creation was to reduce and prevent future cases of corruption, which was affecting public money - and consequently the economy.

[72] OECD. *G20/OECD Principles of Corporate Governance*, op. cit.
[73] DE GEORGE, Richard T. *A history of business ethics*. Pennsylvania: Prentice Hall, 2010, p. 343.

Economics and ethics have historically been side by side, either as a complement or as a reason for controversy. Amartya Sen argues that ethics and economics are impossible to dissociate, and "the importance of the ethical approach has rather substantially weakened as modern economics has evolved"[74]. Profit maximization by itself leaves out the moral perspective and investing in ethics brings costs to the company.

The separation between them causes social damage in different aspects of human development, and when the proportional relationship between economic policies and human development is shown, the obligation to include ethics in the economy is undeniable (because of the consequences that the lack of one cause in the other).

Sen presents a close relationship between the ability to survive (part of human development) and economic growth, and this relationship is not as generally expected, between per capita income and longevity. The key between the ability to survive and economic growth is how economic growth takes place, especially in relation to investment in health and in reducing poverty levels[75]. Health and equality are ethical issues, involving moral decisions regarding the economy.

From the moment a company opts for corrupt decisions, which harm the public budget and, consequently citizens, the lack of ethics affects the economy. Some ethical problems can even end economic relationships. For this reason, Sen defends the need to work on ethical relationships in the economy, as it directly affects everyone.

The lives of human beings are affected by ethical considerations, and influencing human conduct is, after all, an essential aspect of ethics - so clearly economic considerations must be allowed to have some impact on the ethical behaviour to be performed[76]. The ethical behaviour must be performed by everyone, and businesses are not exempted.

The direct relationship between business and ethics also goes back a long way. The globalization of business has brought the globalization of business ethics, and this field has developed as needed: “Business ethics as an academic field is the systematic study of the morality existing in business—the business practices, the values, the presuppositions and so on actually existing”[77].

[74] SEN, Amartya. *On ethics & economics*. United States: Blackwell Publishing, 1987, p. 70.
[75] SEN, Amartya. *Development as Freedom*. New York: Alfred Knopf, 1999.
[76] SEN, Amartya. *On ethics & economics*, op. cit.
[77] DE GEORGE, Richard T. *A history of business ethics*, op. cit.

Once this relationship is understood, it is necessary to draw a bridge to the organizational culture encouraged by compliance, which works with human behaviour within the entity in which it is applied. As will be detailed in the following section, compliance programs are applied to companies as a whole. The tool considers as essential that the organizational culture must be applied from the Chief Executive Officer (CEO) to the cleaning employee.

Even before implementing codes of ethics, the aim is to implement the organizational culture of ethics. The established cultural rules must surpass any written code, since the code of ethics is nothing more than the personification of society's moral values, that is, to make tangible what must be established in an intangible way, so that it really helps implementation, maintenance, and effectiveness of the compliance program.

Ethical performance must be inherent to the business itself, and the codification will only be effective when the moral values, instilled in the business culture, are already found.[78].

Written codes of ethics are manuals that bring together the entire culture and moral values of the company. These are rules, but they should not be followed because they are written there, but because they depart voluntarily from each one. The organizational culture is responsible for creating this environment that implies voluntary ethical decisions.

Organizational culture is about behaviour patterns and collective assumptions; they do not exist individually, but as a group of people who have a way of thinking, feeling and perceiving the environment they share. The organizational culture concerns the way in which groups interact with each other, with internal and external customers and with other parts that make up the organization's environment, including in the field of behavioural ethics[79].

Thus, a compliance program is more than a code of conduct, it is a program that seeks, through communication and training, to establish an organizational culture, making each employee aware of the need and consequences of ethical conduct, it encourages the company's social responsibility.

By distancing itself from ethics, the company will first see its compliance program crumble, as well as taking the risk of having its reputation tarnished, which causes a loss of credibility in the business market[80].

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[78]SANTOS, João Carlos Tomás dos. Establishment of ethics as a pillar of the anticorruption compliance program. *Revista de Direito Penal Econômico e Compliance*, vol. 3/2020, p. 135 – 150, jul.-sep., 2020.

[79]ANTONIK, Luis Roberto. *Compliance, ética, responsabilidade social e empresarial*: uma visão prática. Rio de Janeiro: Alta Books, 2016, p. 144.

[80]SANTOS, João Carlos Tomás dos. Establishment of ethics as a pillar of the anticorruption compliance program, op. cit.

The combination of economy, law and ethics results in transparency, an essential requirement for Compliance. Precisely for this reason, the guiding principle of the tool, that can be considered the baseline of all compliance objectives, is to regulate all actions in accordance with ethics, which should be present in all corporate decisions. Ethical rigor in creating and complying with internal corporate standards is essential for a functional compliance program.

DIVISION II – PRACTICAL DIMENSION

The theoretical part of compliance has been increasingly studied, and as demonstrated, the concepts of compliance and its understandings are immense. Likewise, interest in the practical part of the tool has grown and various application strategies have been adopted. As strong as the theory is, if the application is not properly done, compliance effectiveness will be low.

When speaking of a practical dimension, it is not the practice directed at a specific sector of activity or at a specific type of organisation; it is the practice of compliance as a whole, encompassing the most diverse objectives. For this reason, this section presents several structures of compliance programs, as well as the benefits they can bring.

1 The structuring and application of compliance in practice

For compliance to be effective, it must be applied through a well-structured program that is tailored to the needs of the company that will be using it. The programs are developed in a unique way, considering the environment and people. There are base points that are common to all programs, but the way they will be executed differs.

As seen, ethics is the starting point that any program must start from. All choices must be made in accordance with the company's ethical values, and planned so that they can be receptively accepted by all. Thus, it is a common factor in programs that a strong organizational culture is developed and encouraged.

The programs must be structured in three pillars: prevention, detection, and correction[81]. The first is the most important, holder of the greatest investment of resources, as prevention means less effort for the next steps. Detecting refers to locating where prevention failed, finding what continues to be carried out contrary to ethical and correct these practices. The correction is the elimination of illegal activities detected, to guarantee stability and credibility to the system.

Emphasizing prevention, which is synonymous of risk identification, compliance provides the opportunity to predict all the possible consequences for each action that the company takes, whether performed by the manager or the worker.

> During the phase of risk identification, potential risks that threaten the objectives of the organisation are recorded. Risk identification is an important phase because if risks are not identified here, the odds are that it will never be identified and thus never will be covered. In addition, the moment when a risk is identified is crucial. The earlier identification takes place, the earlier attention can be paid.[82]

Prevention is translated through thinking about all conspiracy theories and imagining everything that can go wrong, everything that at the end of the line somehow compromises the institution's brand - that could end up involved in a scandal or even pay exorbitant amounts of fines[83].

Understanding that all programs will have an ethical basis, and that they are based on preventing, detecting and correcting; we move on to some of the interpretations of compliance programs.

For Ferreira, there are eight instruments for applying compliance. Tone at the top, in which the company's management board must set an example – the tone – so that employees will later follow; a company's own code of ethics and conduct, which will be the guide book for the entire program, and which should cover clearly what is intended to be developed and what counts as illicit and corrupt activity; adopting compliance procedure policies, which is actually the verification that third parties and employees related to the company fall within the guidelines established internally; carry out the inspection of the compliance program, which must be carried out by an autonomous and impartial employee; maintain a business risk mapping, that is, carry out due diligence to avoid future risks; periodic and continuous training, which directly refers to personal management involving all levels of company employees; creation

[81]FERREIRA, Fábia Duarte. A prática do compliance como um instrumento empresarial anticorrupção para preservação das empresas, op. cit.
[82]EUROPEAN COMMISSION. *Risk management guide for tax administrations,* op. cit., p. 21.
[83]CANDELORO, Ana Paula P. Compliance: inovação estratégica para a sustentabilidade das organizações. *Revista RI - Relações com Investidores*, Rio de Janeiro, n. 187, p. 55 – 61, oct. 2014.

of reporting channels to enable the communication of illegal practices - and here it is important to remember that internal investigations must be carried out in accordance with legal standards and, finally, maintain a bridge with audit sector, considering that they can provide important data for carrying out compliance measures[84].

For Ivó Coca Vila, a compliance program has seven pillars: compliance culture; pre-establishment of business objectives; risk assessment; adoption of necessary measures to contain risks; delimitation of scopes of competence; internal communication systems; and systems of supervision and sanction[85].

Negrão and Pontelo understand that there are four efforts that must gain priority for the application of compliance programs. Adopt, within the organization, ethical principles and standards of conduct, and ensure that they are complied with and adhered to; ensure the implementation, adherence and updating of rules and regulations that prevent future problems of non-compliance and the applicable regulation of each business; foster a culture of internal controls in the continuous search for compliance; and ensure that the requirements of regulatory and control bodies are met by the various areas of the organization[86].

Siqueira and Francischetto point out as important features of a program, the support of senior management or management; the constant mapping and analysis of risks; the creation of a document that clearly demonstrates the company's values and ethical principles that must be followed by everyone; verifying that all parties (managers, workers and third parties) comply with the pre-defined guidelines and, in the case of violations, correct them; and the monitoring of business activities so that, problems caused by non-compliance with the ethical and legal precepts that permeate business activity are resolved[87].

Maeda, when stating that compliance programs do not intend for violations to be extinguished, but instead for a reduction in the probability of violations, brings five groups - which are divided into several points - of essential characteristics for the programs: management and leadership support; risk mapping and analysis; policies, controls, and procedures; communication and training; monitoring, auditing and remediation[88].

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[84]FERREIRA, Fábia Duarte. A prática do compliance como um instrumento empresarial anticorrupção para preservação das empresas, op. cit.

[85]VILA, Ivo Cóca. ¿Programas de Cumplimiento como forma de autorregulación regulada?, in SILVA SÁNCHEZ, Jesús-María (Dir.); MONTANER FERNÁNDEZ, Raquel (Coord). *Criminalidad de empresa y compliance: prevención y reacciones corporativas*. Atelier Libros Juridicos: Barcelona, 2013. p. 43-76.

[86]NEGRÃO, Célia Lima; PONTELO, Juliana de Fátima. *Compliance, controles internos e riscos*: a importância da área de gestão de pessoas, op. cit.

[87]SIQUEIRA, Vitor da Costa Honorato de; FRANCISCHETTO, Gilsilene Passon Picoretti. The emergency of compliance programs and their application in the labor context in the light of the company's social function, op. cit.

[88]MAEDA, Bruno Carneiro. Programas de compliance anticorrupção: importância e elementos essenciais, in DEL DEBBIO, Alessandra (Coord.); MAEDA, Bruno Carneiro (Coord.); AYRES, Carlos Henrique da Silva (Coord.). *Temas de anticorrupção e compliance*. Rio de Janeiro: Elsevier, 2013.

These are just a few proposed models, as each author, compliance officer or researcher will highlight different points in the structure of a program. It all depends on where the program will be applied, and several factors must be analysed. The size of the company, the budget to implement the program, the number of risks that the company may be exposed to, how many compliance professionals will be hired, among many other factors. The most important is that programs meet basic compliance needs, covering the three phases of preventing, detecting and correcting.

The biggest investment must be in prevention. This phase should cover risk mapping, knowing the company's area of activity, the third parties with whom the company does business, the functions of each sector, the impact that employees' actions can have, and each factor that may represent a risk. For prevention to be effective, the organizational culture needs to be widely disseminated and compliance training must take place.

If the goal is a well-accepted organizational culture, plans should focus on each employee as an individual with unique and special needs. It is not effective for a counter attendant to receive the same training as a boss responsible for large transactions. The training must be adapted to the specific functions of each sector, showing them how each of their actions can be essential to keep the company compliant with all laws. It's important, of course, that the tone of the top is established, but it's no use to focus on that. The key to a good compliance plan is to focus these plans on individuals.

The training must be constant and not as it happens most of the time, only in the onboarding of new employees. The strategy used on a large scale is to send pages and pages of codes of conduct and company rules. These pages will hardly be read, and will be ignored. The training must take place in a way that effectively is interesting, not just out of obligation.

Regarding detection, whistleblowing channels (where employees can report irregularities) are very useful. It is important to guarantee the safety of employees who use this channel, so that there is no fear in reporting. Another relevant part is to always monitor activities that are related to the highest risk, and a good strategy is to rely on audit support and other risk management tools.

Correction is the last instance of compliance, which will be used when there are failures in other phases. But that's not why it doesn't deserve attention and investment. The difference in compliance to other tools is largely at this stage. When detecting violations, compliance seeks to understand why this happened and to present solutions so that it does not reoccur. Each correction point is a point that must have enhanced prevention and detection.

These are the compliance programs, essential for the laws to be complied with and for ethics to govern the business environment. If structuring a compliance program is a task that requires attention and is not simple, applying all of this is even more difficult. The challenges that a program can face are diverse, and deserve attention because when applying a program, they must have already been considered.

2 The difficulties in compliance programs application

Change is always difficult, and when change requires effort for a reason that is not the individual's problem, motivation is lower. This is the scenario when an employee is told that he/she must follow certain rules and have certain conduct to comply with the company's ethics. Despite being beautiful on paper, organizational culture is the first challenge of compliance programs.

> Employees may be asked to sign lengthy codes of conduct attesting that they know their firms polices; additionally, they may sit through training programs on topics such as privacy, insider trading, and bribery. Yet individuals often pay only enough attention to these generic classes to pass the 10-question quiz at the end. Even at firms spending millions of dollars annually on their programs, compliance often lacks substance.[89]

It is difficult to effectively implement the organizational culture instead of trying to force it and not get a return. For a functional application of compliance, the company as a whole need to accept and understand its importance, it needs to create a culture.

Companies are living organisms, and over time, especially with the help of consultants, they build an organizational culture that encourages learning, or at least doesn't inhibit it. To learn, the manager's mind must be open to change and able to adapt to the day-to-day business of the new times. It is essential to be open to mistakes, and, flexible to learning what these same mistakes can bring to the environment[90].

[89]CHEN, Hui; SOLTES, Eugene. Why Compliance Programs Fail —and How to Fix Them. *Harvard Business Review*, mar./apr, 2018, p. 03.
[90]ANTONIK, Luis Roberto. *Compliance, ética, responsabilidade social e empresarial*: uma visão prática, op. cit.

Another challenge are false programs, which exist solely for the purpose of reducing the penalty in conviction cases: "they are a tool for administrators to increase their power in the company – a justification for the establishment of a security system – and help avoid corporate liability"[91].

As mentioned, several laws provide for the reduction of sanctions if the company has a compliance program, so many have it just for that purpose. This is a problem that goes much deeper, as it concerns the evaluation of programs - which is a subject that is still very unstable.

Governments around the world have tried to establish evaluation parameters for programs, but it is not an easy task as it involves all the issues of conceptualizing compliance, legislating by soft or hard law, and even defining which government agency will be responsible for the evaluation. The United States is at the forefront in this regard because, through the DOJ and SEC, they evaluate programs, and even published a guide, the Evaluation of Corporate Compliance Programs, which establishes parameters.

So, while it's not easy, it's possible to evaluate the programs to ensure there are no false programs. This evaluation can also be pre-made in another way,

> It is necessary not only that the contents of ethical codes or company policies reflect an open process where stakeholders have participated but also that there are supervisory bodies independent of the company's governing bodies, which include independent members and representatives of stakeholders.[92]

What guarantees, in addition and in a simpler way, that the programs are not implemented just for the reduction of sanctions is the application of the organizational culture, so that the company's employees individually follow the ethical rules.

As it is a relevant and new topic, laws are always being updated and new ones created. As explained, soft law that is not binding dominates the compliance world. As it is not binding, following the laws can be a big problem because since the company is not obliged, in theory it will not be committing any infraction or error for not following recommendations - "the challenge of assessing corporate compliance with a wide range of laws and regulation, a lynchpin of self-regulation, turns on the authenticity and sincerity of organizational action"[93].

[91] RODRIGUES, Anabela Miranda. Compliance programs and corporate criminal compliance, op. cit., p. 04.
[92] *Idem, ibidem*, p. 05.
[93] LAUFER, William S. The compliance game. *Revista dos Tribunais*, vol. 988/2018, p. 67 – 80. feb., 2018, p. 06.

This means that again the solution to avoid non-compliance with laws is the organizational culture, which will make following all the recommendations, even if not binding, to be a voluntary act.

Another obstacle in applying compliance programs is the costs involved. "The average multinational spends several million dollars a year on compliance, while in highly regulated industries—like financial services and defence—the costs can be in the tens or even hundreds of millions"[94]. Not all companies have this entire budget available to invest in compliance. One research conducted in Brazil showed that for some companies, compliance costs have dictated significant changes in business operations[95].

The implementation of a compliance policy will undoubtedly bring high costs for the business organization, but the expenses that future losses may bring can possibly be much bigger. The high cost of implementing a compliance plan can be resolved through planning and cost reduction studies. There are several possibilities of implementing a compliance plan and not making it excessively expensive to apply. A well thought out and planned expense with prevention is much better than an unexpected expense to pay fines that can even lead companies to bankruptcy, causing the loss of investors and even the loss of consumers for knowing that the company has been convicted.

Still within the economic nature, the application of compliance also ends up creating barriers in certain businesses that were previously considered acceptable, and due to the new ethical policies, they can no longer be carried out. The tool precisely aims to prevent the consequences of unethical business, and that means cutting off relationships with third parties, collaborators and even customers who don't fit the company's rules and guidelines.

The termination of these relationships should be treated as a benefit and not as a loss, as in the future there will be no monetary loss to the company due to a future conviction (since the companies are liable for the wrongful acts of those with whom they maintain relationships).

Although there are challenges, they can be overcome if compliance programs are built and implemented while aware of these obstacles, as they are already in essence anticipating each one of these situations. An attentive compliance officer will think about all of this, and the result will only be benefits for the companies.

[94] CHEN, Hui; SOLTES, Eugene. Why Compliance Programs Fail —and How to Fix Them, op. cit.
[95] KPMG. *Pesquisa de Maturidade do Compliance no Brasil 2ª Edição*. KPGM, 2017. Available at: <https://assets.kpmg/content/dam/kpmg/br/pdf/2017/01/br-kpmg-pesquisa-maturidade-2a-edicao.pdf>.

3 The benefits of applying compliance programs

Throughout the foregoing, it was evident that having a compliance program is beneficial, but there is still room to further emphasize the reason for investing on it. It starts with the points already mentioned.

Society increasingly demands corporate social responsibility when choosing which products to buy, more than the price is considered. Knowing that the company has concerns about these issues, customers are more interested in using the brand. "Emotional and social value appear to be somewhat "expendable" with consumers in a context of economic uncertainty, while CSR that provides functional value can become an even more salient criteria for decision making"[96]. There are several cases of large brands that suffered economic loss when scandals involving slave labour or sexual harassment became public.

Compliance programs intent to ensure that problems of this type do not occur, through due diligence on work partners and ensuring that everything is legally complied with.

Also in the economic sphere, fines for non-compliance can be big breaks in budget. Labour compensation, fines for environmental destruction, sanction for tax evasion... all of these can be avoided. And if there are still problems, sanctions can be reduced by the existence of effective compliance programs.

By creating an organizational culture, compliance provides a more pleasant work environment, showing concerning with the employees. And considering that employees are the main agents of a compliance program, it is important to ensure that the work environment is satisfactory, while only brings more benefits to the company. Studies already proved that the happier the employees, the better the results of work[97].

Investors consider the risk they take when investing, always aiming for greater profit rather than loss. Companies that already work with a philosophy of risk prevention, and are therefore less likely to have problems, are the ones that will attract more investments. Likewise, adhering to compliance means more business possibilities. Companies are increasingly demanding that the companies they do business

[96]GREEN, Todd; PELOZA, Jhon. How does corporate social responsibility create value for consumers?. *Journal of Consumer Marketing*, vol. 28, nº 1, p. 48-56, 2011, p. 52.

[97]OSWALD, Andrew J.; PROTO, Eugenio; SGROI, Daniel. Happiness and productivity. *Journal of Labor Economics*, 33 (4), pp. 789-822, 2015.

with have risk prevention programs. It is only with compliance programs in place that many contracts are signed.

Throughout the analysis, it is possible to see that the very essence of compliance explains the benefits in the simple attempt to create concepts for the it. More and more, governments and international bodies such as the OECD and the European Commission encourage the use of the tool[98]. The benefits and the entire structure to apply the compliance programs are available, companies just need to notice and start the journey into the vastus world of compliance.

[98]OECD. *Building Tax Culture, Compliance and Citizenship:* A Global Source Book on Taxpayer Education, Second Edition. Paris: OECD Publishing, 2021.

CHAPTER II – ABUSIVE TAX BEHAVIOURS

Taxes are part of life in society, and so they are because they are necessary. The Declaration of the Rights of Man and of the Citizen, published in 1789, already assured that "a common contribution being necessary for the support of the public force, and for defraying the other expenses of government, it ought to be divided equally among the members of the community, according to their abilities"[99].

The expected contribution from individuals and legal entities aims to return the paid taxes to the contributors, but translated into health, public transport, security... the obligations from the governments to its people. In this way, it is fair that the contributions should be equally shared among all. This is the prerogative of the principle of tax equality, which still governs tax law. The equality to which the principle refers does not mean that everyone should contribute the same amount at the quantitative level, but that everyone should contribute in the same way.

Tax equality happens when the tax legislator chooses as the object of taxes, facts and circumstances that are appropriate to the contributory capacity of everyone - and to ensure this, the law needs to guarantee the distribution of tax burdens not only by the normative forecast, but also through of compliance with these[100].

The principle of tax equality has already been the objective of several theories and is approached in different ways by authors. It is important to understand that this principle is directly associated with the criterion of the fiscal capacity. It implies an equal tax for those with equal contributory capacity (horizontal equality) and a different tax (in qualitative or quantitative terms) for those with different contributory capacity in proportion to this difference (vertical equality)[101].

Even with the need and obligation of contribution, many times, people try to escape the equal division of contribution through the practice of acts that aim to not contribute as supposed. These practices are called tax fraud, which can be committed in a variety of ways.

This chapter intends to demonstrate the impact that these frauds can cause. To achieve it, first a brief understanding of the tax systems in European Union is necessary. With good notion, tax fraud is presented and defined, followed by which types of tax fraud are common, specifying the negative impact

[99] NATIONAL ASSEMBLY OF FRANCE. *The Declaration of the Rights of Man and of the Citizen*. France, 1789, p. 02.
[100] SANCHES, J. L. Saldanha. *Manual de Direito Fiscal*. 3ª Ed. Coimbra: Coimbra Editora, 2007, p. 211.
[101] NABAIS, José Casalta. *Direito Fiscal*. 4ª Ed. Coimbra: Almedina, 2006, p. 154.

caused. The way this practice has been fought and regulated is presented, as well some practical cases are analysed to demonstrate how it happens and its impact.

1. The tax system in the European Union

To exist, the action of tax fraud requires a tax system, so the practices will not be compliant with this system. A tax system is a group of rules, taxes, principles, motivation, all the elements involved in the process of asking for taxes. As explained by the Inter-American Center of Tax Administrations (CIAT) a tax system must have defined limits and objectives:

> We consider that a tax system is a set of taxes in force in a country at a given time.
> When talking about a tax system, one must always consider the reality in which it applies. For this reason, on the one hand there is a space limit, because it applies to a specific country; and on the other, a time limit because it governs at a specific period, that is, it follows time.
> The word system implies harmony between taxes and between the fiscal and extra-fiscal objectives of the state.
> By its own definition, system implies that there are different elements, that there is a link between them, a specific order or form, pre-established and common objectives. For this reason, most doctrines claim that reaching the tax system is the ideal, but what we have are tax regimes, which in many countries are characterized by unpredictability, permanent change and tax reforms for the sole purpose of tax collection.[102]

In other words, a true tax system applies in its rules the awareness of the objective of applying taxes, without just charging them meaninglessly. In this sense:

> A rational tax system must respect the fact that taxes in general have a fiscal but also non-fiscal purpose. As regards their fiscal purpose, taxes are used to cover and fulfil the income side of the state budget. Non-fiscally, they are used as a means of potentially affecting the behaviour of economic entities carrying on activities in the national economy, so that the income structure of households and the asset structure are deliberately changed towards greater fairness.[103]

There is no unique tax system applied worldwide, and even the European Union doesn't have a fully shared tax system. Considering that to understand tax fraud a good notion of tax systems is required;

[102] INTER-AMERICAN CENTER OF TAX ADMINISTRATIONS. Tax Systems and Tax Reforms. Some ideas on the topic (i). *CIAT,* n. d. Available at: <https://ciat.org/sistemas-tributarios-y-reformas-tributarias-algunas-ideas-del-tema-parte-1/?lang=en>.
[103] MOKRÝ, Vladimír. Taxes, taxation and the tax system. *BIATEC*, Volume XIV, 12/2006, pp. 17-21, p. 18.

this topic will focus on exploring the tax functioning in the European Union through a brief historical recap, and the demonstration of how the European Union and its Member States relate to tax systems.

Tax has been present among society since the beginning of times. The first kwon form of taxation was the *corvée*, people would work for the tax collectors to pay taxes (that in this time were a right of the tax collector), basically acquiring the status of forced labour. The *corvée* was maintained as a way of charging the ones who could not pay taxes. In the European territory, some nations applied this tax system until the 19th century[104].

During a long period of time this was the main form of taxation, and this taxation was only direct taxation, different from the tax systems from today that apply both direct and indirect tax[105]. To understand the evolution of taxes, it should be noted that direct and indirect taxes are the different types of taxes.

The notions of classifying direct or indirect taxes are based on several criteria, namely the financial criteria (direct taxes immediately reach the contributory capacity, and indirect taxes mediately); the national accounting criterion (those that do not constitute production costs for the company are direct and those that do are indirect); the criteria of economic repercussion (if the tax reaches the final consumer/final purchaser of the good, it is indirect, if not, it is direct); the criteria of the administrative assessment (the tax is direct if there is an administrative or tax assessment act, if not indirect); and finally, the criteria of the nominative list (direct taxes the ones on a list and indirect taxes the ones that are not)[106].

Fundamentally, in direct taxes, the debtor of the tax and the one who will bear it in economic terms coincide; in indirect taxes, the tax debtor passes it to the person who must bear it[107]. Examples of direct taxes are the ones under personal income, property; and of indirect taxes sales, import duties, among others.

From the *corvée,* the tax figure started to develop, especially during the Roman empire and the Byzantine Empire. The application of fees became more intense and tax avoidance was already beginning to appear through the exemption of payment[108]. Those who held power, that is, the richest, were not subject to paying taxes - this pattern became repetitive, even in the taxes charged by the church.

The medieval period in Europe, marked by feudalism, is still studied in schools today as the period when peasants paid so many fees to feudal lords that they barely survived. The wave of change

[104] BURG, David F. A World History of Tax Rebellions: An Encyclopedia of Tax Rebels, Revolts and Riots from antiquity to the present. Routledge, 2003.
[105] *Idem, ibidem*.
[106] NABAIS, José Casalta. *Direito Fiscal,* op. cit., pp. 42-46.
[107] SANCHES, J. L. Saldanha. *Manual de Direito Fiscal*, op. cit., p. 25.
[108] BURG, David F. A World History of Tax Rebellions: An Encyclopedia of Tax Rebels, Revolts and Riots from antiquity to the present, op. cit.

began in Greece when the idea of democracy gained traction. The taxes as applied were against freedom and dignity[109]. From that point on, the fee systems began to change little by little, until they arrived at what we know today.

Around the year 1820, taxes began to be applied to all consumer products, such as salt, sugar, soaps... And the main reason for this was to pay for England's wars, specifically with France. The trend quickly spread across European territory[110]. From that moment on, the tax on products, as well as on income, was consolidated. A lot happened in the almost two hundred years that followed, full of several rebellions due to abusive taxes, until the systems were what they are today (still counting on abusive taxes in some cases).

Between 1970 and 1990, some changes were observed in the European territory. Taxes increased with expansion of public sector commitments to welfare provision and the high levels of unemployment[111]. In 1992, the "Maastricht Treaty and later the Stability and Growth Pacts created a framework in which many EU countries have implemented fiscal consolidation efforts"[112]. Although some taxes continued to rise, with these legal documents other taxes stabilized.

From the 1990s onwards, European countries tended to reduce tax rates as much as possible. It was a period marked by several measures and regulations that promoted the decreasing rates[113].

Part of this is also due to the creation of the European Union in 1992. Everything became simpler, and the abolition of taxes in the trade between member countries made a more pleasant tax regime for the payers possible. The creation of the European Union was followed by the introduction of several common and semi-harmonized points that shape the EU tax systems.

The EU's Exchange Rate Mechanism is one of the acts that had an important role in simplifying taxes related to trade. Once this mechanism was set up in 1999, it ensures "that exchange rate fluctuations between the euro and other EU currencies do not disrupt economic stability within the single market, and to help non euro-area countries prepare themselves for participation in the euro area"[114]. This opened the door for more countries to simplify their tax regimes and follow the EU guidelines.

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[109] *Idem, ibidem.*
[110] *Idem, ibidem.*
[111] JOUMARD, Isabelle. Tax Systems in European Union Countries. *Economics Department Working Papers, no. 301*. Paris: OECD Publishing, 2001, p. 03.
[112] *Idem, ibidem*, p. 04.
[113] *Idem, ibidem.*
[114] EUROPEAN COMMISSION. ERM II – the EU's Exchange Rate Mechanism. *European Commission*, n. d. Available at: <https://ec.europa.eu/info/business-economy-euro/euro-area/introducing-euro/adoption-fixed-euro-conversion-rate/erm-ii-eus-exchange-rate-mechanism_en>.

Another relevant point in the context of European tax systems is the Valued Added Tax (VAT). This tax, mandatory in all Member States, exists from the necessity of having a neutral and transparent market, and the main legislation governing it is the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax[115].

The concept of VAT is "a general, broadly based consumption tax assessed on the value added to goods and services. It applies more or less to all goods and services that are bought and sold for use or consumption in the European Union"[116]. Each sale of goods and each provision of services is a tax fact that is subject to regulatory provisions and that generates the tax obligation[117].

The evolution of this tax also represents the phenomenon of community tax harmonization: initially it was a tax based on a community directive and that each country approached in its own way and today it is a European tax built around decisions of the Court of Justice of European Union (CJEU)[118].

That means that although being biding, each Member State can choose how to apply it in what concerns form and methods when transposing it to national legislation, always observing the functioning of it:

> The VAT due on any sale is a percentage of the sale price but from this the taxable person is entitled to deduct all the tax already paid at the preceding stage. Therefore, double taxation is avoided and tax is paid only on the value added at each stage of production and distribution. In this way, as the final price of the product is equal to the sum of the values added at each preceding stage, the final VAT paid is made up of the sum of the VAT paid at each stage.[119]

Another point shared by Member States are the excise duties. Excise duties are "indirect taxes on the sale or use of specific products, such as alcohol, tobacco and energy. The revenue from these goes entirely to the country to which they are paid"[120]. That is, Member States agree to establish minimum rates of excise duty, ensuring that the EU rules are followed.

These taxes are justified by targeting products whose use is seen with disfavour as they entail a high social cost, such as alcohol and tobacco, and petroleum products and energy (which are the

[115] COUNCIL OF THE EUROPEAN UNION. *Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax*. Brussels, 2006. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32006L0112&from=EN>.
[116] EUROPEAN COMMISSION. What is VAT?. *European Commission*, n. d. Available at: <https://ec.europa.eu/taxation_customs/what-vat_pt>.
[117] SANCHES, J. L. Saldanha. *Manual de Direito Fiscal*, op. cit., p. 27.
[118] *Idem, ibidem*, p. 90.
[119] EUROPEAN COMMISSION. What is VAT?, op. cit.
[120] EUROPEAN COMMISSION. Administrative cooperation in the field of excise duties. *European Commission*, n. d. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=legissum%3A2103_1>.

increasingly important ecological taxes)[121]. This high tax burden is expected to mean a reduction in consumption.

The main provision at EU level regarding excise duties is the Council Directive 2008/118/EC of 16 December 2008. This Directive covers the categories of products that Member States must apply excise duties to; the principles on where excise duty revenue accrues; and the rules on the production, storage and movement of excise products[122].

One more common point among EU tax systems are the sanctions applied by each member state. The sanctions are national responsibility that must follow EU guidelines:

> Whilst penalty regimes are not harmonized at the EU level, and member states are therefore free to choose the penalties that seem most appropriate, the CJEU has consistently reiterated that this power must nevertheless be exercised in accordance with general principles of EU law, and in particular the principle of proportionality.[123]

Despite all the commonalities, a single tax regime for the entire EU has never been implemented. The European Union's understanding on the matter is that "the EU does not have a direct role in collecting taxes or setting tax rates. The amount of tax each citizen pays is decided by their national government, along with how the collected taxes are spent. The EU does, however, oversee national tax rules in some areas [...]"[124].

Thus Members are free to choose how their tax systems will be, always observing the EU guidelines (as will be presented in the third section of this division, there are several documents in the EU that address tax, especially tax fraud in its most diverse forms). This freedom, however, fully applies only in relation to direct taxation.

> Tax policy in the European Union (EU) has two components: direct taxation, which remains the sole responsibility of Member States, and indirect taxation, which affects free movement of goods and the freedom to provide services in the single market.

[121]SANCHES, J. L. Saldanha. *Manual de Direito Fiscal*, op. cit., p. 58.
[122]EUROPEAN COMMISSION. Common Excise Duty Provisions. *European Commission*, n. d. Available at: <https://ec.europa.eu/taxation_customs/taxation-1/excise-duties/common-excise-duty-provisions_en>.
[123]DE LA FERIA, Rita. Tax Fraud and Selective Law Enforcement. *Journal of law and society*, v. 47, n. 2, June, 2020, pp. 240–270, p. 255.
[124]EUROPEAN UNION. *Towards fair, efficient and growth-friendly taxes*, n. d. Available at: <https://european-union.europa.eu/priorities-and-actions/actions-topic/taxation_en>.

> With regard to direct taxation, the EU has however established some harmonised standards for company and personal taxation, and member countries have taken joint measures to prevent tax avoidance and double taxation.
>
> On indirect taxation, the EU coordinates and harmonises law on value-added tax (VAT) and excise duties. It ensures that competition on the internal market is not distorted by variations in indirect taxation rates and systems giving businesses in one country an unfair advantage over others.[125]

Therefore, although there is no single system, the concepts regarding tax - including tax fraud - are shared among many countries. The notion of right and wrong is the same, what changes is the legal issues that can be approached in different ways.

This understanding sets the fight against tax fraud in a single front, based on ideas shared by many, facilitating the concept and fight against tax fraud. This base is extremely important because "currently, 28 different corporate tax systems in the EU create opportunities for aggressive tax planning, negatively affecting tax morale and tax fairness. This tax patchwork also results in high compliance costs and hampers investment"[126].

Tax fraud practices in its most diverse ways are closely related to the concepts and notions discussed here affecting Member States as well as the EU itself, and for this reason, with the perception of how taxes are handled in the EU, the process of understanding tax fraud becomes simpler. This leads to the next section, a study of tax fraud practices.

2. The meaning and impact of tax fraud and other abusive tax behaviours

The concept of tax fraud has been discussed by law makers and economists for decades, and even so, this concept is still developing. This is due to the complexity of the subject and the fact that as new laws and ways of combating it are implemented, new ways of practicing fraud emerge. Likewise, other abusive tax behaviours such as tax planning and tax avoidance occurs at the same time as tax fraud. To follow this concept that needs continuous updates, it starts with the meaning of the word set.

[125] EUROPEAN UNION. *Taxation*. European Union, n. d. Available at: <https://eur-lex.europa.eu/summary/chapter/21.html>.
[126] EUROPEAN COMMISSION. Executive Summary of the Impact Assessment Accompanying the document Proposals for a Council Directive on a Common Corporate Tax Base and a Common Consolidated Corporate Tax Base (CCCTB). *European Commission*, Strasbourg, 2016. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016SC0342&from=EN>.

> Tax fraud can be largely defined as behaviour aimed at obtaining an unlawful tax advantage and/or causing unlawful tax loss. Although the means of obtaining such an advantage vary greatly, as do the potential costs resulting from the fraud, there is often a failure to grasp the complexity of the phenomenon, which is then reflected in the inadequacy of the measures adopted to combat it.[127]

In this way, all behaviours exercised through unlawful ways that start from an individual(s), legal entity(ies) or both, that has the final objective of somehow obtaining an advantage that will cause harm can be considered tax fraud and considered as a crime. When the behaviours are practiced with the same purpose, but exercised through lawful ways, other abusive practices such as tax avoidance and aggressive tax planning occur.

More or less directly protecting the State's assets, tax fraud could criminalize any and all behaviour that jeopardized the State's tax interests; any behaviour likely to cause an illegitimate decrease in tax revenues not only deserves censure but could also benefit from criminal reaction[128].

Subsequently, the next topics will focus on the impact of tax fraud, the criminal nature of tax fraud and the analysis of the types of tax fraud.

2.1 Consequences associated with abusive tax behaviours

All tax fraud practices have negative consequences, the institute of tax fraud in general, because it exists, is a detriment. In addition to the moral and social consequences, the numerical impact is high.

To understand the loss, one fact must be known: "Taxes are the main source of revenue for the national budget of a country or region"[129]. Therefore, all actions that lead to any loss of revenue by governments have a high impact in numbers and structure – "These situations undermine the integrity of the tax system and potentially increase the difficulty of reaching revenue goals"[130].

Predicting the exact number of monetary losses due to tax fraud is difficult, so the numbers are always presented as estimates. The European Commission estimates that more than one trillion of euros are lost due to tax fraud[131]. Only Base erosion and profit shifting (BEPS) practices represent to countries

[127] DE LA FERIA, Rita. Tax Fraud and Selective Law Enforcement, op. cit.
[128] POMBO, Nuno. *A fraude fiscal: a norma incriminadora, a simulação e outras reflexões.* Coimbra: Almedina, 2007, pp. 222-223.
[129] FRUNZA, Marius-Cristian. *Value Added Tax Fraud*, op. cit., p. 01.
[130] OECD. *Addressing the Tax Challenges of the Digital Economy*, op. cit., p. 100.
[131] EUROPEAN COMMISSION. *A huge problem*, n. d. Available at <https://ec.europa.eu/taxation_customs/huge-problem_en>.

"100-240 billion USD in lost revenue annually, which is the equivalent to 4-10% of the global corporate income tax revenue"[132].

The act of profit shifting largely practiced on BEPS can represent generalized damage: "In addition, when certain taxpayers are able to shift taxable income away from the jurisdiction in which income producing activities are conducted, other taxpayers may ultimately bear a greater share of the burden"[133]. This is the main point of attention and operation of tax fraud and its impact in general. When there is a failure to receive tax on one side, the other will always have to pay because the government needs that money - it was already counting on receiving it.

In 2004 Members States estimated around 10% of net Value Added Tax (VAT) receipts in loss because of tax fraud[134]. Added to lost values, VAT fraud causes inequality: "where fraudulent businesses charge less tax, and thus a lower price, than non-fraudulent ones in order to obtain a competitive advantage, inequity may also arise"[135].

One recent study requested by the European Commission estimated that the "yearly average revenue losses due to international tax evasion for the EU-28 over the study period is estimated at EUR 46 billion, or approximately 0.46% of GDP"[136] - this means that the loss between 2004 and 2016, just 12 years, was more than 552 billion euros.

In addition to the revenue loss, people and institutions not involved in fraud are indirectly affected by the non-return of tax payments - roads, hospitals; all investments that are not receiving the expected income.

In short, any abusive tax behaviour will have negative consequences. They can affect the integrity of the tax system, cause governments to lose revenue, and negatively impact taxpayers' day-to-day lives. It is precisely for all the damage caused that some of these practices are also presented as tax crimes, which will be presented in the next topic.

[132] OECD. International collaboration to end tax avoidance, op. cit.

[133] OECD. *Addressing the Tax Challenges of the Digital Economy*, op. cit., p. 100.

[134] COMMISSION OF THE EUROPEAN COMMUNITIES. *Report from the Commission to the Council and the European Parliament on the use of administrative cooperation arrangements in the fight against VAT fraud*. Brussels, 2004. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52004DC0260&from=EN>.

[135] DE LA FERIA, Rita. Tax Fraud and Selective Law Enforcement, op. cit, p. 251.

[136] EUROPEAN COMMISSION. *Estimating international tax evasion by individuals*. Luxembourg: Publications Office of the European Union, 2019, p. 92.

2.2 The criminal sphere of tax fraud

Originally, practices that affect tax revenue are tax offenses that are legislated and sanctioned in the tax sphere, however, tax fraud is also typified as a crime in legal systems; the legislation typifies conducts characterizing several tax crimes practices, such as those pointed out in the next section.

There is a natural and necessary criminal character to tax fraud – "Compliance will decrease significantly if a tax offender goes unpunished, consistent with deterrence theory, regardless of perceived culpability"[137]. Without delving deeply into penal theory, this work is limited to the statement that there is a need for punishment for the practice of tax crimes through the principle of retributive justice (which in simple words is the subjective punishment of those who break the law[138]).

Tax law alone cannot remedy the liability of tax fraud crimes in integrity, after all: "in a case of tax fraud, repayment of taxes evaded is compensatory justice, but punishment would occur over-and-above the tax repayment, and is meted out as a fine, which is sometimes accompanied by imprisonment"[139].

Therefore, tax fraud relates to tax law and criminal law. It is not possible to approach the subject in its entirety without invoking characteristics of the other legal sphere. It is worth adding to this work, despite being focused on the practice of tax fraud in the sphere of tax law, a brief criminal bias.

Tax crimes are the subject of several theories and understandings in criminal law, which deal with various points such as guilt, intent, sanctions, character of the sentence... it is a subject that requires a comprehensive work. A simple context that provides a greater notion of how tax crimes are seen by criminal law is that in general, every practice with intention of an action (even if it is attempted) and the consequence of this action that goes against tax rules is an illicit practice that will be criminally punished.

It is important to mention that the presented context sometimes receives the understanding that tax illicitness and tax infraction are different practices, that lead to different criminal consequences. Tax illicitness leads to more than one type of criminal reaction - depending on the nature of the practice - that

[137] KING, Tisha; FARRAR, Jonathan. To Punish or Not to Punish? The Impact of Tax Fraud Punishment on Observers' Tax Compliance. *Journal of Business Ethics*, 2021. Available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3826736>, p.29.

[138] *Idem, ibidem*.

[139] *Idem, ibidem*, p. 07.

can be restorative, preventive, compensatory, compulsory, and punitive. The tax infraction by its turn, can lead only to one type of reaction: punitive[140].

It can be a challenge to apply criminal laws in practice to tax crimes, since in general, typification includes open possibilities with generalized and indeterminate expressions that are not exhaustive. In the doctrine there are criticisms of this tendency that have been going on for years, since criminal laws regarding tax crimes should be interpreted restrictively in the sense of only including tax facts provided for by law, and not analogous facts[141].

The most important is that penalties correspond, to fully fulfil their objectives, to a dominant feeling of censorship of the community to whose criminal norms are directed[142]. This statement reinforces the need for penalties for tax crimes and their criminal nature.

Understanding the close relationship between the tax and criminal spheres, the next section will present the most known forms of tax fraud.

2.3 Abusive tax behaviours: Tax fraud, aggressive tax planning and tax avoidance

Is often complex to frame an abusive tax behaviour in a certain classification because the nature of the act can involve many factors; thus, it is possible that the tax fraud actions are hybrid, falling into different classifications.

It is important to have the basic understanding that all types of fraud must have three elements to be classified as fraud: concrete and tangible (material) facts, a deliberate intention of fraud (intentional and moral element) and an advantage must be derived from it[143].

Another important notion is that this work first approaches tax fraud as the main abusive tax behaviour, once it is the one practiced through illicit ways, and considered as a tax crime. In the same way, the work realizes the consequences of other abusive tax behaviours, so it also presents them.

[140] GOMES, Nuno Sá. *Evasão fiscal, infração fiscal e processo penal fiscal*, op. cit., p. 18.
[141] *Idem, ibidem*, p. 30.
[142] POMBO, Nuno. *A fraude fiscal: a norma incriminadora, a simulação e outras reflexões,* op. cit., p. 31.
[143] VERNIER, Éric. *Fraude fiscale et pardis fiscaux.* 2ª édition. Paris: Dunod, 2018.

This leads to the study of tax fraud and other abusive tax practices, focusing on an approach that demonstrates the concept of each behaviour and a practical bias that allows to understand how the behaviours happen.

2.3.1 Tax fraud

Tax fraud is certainly the best known and most reported type of abusive tax behaviours, in addition to being one of the first practices studied. Tax fraud is presented here as synonymous of tax evasion, since this work has the understanding that even when the concepts are approached in separate ways, they share a status of crime and an illicit character. Tax fraud and tax evasion are complementary concepts, and a separated approach would not fulfil this work purposes, thus they are approached as one behaviour.

Many of the laws that target more than one type of abusive behaviours include tax evasion/tax fraud in its titles. The attention that this practice receives is justified: "During recent years, tax evasion has been one of the most serious problems in the economy of any country, whether developed or developing. With the EU creation and enlargement, this phenomenon has seen an upward trend, given in part to the absence of legislation to regulate the situation.[144]"

Every tax system is designed for taxpayers to follow it compliantly, declaring profits and paying accordingly but as stated at the beginning of the chapter on tax fraud, people are constantly trying to pay less, and evade their tax obligations. From this practice arises the name tax evasion, which has its literal meaning, to evade from tax.

For the European Commission tax evasion "generally comprises illegal arrangements where tax liability is hidden or ignored, i.e. the taxpayer pays less tax than he/she is supposed to pay under the law by hiding income or information from the tax authorities"[145].

[144]RIZEA, Marinel: CROITORU, Lucia Croitoru; UNGUREANU, Mihai Dragoş. Acts of tax evasion and fraud and financial impact of these phenomena in the European Union. *Surpassing the crisis and resuming the economic growth – main objective of the monetary policy promoted by the National Bank of Romania*, 2010, pp.116-125. Available at: <https://www.researchgate.net/profile/Geanina-Tudose/publication/227487250_SURPASSING_THE_CRISIS_AND_RESUMING_THE_ECONOMIC_GROWTH_-_MAIN_OBJECTIVE_OF_THE_MONETARY_POLICYPROMOTED_BY_THE_NATIONAL_BANK_OF_ROMANIA/links/55f1b65808ae199d47c46ede/SURPASSING-THE-CRISIS-AND-RESUMING-THE-ECONOMIC-GROWTH-MAIN-OBJECTIVE-OF-THE-MONETARY-POLICY-PROMOTED-BY-THE-NATIONAL-BANK-OF-ROMANIA.pdf#page=116>, p. 117.

[145]EUROPEAN COMMISSION. Time to get the missing part back. *European Commission*, n. d. Available at: <https://ec.europa.eu/taxation_customs/time-get-missing-part-back_en>.

It should be noted from the outset that tax evasion is illegal, directly infringing the tax law[146]. The inherent illegality of tax evasion is because the practice requires the violation of some law, that is, an illegality. Tax evasion is a practice that has both a tax and criminal nature, and its sanctions are many and can be of different natures, causing illegality to be both fiscal and/or criminal.

In this sense, considering the meaning and the nature of tax evasion:

> Tax evasion is the illegal non-payment or under-payment of taxes, usually by deliberately making a false declaration or no declaration to tax authorities – such as by declaring less income, profits or gains than the amounts actually earned, or by overstating deductions. It entails criminal or civil legal penalties. [...] Proving intention is difficult; therefore the dividing line between avoidance and evasion is often unclear.[147]

There are two types of offenses involved in tax evasion: omission and false declaration. The omission occurs, for example, for not declaring the total income, and thus paying less; and the false declaration occurs through the altered declaration, such as fake invoices[148].

Thus, tax evasion is an action, which takes place through illicit acts (of omission or false declaration) whose objective and result is the non-payment of tax obligations in their entirety (paying less or not paying).

It does not mean that, because it is illegal, the conduct practiced will necessarily be defined by law. The concept of tax evasion may include behaviours that doctrine and legislation have been recognizing as tax avoidance if they are accused of using artificial or fraudulent means and abuse of legal forms[149]. European scholars present their understanding of these behaviours based on the legislation of the countries studied.

The Portuguese doctrine presents tax fraud as a common crime (anyone can practice it), a crime of binding execution (it is legally provided for in an exhaustive way); it is a crime of concrete danger; it is a crime that does not require the victim's participation; and it is a crime that requires specific intent.[150]

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[146]GOMES, Nuno Sá. *Evasão fiscal, infração fiscal e processo penal fiscal*, op. cit., p. 26.
[147]TRANSPARENCY INTERNATIONAL. Tax evasion. *Transparency International*, n. d. Available at: <https://www.transparency.org/en/corruptionary/tax-evasion>.
[148]OECD. International Tax Avoidance and Evasion: Four Related Studies. *Issues in International Taxation, No. 1*, Paris: OECD Publishing, 1987, p. 16.
[149]GOMES, Nuno Sá. *Evasão fiscal, infração fiscal e processo penal fiscal*, op. cit., p. 29.
[150]POMBO, Nuno. *A fraude fiscal: a norma incriminadora, a simulação e outras reflexões,* op. cit., p. 227, p. 293.

For the French doctrine tax fraud can be defined as an illicit practice that aims to cheat taxable amounts into not paying taxes due[151]. Tax fraud is not provided for in the penal code, but only in the general French tax code, and it is the tax authority responsibility to take the burden of proof to the criminal court.

The Spanish doctrine, for example, presents tax fraud as practices that leads to the reduction of the tax burden, such as the non-declaration of the applicable tax after the taxable event; declaration of lower taxable base to which it would correspond; incorrect application of tax rates; incorrect application of tax incentives to the tax base; and the non-payment of the tax debt or payment after the deadline, even having made the declaration[152].

The figures of tax fraud in the Italian context can find their specific characteristics in the artifices, deceptions or manipulations to deceive the tax authorities, including in this provision also the obtaining of undue tax refunds[153].

Despite some different nuances, the practice of tax fraud is treated basically in the same way by different countries. As mentioned at the beginning, it is emphasized that tax fraud are behaviours which always aim to have some advantage, causing damage to tax revenue.

The concept of tax fraud is very clear, realizing what the objective of the practice is. The only uncertainty remains in the differentiation between this practice, tax avoidance and aggressive tax planning, which is addressed in the following topics.

2.3.2 Aggressive tax planning

Aggressive tax planning is another tax concept that does not have a single definition. The practice originates from a legitimate practice - tax planning. In some understandings aggressive tax planning is one way of practicing tax avoidance because they are practices that share the same intention; the doctrine sometimes does not differentiate between these types of fraud. This work, by choosing to bring individual concepts and make known the most recurrent types of abusive behaviours, presents aggressive tax planning as an individualized practice.

[151] VERNIER, Éric. *Fraude fiscale et pardis fiscaux*, op. cit.
[152] GÓMEZ, Carlos Contreras. *Planificación fiscal:* Principios, metologías e aplicaciones. Madrid: Editorial Universitaria Ramón Areces, 2016, p. 28.
[153] BRUNETTI, Michele. *Frode fiscale e falso in bilancio dalla genesi alle riforme del 2015: evoluzione, criticita e profili applicativi*. Roma: PM edizione, 2016.

As its name suggests, this practice refers to planning actions involving taxes in advance. There is nothing wrong with ensuring that a company's or individual's tax planning is done with the aim of fulfilling its obligations legitimately, paying only what is necessary, avoiding double taxation and avoiding unnecessary expenses and fines. However, over time, these practices evolved and the opportunity to pay less taxes than supposed was perceived.

> Countries around the world have traditionally treated tax planning as a legitimate practice. Over time, however, the tax planning structures have become ever-more sophisticated. They develop across various jurisdictions and effectively, shift taxable profits towards States with beneficial tax regimes. A key characteristic of the practices in question is that they reduce tax liability through strictly legal arrangements which however contradict the intent of the law.[154]

A legal practice whose use can represent gains has become an alternative to escape tax obligations, taking the name, when it has this intention, of aggressive tax planning. The concept adopted by the European Commission consists in "taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability"[155]. In other words, the practice is aggressive because it takes advantage of the possibility of planning and studying tax rules in advance to find loopholes for the wrong ends.

The fast and constant evolution of aggressive tax planning justifies the difficulty in combating the practice and finding effective measures, since the ways to act are increasingly diverse. The aggressive tax planning is widely used for profit shifting, with the expectation of paying the lowest number possible on profits, however the dual use of loss is also an objective of the practice. Some of the most common strategies for this second aim are:

> Loss-shifting schemes, schemes shifting profits to a loss-making party, schemes circumventing time restrictions on the carry-over of losses, schemes circumventing change of ownership/activity restrictions on the carry-over of losses, schemes circumventing rules on the recognition or treatment of losses, schemes creating artificial losses and schemes involving the dual/multiple use of the same loss.[156]

[154] EUROPEAN COMMISSION. *Commission Recommendation of 6 December 2012 on aggressive tax planning*. Brussels, 2012. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012H0772&from=EN>.

[155] *Idem, ibidem*.

[156] OECD. *Corporate Loss Utilisation through Aggressive Tax Planning*. Paris: OECD Publishing, 2011, p. 10.

These loss-shifting strategies tend to be dangerous, as false losses are often declared to counterbalance taxation with profit – "These arrangements typically seek to create expenses or losses to offset other income, generally avoiding the taxation of any corresponding gain or profit"[157]. Whether for profit or loss, aggressive tax planning is a form of tax fraud that has been widely used and has resulted in losses.

Currently, the main legislation on the subject is the Commission Recommendation of 6 December 2012 on aggressive tax planning, and the material and studies produced by the OECD. There is still a need for constant study on the subject, which has been receiving more attention, and possibly the legislation will be able to address aggressive tax planning through hard law and not just soft law.

2.3.3 Tax avoidance

Unlike tax fraud, tax avoidance is done legally, not going directly against laws - on the contrary, it involves an intensive study of tax laws: "Tax avoidance is defined as acting within the law, sometimes at the edge of legality, to minimise or eliminate tax that would otherwise be legally owed. It often involves exploiting the strict letter of the law, loopholes and mismatches to obtain a tax advantage that was not originally intended by the legislation"[158].

It is therefore a matter of complying with the law, but in the opposite sense of this - "It usually refers to the practice of seeking to avoid paying tax by adhering to the letter of the law but opposed to the spirit of the law"[159]. This practice becomes harmful like all the others, because despite using legal means, once practiced there is no tax obligation when there should be.

What is at stake in this practice is to avoid the application of the tax rule, to prevent the birth of the legal-tax relationship, with the objective of obtaining a patrimonial advantage, regardless of its modality. Through careful management (and formally licit), it is possible to exempt from the tax fact, with no obligation to be paid[160].

[157] Idem, ibidem, p. 10.
[158] EUROPEAN COMMISSION. Time to get the missing part back, op. cit.
[159] TRANSPARENCY INTERNATIONAL. Tax evasion, op. cit.
[160] POMBO, Nuno. *A fraude fiscal: a norma incriminadora, a simulação e outras reflexões,* op. cit., p. 27.

The limits of tax avoidance are defined by each country and the competent tax authority, because after all, fighting and sanctioning this practice is to administer the law according to what they understand the legislator intended to expose[161].

Within the practice of tax avoidance, some specific behaviours stand out, but share the same means and objectives of tax avoidance.

2.3.3.1 Base erosion and profit shifting (BEPS)

The domestic tax base erosion and profit shifting (BEPS) is one of the forms of tax avoidance that has been gaining attention in the last years since it is causing a big money loss. There is a natural tendency for national tax systems to be contrary to profit shifting, after all

> Most national tax systems are discriminatory regarding transactions with foreign countries, partly because much more tax is at stake than in domestic transactions. That is because domestic tax revenue clearly falls if taxable profits are shifted from a domestic corporation to a foreign corporation, but may well be unaffected if taxable profits are shifted between two domestic corporations.[162]

In addition to this natural concern, the possibility of profit shifting makes room for BEPS to occur. BEPS consists of legally exploring ways to circumvent the system, shifting profits to low-tax or non-tax jurisdictions – like the tax heavens - causing the erosion of the tax system where the business is based. Erosion of the tax base poses a serious risk to a country's revenue, sovereignty, and fiscal equity[163].

The European Union presents BEPS as: "tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations"[164]. In practice, this concept takes place in "situations in which taxable income can be artificially segregated from the activities that generate it, or in the case of value added tax (VAT), situations in which no or an inappropriately low

[161] OECD. International Tax Avoidance and Evasion: Four Related Studies, op. cit., p. 16.
[162] KLEMM, Alexander. *Issues in business taxation*. London: Institute for Fiscal Studies (IFS), 2005, p. 138-145, p. 140.
[163] OECD. *Combate à erosão da base tributária e à transferência de lucros*. Paris: OECD Publishing, 2013.
[164] EUROPEAN UNION. Tackling corporate tax avoidance. *European Union*, n. d. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=legissum%3A4309171>.

amount of tax is collected on remote digital supplies to exempt businesses or multi-location enterprises (MLEs) that are engaged in exempt activities"[165].

The most used strategies for the practice of BEPS are:

> Minimisation of taxation in the market country by avoiding a taxable presence, or in the case of a taxable presence, either by shifting gross profits via trading structures or by reducing net profit by maximising deductions at the level of the payer.
>
> Low or no withholding tax at source.
>
> Low or no taxation at the level of the recipient (which can be achieved via low-tax jurisdictions, preferential regimes, or hybrid mismatch arrangements) with entitlement to substantial non-routine profits often built-up via intra-group arrangements.
>
> No current taxation of the low-tax profits at the level of the ultimate parent.[166]

The OECD/G20 Inclusive Framework on BEPS developed 15 actions to "tackle tax avoidance, improve the coherence of international tax rules, ensure a more transparent tax environment and address the tax challenges arising from the digitalisation of the economy"[167], possibly ending BEPS. The initiative counts with 141 countries that are implementing those 15 actions inside their jurisdictions.

2.3.3.2 VAT fraud and avoidance

As mentioned earlier, VAT is an important common concept to the EU, and therefore VAT fraud is a subject that has been studied with more attention in the last years, and the literature regarding it is increasing. This is due to the fact the VAT is exposed to an extensive list of frauds, and the most common schemes are getting known. One full work could be focused on it, so this work will focus on the understanding of what VAT fraud is and its most known forms.

The functioning of VAT can be explained in a simple way:

[165] OECD. *Addressing the Tax Challenges of the Digital Economy*. Paris: OECD Publishing, 2014. Available at: <https://www.oecd-ilibrary.org/docserver/9789264218789-en.pdf?expires=1647099614&id=id&accname=guest&checksum=618A22221627CEACDDA0E1270CF62EB3>, p. 100.

[166] *Idem, ibidem*, p. 101.

[167] OECD. International collaboration to end tax avoidance. *OECD*, 2021. Available at: <https://www.oecd.org/tax/beps/>.

> Value Added Tax (VAT) is an indirect consumption tax, charged on most trades of goods and services. The base of the VAT is the value added by the economic agent. For example an industrial company purchasing raw materials for 100 euros and transforming them into a finite product sold for 130 euros has a VAT liability on the 30 euros of value added in the production process.[168]

Through this system, the final customer will not pay the tax to the government, but to the business that has already paid this tax directly to the government. As it is a multi-step system, which involves more than the direct taxpayer, VAT should not be the subject of so many frauds, but strategies have been developed to do so.

The VAT fraud can be subdivided in three main groups: evasion, organized fraud and VAT avoidance. In the first two groups:

> Evasion results from either informality or part-time crime, and can be defined as the deliberate omission, concealment, or misrepresentation of information to reduce VAT liability. Organized fraud, on the other hand, involves coordinated and systematic actions, with varying levels of sophistication and organization, towards obtaining an unlawful VAT financial advantage.[169]

As can be seen, this two divisions are linked to tax fraud. In abusive behaviours associated with VAT, organized fraud represents more costs than evasion and tends to be practiced by more internationally organized groups[170].

Within these two groups there are some VAT fraud typologies that some authors classify differently, as these types are not all specifically legislated; definitions are doctrinal (as mentioned before, not all tax fraud forms are legislated).

The third group, related to tax avoidance, finds its place precisely in these gaps, and in non-typified crimes. It is part of the act of avoiding paying VAT through legal ways, not directly infringing laws.

The shadow economy; the missing trader; the accounting *shenanigans;* and misrepresentation of product are practices of VAT fraud and avoidance, that will be presented.

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[168] FRUNZA, Marius-Cristian. *Value Added Tax Fraud*. New York: Routledge, 2018, p. 01.
[169] DE LA FERIA, Rita. Tax Fraud and Selective Law Enforcement, op. cit, p. 245.
[170] *Idem, ibidem.*

The formal economy is one that should be practiced every day, acts correctly declared, receipts correctly issued, all in accordance with established norms. Everything that is done without going through these formalities, that is considered illegal and not only, is part of shadow economy.

> Also called the underground, informal, or parallel economy, the shadow economy includes not only illegal activities but also unreported income from the production of legal goods and services, either from monetary or barter transactions. Hence, the shadow economy comprises all economic activities that would generally be taxable were they reported to the tax authorities.[171]

When the VAT application process should take place, it sometimes doesn't as trade and sell transactions are hidden within the shadow economy. This happens because there are "unregistered traders that exert an economic activity, without being registered with the respective tax office. Thus, all the underlying trades of an unregistered trader are liable to VAT"[172]. VAT is not paid because in theory there are no products to which VAT is applied. This same category of fraud also includes undeclared sales, which fall into the shadow economy.

The missing trader intra-community is a behaviour that takes place between cross-border transactions of goods and services. As known, the European Union over time abolished taxes between EU countries, that is, VAT is not paid between EU borders. Basically, this practice takes place in the differences in VAT rates between EU countries. A product from another EU country is bought without VAT and then sold domestically with VAT - so VAT is not paid to the authority it should be, guaranteeing undue profit to the seller[173].

The missing trader also develops more complexly in other figures. One of them is carousel fraud. "The same item circulates many times through a chain of companies situated in at least two countries. One of the companies (the Missing Trader) fails to pay the VAT liability to its local tax authority. The amount of the pocketed tax is proportional to the number of times the goods turn in the carousel"[174]. Often the good does not even leave the country and the documentation is falsified, and this benefits from the

[171] SCHNEIDER, Friedrich; ENSTE, Dominik. *Hiding in the Shadows: The Growth of the Underground Economy.* Washington, D.C : International Monetary Fund, 2002, p. 02.
[172] FRUNZA, Marius-Cristian. *Value Added Tax Fraud*, op. cit., p. 06.
[173] *Idem, ibidem.*
[174] *Idem, ibidem,* p. 07.

virtual world that facilitates the practice. One of the techniques used to avoid exposing the scheme is cross invoicing, which consists of getting invoices from several legal entities.

The third fraud typology is the accounting *shenanigans*.

> Accounting shenanigans encompass a set of techniques aimed at manipulating the financial statement and fillings of a company in a way that would present the firm in a different light from its real situation. Accounting shenanigans are often used in financial crime to abuse the confidence of investors in a company.[175]

For this purpose, the book values of transactions are manipulated, for more or less, causing the VAT values to decrease or increase. As the variables are quantity and value, the energy market is the main target of this practice.

The last form to be presented is the misrepresentation of product type – "buying a product with a given VAT rate and rebranding the product in such a way that a different VAT rate is applied"[176]. The rating change may represent a higher VAT amount, generating a profit for the seller; or if it represents a lower value, the seller can ask the government for the value and make a profit as well.

There are still other ways of VAT fraud and avoidance, which is why this issue deserves so much importance and so much legislation (which was mentioned in the previous section) has already been made in this direction.

2.3.3.3 The use of cryptocurrency for tax avoidance

Cryptocurrency is a considerably new concept, that has been growing in the last years. While a precise definition is not consensual, for the European Union it is "the technique of protecting information by transforming it (i.e. encrypting it) into an unreadable format that can only be deciphered (or decrypted) by someone who possesses a secret key"[177].

[175] *Idem, ibidem,* p. 12.
[176] *Idem, ibidem,* p. 13.
[177] POLICY DEPARTMENT FOR ECONOMIC, SCIENTIFIC AND QUALITY OF LIFE POLICIES. *Cryptocurrencies and blockchain* - Legal context and implications for financial crime, money laundering and tax evasion. Brussels: European Union, 2018, p. 15.

The policies adopted in relation to crypto are different, some consider it as a currency or money or an asset. The big issue is that once the transactions happens only in the virtual space (cyberspace) sellers and purchasers are only identified as numbers, and it becomes very hard for the governments and tax authorities to identify the real font of income[178].

Still, as it is a relatively new topic, at the level of hard law, legislation is scarce, so it becomes easy to practice tax avoidance - without infringing laws and through legally permitted means.

A study requested by the European Union Tax Committee has indicated some points that can contribute to abusive tax behaviours with the use of cryptocurrencies[179]. The first point is the one that gets the most attention, anonymity - without knowing who the real players in the crypto transactions are, it is impossible to due monitor it. Even if the individuals avoid taxes, there is no name to attribute the liability. A second issue is the cross-border nature of cryptocurrencies, once the crypto easily transits between countries it is even harder to regulate and control it. There is no consensus between the rules to be applied nationally, at the international level it is even more complex. As a third problem, there is no central intermediary, and it means that there is no institution doing the regulation control. Another point is that cryptos fall into gaps in legislation, there is nothing that applies directly and this gives rise to greater lack of control. Finally, the encryption of cryptocurrencies ends up leaving the line with cybersecurity, data protection and privacy very tenuous. Many reinforce that cryptos represent privacy security, but at the same time it can be used precisely for illegal purposes - such as tax avoidance.

With all this, combating tax avoidance through the use of cryptos becomes a difficult task. According to the Fourth Anti-Money Laundering Directive[180] none of the crypto players are obliged entities, which means there is no information for the tax authorities. The Fifth Anti-Money Laundering Directive[181] brought an attempt to take some information to the tax authorities, making virtual currency exchange platforms and custodian wallet providers obliged entities. This may be the first step to avoid tax evasion through the use of cryptos, but there is still a long way to go before full transparency in this universe.

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[178] DAVID, Tan Weng Chiang. Bitcoin Transactions: The New Frontier of Income Tax Evasion in Thailand. Chonburi: Burapha University International College, 2018. Available at: <https://so05.tci-thaijo.org/index.php/lawjournal/article/view/197462/137565>.

[179] POLICY DEPARTMENT FOR ECONOMIC, SCIENTIFIC AND QUALITY OF LIFE POLICIES. *Cryptocurrencies and blockchain* - Legal context and implications for financial crime, money laundering and tax evasion, op, cit, pp. 53-47.

[180] EUROPEAN PARLIAMENT. *Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC*. Strasbourg, 2015. Available at: < https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015L0849&from=EN>.

[181] EUROPEAN PARLIAMENT. *Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU.* Strasbourg, 2018. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L0843&from=EN>.

The use of cryptocurrencies, in case they are considered a digital product, also represents greater VAT exposure to tax avoidance:

> If Bitcoin were seen as a digital product, the following challenges could arise: the use of bitcoins for payment for goods or services could be seen as a barter, increasing the costs for participating businesses; individuals using bitcoins on a continuing basis could be seen as taxable persons carrying out an economic activity; it could be difficult to identify the place where the customer is located, which is the place of supply for electronically supplied services; and there would be a risk that fraudulent schemes could be designed in order to embezzle collected VAT.[182]

Some crypto platforms such as Kraken have already invested in compliance programs and in being in accordance with regulations[183], as alternatives to avoid problems such as tax avoidance, money laundering, among others.

This demonstrates that although there is still room for tax avoidance through cryptocurrencies, the subject is already receiving attention and new ways to circumvent the problem will emerge.

3. Applicable legislation

Once tax fraud is a big issue, the EU has been developing and creating recommendations, regulations and directives that leads to its reduction. The list of all legal provisions is large, and in this topic, we highlight some of the most relevant ones that meet what has already been exposed in relation to the matter. At the same time, each Member State has been working on its own legal structures to prevent tax fraud. Some of these diplomas will also be presented as a sample of tax fraud prevention and fight.

The demonstration of the legislation both in cross-border and inside borders is extremely relevant since one depends on the other

> Both collecting taxes and combating tax fraud and tax evasion are the responsibility of EU countries' national authorities. However, much of the fraud happens across borders and a

[182] BAL, Aleksandra. VAT Treatment of Initial Coin Offerings. *International VAT Monitor*, May/June, 2018, pp. 118-125, p. 119.
[183] KRAKEN. Is Kraken licensed or regulated?. Kraken, n. d. Available at: <https://support.kraken.com/hc/en-us/articles/360031282351-Is-Kraken-licensed-or-regulated->.

> single country acting on its own will not achieve a lot. The EU has long provided tools to help member countries fight fraud more effectively.[184]

A small mention of legislation around the globe regarding tax fraud will be presented, since despite the focus of the work being the European Union, tax fraud also has space and great incidence in other territories.

3.1 Tax fraud legislation at European Union level

As can be seen from all the above, the practice of tax fraud affects the EU beyond the Member States, which is why legal diplomas are constantly being introduced to reduce this practice. And evidently, these legal acts set the tone for Member States to create their own.

Following the chronological order of publication, the first legal diploma presented is the Directive 2010/24/EU, that regards recovery of claims relating to taxes, duties and other measures. The aim of this Directive is to combat tax evasion, though the EU countries working more closely together, aiding each other[185].

This directive is extremely important as it provides several measures to allow Member States to cooperate between them, highlighting the exchange of information between Member States; the presence of officials from one Member State in another; and the duty of the requested Member State to assist the requesting Member State in recovery claims.

Regarding tax fraud, the directive guarantees tax neutrality and guarantees the reduction of discriminatory protection measures in cross-border transactions aimed at preventing fraud. The Directive manages to have these guarantees through the assured measures, once "the Directive provides for the 2002 OECD standard on exchange of information on request and thus makes it impossible for taxpayers

[184] EUROPEAN COMMISSION. Time to get the missing part back, op. cit..

[185] COUNCIL OF THE EUROPEAN UNION. *Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures*. Brussels, 2010. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010L0024&from=EN>.

to hide behind banking secrecy"[186] and "reinforces the possibility of taking precautionary measures and allows for early action on the basis of an original document of the requesting state"[187].

In sequence, the Regulation (EU) No 904/2010 on administrative cooperation and combating fraud in the field of value added tax was published. This Regulation also aims to increase the cooperation between the Members and tax fraud prevention, but regarding the Value Added Tax (VAT) and the exchange of information by electronic means. The process that this directive guarantees is centred in three points: VAT is assessed and applied correctly; VAT fraud is detected and prevented; and VAT revenue is protected[188].

In practice, this happens through some measures guaranteed in the Regulation, such as emphasizing that the electronic storage and transmission of certain data for VAT control allows the rapid exchange of information and automated access to information, which reinforce the fight against fraud; ensuring the automatic exchange of information without prior request; among other determinations.

In 2011 the Directive 2011/16/EU on cooperation between EU Member States' tax administrations was promulgated. This Directive reflects the need for mutual assistance in the field of taxation, once "there is a tremendous development of the mobility of taxpayers, of the number of cross-border transactions and of the internationalisation of financial instruments, which makes it difficult for Member States to assess taxes due properly"[189].

The Directive explains that Member States alone cannot deal with this, which ends up inciting tax fraud, and therefore new rules common to all are necessary, starting from a new administrative cooperation between the Member States' tax administrations. Thus, the central point of this Directive in relation to combating tax fraud is to establish a mandatory automatic exchange of information without preconditions.

Published in the same year, the Directive 2011/96/EU of the Council of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States deserves a brief mention. The objective of this Directive is "to exempt dividends and other

[186]THIEL, Servaas Van. European Union action against tax avoidance and evasion, in John Whalley and Chang Woon Nam (Ed.), Tax evasion in Europe, *CESifo*, volume 13, no. 2, Germany, 2012, p. 13-19, p. 14.

[187] *Idem, ibidem*.

[188]COUNCIL OF THE EUROPEAN UNION. *Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax*. Luxembourg, 2010. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010R0904&from=EN>.

[189]COUNCIL OF THE EUROPEAN UNION. *Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC*. Brussels, 2011. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011L0016&from=EN>, p. 01.

profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company"[190].

Seeking to eliminate double taxation, it ensures fiscal neutrality – "Neutrality is one of the principles that help to ensure the collection of the right amount of revenue by governments"[191]. Collecting tax correctly - so there is no double taxation - encourages the payment of tax obligations, reducing the incidence of tax fraud.

This Directive was amended in 2014 with the Directive 2014/86/EU of the Council of 8 July 2014 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. In order to ensure that the 2011 Directive did not leave room for double taxation, the 2014 Directive brought changes[192].

In 2012 the Regulation (EU) No 389/2012 on administrative cooperation in the field of excise duties came to ensure the correct application of legislation on excise duties and as consequence improve national controls on the revenue generated[193].

The Regulation focus on the control over data regarding excise duties, foreseeing automatic exchange of information and the use of the computerised system. As noted in the legal documents already discussed, the exchange of information and control over data is extremely beneficial in the fight against tax fraud, and it would not be different in excise duties.

Another relevant document is the Commission recommendation 2012/772/EU of 6 December 2012 on aggressive tax planning. As demonstrated in the previous section, aggressive tax planning is a big problem. Thus, this Recommendation despite not being hard law has high value and intends precisely to recommend the adoption of a common general anti-abuse rule. And in this sense, it suggests the adoption of a clause:

> Where this Convention provides that an item of income shall be taxable only in one of the contracting States or that it may be taxed in one of the contracting States, the other contracting

[190] COUNCIL OF THE EUROPEAN UNION. *Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States*. Brussels, 2011. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011L0096&from=EN>, p. 01.

[191] OECD. *International VAT/GST Guidelines*. Paris: OECD Publishing, 2017, p. 20.

[192] COUNCIL OF THE EUROPEAN UNION. *Council Directive 2014/86/EU of 8 July 2014 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States*. Brussels, 2014. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0086&from=EN>.

[193] COUNCIL OF THE EUROPEAN UNION. *Council Regulation (EU) No 389/2012 of 2 May 2012 on administrative cooperation in the field of excise duties and repealing Regulation (EC)*. Brussels, 2012. Available at: < https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0389&from=EN>.

> State shall be precluded from taxing such item only if this item is subject to tax in the first contracting State.[194]

This is expected to lead to a reduction in the incidence of double non-taxation, which is why this Recommendation should be widely adopted (as an example of inserting it in national tax systems, the Portuguese General Tax Law addresses this subject in its article 38, no 2[195]).

One more relevant legal provision is the Directive (EU) 2016/1164, popularly known as ATAD (Anti Tax Avoidance Directive), about tackling corporate tax avoidance. The idea of the Directive is to establish general rules that can be applied in the internal markets of the twenty-eight different tax systems, and the specific application of these rules is up to the Member States. Rules should be made considering five areas: limitations to the deductibility of interest; exit taxation; a general anti-abuse rule; controlled foreign company rules and rules to tackle hybrid mismatches[196].

With these rules, BEPS is expected to be tackled and "it creates a minimum level of protection against corporate tax avoidance throughout the EU, while ensuring a fairer and more stable environment for businesses"[197]. This Directive has a very important role, as it was the base for many countries to create and or even improve their legislation that concerns tax fraud.

And finally, the most recent among the measures highlighted, is the Regulation (EU) 2021/847 establishing the 'Fiscalis' programme for cooperation in the field of taxation. The *Fiscalis* program was originally established in 2020 by the European Parliament, and this Directive is responsible to implement it.

> The Programme should contribute to: supporting tax policy and the implementation of Union law relating to taxation; preventing and fighting tax fraud, tax evasion, aggressive tax planning and double non-taxation; preventing and reducing unnecessary administrative burdens for citizens and businesses in cross-border transactions; supporting fairer and more efficient tax systems; achieving the full potential of the internal market and fostering fair competition in the Union; supporting a joint Union approach in international fora; supporting the administrative

[194] COUNCIL OF THE EUROPEAN UNION. *Commission Recommendation of 6 December 2012 on aggressive tax planning*. Brussels, 2012. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012H0772&from=EN>, p. 02.

[195] PORTUGAL. *Decreto-Lei n.º 398/98*. Lisboa, 1998. Available at: <https://dre.pt/dre/detalhe/decreto-lei/398-1998-191558>.

[196] COUNCIL OF THE EUROPEAN UNION. *Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market*. Brussels, 2016. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L1164&from=EN>.

[197] EUROPEAN COMMISSION. The Anti Tax Avoidance Directive. *European Commission*, n. d. Available at: <https://ec.europa.eu/taxation_customs/anti-tax-avoidance-directive_pt>.

> capacity building of tax authorities including by modernising reporting and auditing techniques; as well as supporting training the staff of tax authorities in that regard.[198]

The Directive recognizes the importance of combating tax fraud and aggressive tax planning; and foresees many measures in this sense. The possibility of involving external experts; the possibility of combining the *Fiscalis*' initiatives with other Union measures in related fields; and the possibility of extent the European electronic systems for cooperation with third countries not parties of the Programme are some among many previsions. Furthermore, the Directive addresses a great deal of collaboration between the EU and the Member States, supporting internal markets, guaranteeing cost reduction and mutual benefits.

The Programme is of great importance as it is part of the European Union's (EU) 2021-2027 multiannual financial framework, and if observed with caution, the Directive that establishes it reflects everything that has been addressed in the legal diplomas of the previous years that intend to combat tax fraud.

The need for cooperation and information sharing of EU legal diplomas are the most emphasized measures throughout the approached diplomas. What can encourage it to be more effective are the regulations at the national level of the Member States (and which, as will be seen in the next chapter, can be encouraged by compliance programs). This is because the laws are applied to companies directly, and the adherence to them will be based on the limits and level of supervision by the tax authorities of each country. Some examples of laws from the Member States will be presented.

3.2 Tax fraud legislation at Member States of the European Union

Each Member State has increasingly made efforts to reduce tax fraud. In general, Member States follow EU guidelines, transposing EU regulations to their national tax system. However, sometimes the opposite happens, the Member States end up dictating the necessary legislation for the EU. For example, the aforementioned Council Directive 2010/24/EU emerged after member states took their own initiatives on the matter:

[198] COUNCIL OF THE EUROPEAN UNION. *Regulation (EU) 2021/847 of the European Parliament and of the Council of 20 May 2021 establishing the 'Fiscalis' programme for cooperation in the field of taxation and repealing Regulation (EU) No 1286/2013*. Brussels, 2021. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0847&from=EN>, p. 01 – 02.

> Tax jurisdictions with higher average tax burdens have routinely introduced unilateral anti-abuse clauses to counter artificial tax planning constructions. They have also concluded a large number of bilateral (tax or information exchange) agreements, which provide for the exchange of 'foreseeably relevant' information on request, without regard to domestic bank secrecy rules (the 2002 OECD minimum standard).[199]

This demonstrates how important the prevention of tax fraud at the national level is. And in addition that, but it is also the national legislation that will decide the tax limits, guaranteeing that tax fraud will not have space. At the same time there is a responsibility of Member States to combat tax fraud on their own, which stems from the sovereignty of states: "The fight against tax fraud is shared between Member States and the EU. Coming under tax policy, it has remained closely linked to Member State sovereignty, protected by the requirement for unanimity and a special legislative procedure which keeps tax matters firmly under the Council's control"[200].

Thus, it is worth highlighting some of the legislation of EU Members that address tax fraud prevention and at the same time demonstrate how the concern about the issue has been addressed for years and continues to develop.

In 1998, Portugal already started tax fraud prevention by condemning the practice of tax avoidance in the *Decreto-Lei n.º 398/98*[201], even if still not so incisively. The tax evasion was approached in the *Lei n.º 15/2001*[202], and since them, the efforts to prevent tax fraud have been developed. The most recent initiative in this matter from Portugal was in 2019, when the country partially transposed ATAD to its internal law trough the *Lei n.º 32/2019*[203] (ATAD needs to be transposed by all Member States).

The Netherlands first approached tax evasion in 1959 with the publication of the General Act pertaining to national taxes (*Algemene wet inzake rijksbelasting*)[204], criminally sentencing the practice. In 2002 the General Act was reviewed and republished. The Act of recovery from 1990[205] (*Invorderingswet 1990*) also addressed the issue, providing for imprisonment and application of fines for the practice.

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[199]THIEL, Servaas Van. European Union action against tax avoidance and evasion, op. cit., p. 13.

[200]EUROPEAN PARLIAMENT. *The fight against tax fraud*. Strasbourg: European Parliament, 2019. Available at: <https://www.europarl.europa.eu/RegData/etudes/BRIE/2019/633153/EPRS_BRI(2019)633153_EN.pdf>, p. 01.

[201]PORTUGAL. *Decreto-Lei n.º 398/98*, op. cit.

[202]PORTUGAL. *Lei n.º 15/2001*. Lisboa, 2001. Available at: <https://www.pgdlisboa.pt/leis/lei_mostra_articulado.php?nid=259&tabela=leis&so_miolo=>.

[203]PORTUGAL. *Lei n.º 32/2019*. Lisboa, 2001. Available at: <https://www.pgdlisboa.pt/leis/lei_mostra_articulado.php?nid=3058&tabela=leis&ficha=1&pagina=1&so_miolo=>.

[204]THE NETHERLANDS. *Algemene wet inzake rijksbelasting*. Baarn, 1959. Available at: <https://download.belastingdienst.nl/itd/beleid/awr0503.pdf>.

[205]THE NETHERLANDS. *Invorderingswet 1990*. The Hague, 1990. Available at: <https://www.global-regulation.com/translation/netherlands/3074436/tax-collection-act-1990.html>.

Spain already had tax fraud prevention laws, and the new *Ley 11/2021* transposed the Directive (UE) 2016/1164 to national level with the objective of preventing and fighting against tax fraud[206]. In addition to implementing various measures proposed in ATAD, other initiatives were legislated. Spanish legislation already had anti-abuse tax rules, so this new Law focused on other elements of ATAD that weren't directly addressed before, such as the exit tax and controlled foreign company rules. In addition, the Law emphasizes the need to broaden the concept of tax havens, changing the term to non-cooperative jurisdictions. This term change is relevant as it may be a trend in other jurisdictions.

The Fiscal Code from Germany (*Abgabenordnung*) was published in 2002[207] already counting with a whole section devoted to tax fraud. In addition to addressing other related tax-crimes (illegal import, export or transit of goods...), the German Code provides for imprisonment and fines for those who commit them.

The French tax code, *Code général des impôts*[208], also was published in 2012 with a section devoted to tax evasion. Like the other codes, it provides for the penalty of fine and imprisonment, and differently, it is still associated with the French Criminal Code, which also addresses and brings punishment into practice.

With the demonstration of the fight against tax fraud in five Member States, it is clear that the national concern exists and is in line with what the EU has been done. In the same way that tax fraud is evolving, combating it needs to keep up - laws need to be adapted and new ones created; thus, Member States have nationally legislated and adhered to EU legal documents.

The joint work of Members with the EU can only enrich and boost the fight against tax fraud, which is why it is so important that one is in harmony with the other. Likewise, the problem is also present in other parts of the world. Therefore, in the next topic, the fight against the practice outside the EU is briefly addressed.

[206] GOBIERNO DE ESPAÑA. *Ley 11/2021, de 9 de julio*. Madrid, 2021. Available at: <https://www.boe.es/buscar/doc.php?id=BOE-A-2021-11473>.
[207] GERMANY. *Abgabenordnung*. Germany, 2002. Available at: <https://www.gesetze-im-internet.de/englisch_ao/englisch_ao.pdf>.
[208] FRANCE. *Code général des impôts*. France, 2012. Available at: <https://www.legifrance.gouv.fr/codes/texte_lc/LEGITEXT000006069577/2022-02-19/>.

3.3 Tax fraud legislation around the globe

Although the focus of this work is on tax fraud in Europe, a small overview of how the matter has been treated around the world is valid emphasizing the importance of the topic. If the problem affects one place, the others will suffer indirectly, after all, as demonstrated, the consequences of tax fraud are many. The decrease in the practice in other territories also benefits the EU, while laws serve as inspiration for a joint improvement worldwide (for the same reason, cases from different locations are presented in the following section).

The Internal Revenue Code (IRC) from 1986 is the main tax law document from the United States, and it is divided in several volumes plus an apart title named Title 26 of the United States Code. The second one is the most relevant regarding tax fraud, as it addresses the tax evasion as a crime, foreseeing monetary fines and imprisonment[209]. The Internal Revenue Service (IRS), the body that spearheads the fight against tax fraud, has invested heavily in soft law: "the IRS publishes a regular series of other forms of official tax guidance, including revenue rulings, revenue procedures, notices, and announcements"[210].

The United Kingdom has been incisively fighting tax fraud. With a focus on encouraging people to report tax evasion, the government has invested heavily in reporting campaigns. Allied to this, there is legislation providing for imprisonment and fines, such as the Criminal Finances Act 2017, which holds responsibility for failure to prevent the facilitation of tax evasion crimes in the UK[211].

In South America, Brazil has extensive tax fraud prevention legislation. The laws that stand out are *Lei nº 4.729*[212], which defined the crime of tax evasion; *Lei nº 4.502*[213], which provided the first precise definition of tax fraud for the country (fraud is any intentional action or omission aimed at preventing or delaying, in whole or in part, the occurrence of the triggering event of the main tax obligation, or to exclude or modify its essential characteristics, in order to reduce the amount of the tax due to avoid or defer your payment.), and *Lei nº 8.137*[214], which defined various crimes against the tax system.

[209] UNITED STATES OF AMERICA. *Title 26 of the United States Code*. United States, 1986. Available at: <https://www.law.cornell.edu/uscode/text/26>.
[210] INTERNAL REVENUE SERVICE. Tax Code, Regulations and Official Guidance. *Internal Revenue Service*, 13 jan. 2022. Available at: <https://www.irs.gov/privacy-disclosure/tax-code-regulations-and-official-guidance#irc>.
[211] UNITED KINGDOM. *Criminal Finances Act*. England, 2017. Available at: <https://www.legislation.gov.uk/ukpga/2017/22/contents/enacted>.
[212] BRASIL. *Lei nº 4.729, de 14 de julho de 1965*. Brasília, DF, 1965. Available at: <http://www.planalto.gov.br/ccivil_03/leis/1950-1969/l4729.htm>.
[213] BRASIL. *Lei nº 4.502, de 30 de novembro de 1964*. Brasília, DF, 1964. Available at: <http://www.planalto.gov.br/ccivil_03/leis/L4502compilado.htm>.
[214] BRASIL. *Lei nº 8.137, de 27 de dezembro de 1990*. Brasília, DF, 1990. Available at: <http://www.planalto.gov.br/ccivil_03/leis/l8137.htm>.

Likewise, all corners of the world have received attention for the practice of tax fraud. From Australia with the Criminal Code Act of 1995 to Indonesia with the Harmonization of Tax Regulations (HPP) Law of 2021, there is a need to combat tax fraud.

And so, the fight against tax fraud spreads across the globe, always looking for the best ways, using successful laws as a basis for new ones. Unfortunately, throughout history, whether due to lack of laws or non-compliance with them, tax fraud has happened.

CHAPTER III – RISK MANAGEMENT AS A MECHANISM FOR COLLABORATION BETWEEN TAX ADMINISTRATION AND TAXPAYERS

Throughout this work, compliance programs were known in depth as well as tax fraud. This chapter is responsible for making the much-needed link between the two topics, demonstrating how the use of compliance programs by businesses (taxpayers) can help reducing tax fraud and other abusive tax behaviour practices; and assist tax administration.

1. Compliance programs in business: the taxpayer as a collaborator of the tax administration

The expression tax administration refers to all the elements that are part of the organization of a tax system. In general, when dealing with EU Members, the tax administration is the tax authority of each country. At EU level, tax administration can be used to refer to the European Commission. The most important is to understand tax administration as the bodies responsible for the management and functioning of a tax system.

These bodies comprise more than the central figure of the tax authority and may also include local authorities (which can create, legally discipline and charge sanitation, urban licensing, advertising fees, etc.), public universities (fees), Public Hospitals (moderation fees), Notaries (registration fees); all bodies that may charge fees for the provision of various services[215].

The tax administration takes shape through the practice of various acts, which can be merely material acts - such as the receipt of a document or petition, the issuing of a certificate, the analysis of an accounting or writing or the hearing of a taxpayer - as real legal acts called administrative acts, fixing legal effects in the sphere of a certain subject — such as the settlement of a tax, the valuation of an asset, the rejection of a claim or the attachment of a property.[216]

Officially, and specifically regarding the EU Members "The task of a tax administration is to collect all tax revenues due in a fair and efficient way with limited costs for taxpayers and the tax administration

[215] ROCHA, Joaquim Freitas da. *Lições de Procedimento e Processo Tributário*. Coimbra: Almedina, 2021, pp. 07-08.
[216] *Idem,. ibidem.*

itself. Therefore, a tax administration needs (1) to ensure that taxpayers comply with the rules and (2) adequate resources (well trained staff, IT, budget)"[217].

The tax administration is who controls tax fraud, and who tries to prevent it. As demonstrated through the legislations presented, national and international initiatives have been made to this end. Among those mentioned, collaboration between members, exchange of information, creation of rules that can be applied to different tax systems and neutrality are some of the most proposed. Furthermore, solutions at the tax administration level usually have a sanctions character as a strategy, and not necessarily prevention.

However, there is an international movement that has approached another solution to reduce tax fraud: risk management. Risk management in the tax field can be seen as "a structured process for the systematic identification, assessment, ranking, and treatment of tax compliance risks (e.g., failure to register, failure to properly report tax liabilities etc). Like risk management in general, it is an iterative process that consists of well-defined steps to support improved decision-making"[218].

The importance of risk management has been increasingly recognized in recent years.

> Tax good governance is the foundation on which fair taxation is built. Broadly, tax good governance encompasses tax transparency, fair tax competition, the absence of harmful tax measures and the application of internationally agreed standards. In recent years, there has been significant action – at EU and international level – to strengthen these principles and to ensure that they are upheld.[219]

Corporate governance, internal control, know your customer and compliance programs are some of the tools used for risk management in the tax field. This work focuses its attention on compliance programs, but recognizing that the nominations of other risk management tools can sometimes be used, and their effect is also applicable to compliance (as presented in the first chapter).

[217]EUROPEAN COMMISSION. Tax administration and tax compliance. European Commission, n. d. Available at: <https://ec.europa.eu/taxation_customs/taxation-1/tax-co-operation-and-control/general-overview/tax-administration-and-tax-compliance_pt>.

[218]OECD. Compliance Risk Management: Managing and Improving Tax Compliance. *OECD*, 2004. Available at: <https://www.oecd.org/tax/administration/33818656.pdf>, p. 08.

[219]EUROPEAN COMMISSION. *Communication from the Commission to the European Parliament and the council on Tax Good Governance in the EU and beyond*. Brussels, 2020. Available at: <https://ec.europa.eu/taxation_customs/system/files/2020-07/2020_tax_package_tax_good_governance_communication_en.pdf>, p. 01.

Risk management solutions are different from the others, because instead of going from the tax administration to the taxpayer (such as the imposition of laws for information exchange), it starts from the taxpayer to the tax administration.

> The objective of applying Risk Management is to enable a tax administration to accomplish its mission(s) by facilitating management to make better decisions. Risk management is a structured process, consisting of well-defined steps, according to which a systematic identification, analysis, prioritisation and treatment of risks is taking place, so as to support improved decision-making.[220]

It is important to recall the spheres of compliance that were presented in the first chapter. Although the tool has mostly an internal character (subjective character), it also has an external character (objective) since the use of compliance programs is linked to legislation. This means that when a compliance program is applied, it will logically be structured based on legislation.

Through this link with external legislation, and also remembering the first chapter, compliance programs adopt the principles of public administration and make them part of the private sphere as well. The other point to be recapitulated is that compliance programs act as allies of the public administration (which in tax matters will be the tax administration), because by acting in accordance with the laws, it helps in their execution.

In the current scenario, of digital transactions, cryptocurrencies, cross border companies and all the artifices that are available; tax administration can no longer handle it alone. Help is needed from taxpayers (which in this work are specifically the businesses) – "Combatting tax evasion and avoidance therefore requires more openness between tax authorities and greater cooperation between governments. There must also be a stronger onus on companies to engage in tax practices that are transparent and fair"[221].

This all means that businesses, by applying compliance programs correctly, will be compliant with their tax obligations, while at the same time acting as an extension of the tax authorities. And this is exactly the key point in reducing tax fraud through the use of compliance programs.

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[220] EUROPEAN COMMISSION. *Risk management guide for tax administrations,* op. cit., p. 12.

[221] EUROPEAN COMMISSION. *Communication from the Commission to the European Parliament and The Council on tax transparency to fight tax evasion and avoidance*. Brussels, 2015. Available at: <https://ec.europa.eu/taxation_customs/system/files/2016-09/com_2015_136_en.pdf>, p. 02.

We then move on to the approach of how compliance programs can aid tax administration resulting in a reduction in tax fraud by explaining it in three dimensions: ethical, legislative and transparency.

1.1 Risk management mechanism: ethics through compliance programs

The first chapter showed how ethics and business are connected and should not be separated, since any decision carries an ethical weight. All corporate decisions should be made ethically, and so should tax related decisions.

Every time a taxpayer is going to comply with his tax obligations, there are two options, to pay correctly or not:

> The tax declaration decision is a decision under uncertainty. The reason for this is that failure to report one's full income to the tax authorities does not automatically provoke a reaction in the form of a penalty. The taxpayer has the choice between two main strategies: (1) He may declare his actual income. (2) He may declare less than his actual income. If he chooses the latter strategy his payoff will depend on whether or not he is investigated by the tax authorities. If he is not, he is clearly better off than under strategy (1). If he is, he is worse off. The choice of a strategy is therefore a non-trivial one.[222]

Considering the above scenario, clearly the choice is a business strategy. And when choosing not to pay the correct amount (that is, to practice any form of tax fraud), the chosen strategy is based on a lack of ethics. The possibility of making a profit outweighs the ethical factor.

The process of avoiding the unethical decision - practicing tax fraud - starts with understanding that it is an ethical decision. There is a need to ensure ethics awareness – "Ethics awareness is the ability to perceive whether a situation or decision has an ethical dimension"[223]. This means that there is a need that when the decision not to comply with tax obligations is taken, there is an immediate reflection that the action was unethical.

[222]ALLINGHAM, Michael G.; SANDMO, Agnar. Income tax evasion: a theoretical analysis. *Journal of Public Economics*, 1, 1972, pp. 323-338, p. 324.
[223]FERREL, O.C. Ferrell; FRAEDRICH, John; FERRELL, Linda. *Business Ethics: Ethical Decision Making and Cases*. 13th ed. Boston: Cengage, 2022, p. 137.

> It is easier to overlook certain issues requiring an ethical decision, particularly if the decision becomes a routine part of the job. This makes it important for organizations to train employees on how to recognize the potential ethical ramifications of their decisions. Familiarizing employees with company values and training them to recognize common ethical scenarios can help them develop ethical awareness. Employees need to understand how their decisions can have an ethical dimension.[224]

This leads to the organizational culture mentioned in the first chapter, that is one of the compliance programs responsibilities. It is essential that the organizational culture - the culture of compliance - is not only understood but adhered to. "Staff and management buy-in is essential for the effective operation of any compliance risk management system. This in turn is created by a clear and demonstrable commitment from the organisation and its leaders to any new compliance strategy, as well as sensitive management to foster common understanding and acceptance"[225].

Considering that the programs are developed considering the specifics of each business, a business that is subject to tax fraud will have the compliance program focused on working on ethics in relation to tax fraud. For this reason, in addition to defining an ethical organizational culture, compliance programs ensure that this culture will include actions related to tax fraud, addressing *tax morale*.

Tax morale is a very specific term, defined by OECD as "the intrinsic motivation to pay taxes, is a vital aspect of the tax system, as most tax systems rely on the voluntary compliance of taxpayers for the bulk of their revenues"[226]. This means that it is ethics that will guide the tax morale of a business, guaranteeing or not the payment of taxes.

Increasing *tax morale* through ethics is an important point, which is sometimes overlooked among other actions, and which can be guaranteed by compliance programs.

> Improving tax morale therefore holds the potential to increase revenues with (relatively) little enforcement effort. In the short term this potential can be realised largely through behavioural economic approaches, while in the longer term more structural changes are needed to build trust and legitimacy among taxpayers. Given this potential, it is surprising that tax morale has received comparatively little attention.[227]

[224] *Idem, ibidem,* p. 138,

[225] OECD. Compliance Risk Management: Managing and Improving Tax Compliance, op. cit., p. 13.

[226] OECD. Tax Morale: *What Drives People and Businesses to Pay Tax?.* Paris: OECD Publishing, 2019.

[227] *Idem, ibidem.*

The increase of revenues is ensured by the reduction of tax fraud, which concludes that "increased business tax morale could lead to greater compliance"[228].

Of course, the job of compliance programs to institute an organizational culture that influences *tax morale* does not have a magical effect that will end tax fraud. But it's a start. It is the certainty that at least there will be a reflection before committing any fraud, it is the certainty that that business has ethical values of being compliant with its tax obligations.

> Risk management means taking deliberate action to improve the odds of good outcome and reducing the odds of bad outcome. Risk management is not a magic formula that always will give the right answers. It is a way of working and thinking that will give better answers to better questions. It is a tool for decision-making and will help the organisation to reach its objectives.[229]

Through compliance programs, the probability of not having tax fraud increases, and also increases the probability of whistleblowing (as mentioned in the first chapter, it is one of the strategies of compliance programs).

Thus, it is evident that ethics is one of the dimensions that compliance programs have when acting as a tax fraud reducer; and this dimension essentially is from the taxpayers to the tax administration.

1.2 Risk management mechanism: legislation enforcement through compliance programs

When we talk about compliance programs and enforcement of legislation, we talk about the internal character of the tool acting together with the external character. It's about establishing internal regulations, ensuring that all actions in that business will be conducted in accordance with applicable external legislation.

After making the laws, the tax administration has an obligation to also make sure that the law is understood and applied. The taxpayer has, in turn, the obligation to understand and comply with the law.

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[228] *Idem, ibidem.*

[229] EUROPEAN COMMISSION. *Risk management guide for tax administrations,* op. cit., p. 13.

> Revenue authorities have a central role (and vested interest) in ensuring that taxpayers and other parties understand their obligations under the revenue laws. For their part, taxpayers and others have an important role to play in meeting their obligations as, in many situations, it is only they who are in a position to know that they may have an obligation under the law.[230]

Naturally, the responsibility comes from the tax administration to the taxpayer. However, when using compliance programs in businesses that are taxpayers, this responsibility is reversed, from the taxpayer to the tax administration. Tax administration is constantly overloaded, and the complexity of a tax system requires outside help.

> The laws provide the basis for taxation. It is not possible to appraise the efficiency or effectiveness of tax administration without taking into account both the degree of complexity of the tax structure it is expected to administer and the extent to which that structure remains stable over time. Even the most sophisticated tax administration can easily be overloaded with impossible tasks.[231]

Thus, the business begins to act as an extension of the tax authority, helping to ensure the enforcement of tax laws; and for this to happen correctly, compliance programs need to be structured correctly. The first point is to establish the risks, to make the proper assessment to understand all the possible consequences for each action.

> A threat assessment identifies the specific risks of tax crimes that are prevalent in the jurisdiction. This should take into account the particular context or environment (cultural, political, legal, economic and technological), and where relevant, draw on the insights of other agencies responsible for fighting financial crimes. It can be effective to prioritise the threats in terms of the likelihood and the impact if such threats are realised.[232]

This assessment work involves knowing all the types of tax fraud presented in this work, and knowing the ways in which they are practiced. This way, the compliance program will have initiatives that predict the risk of fraud happening, preventing it from actually occurring.

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[230] OECD. Compliance Risk Management: Managing and Improving Tax Compliance, op. cit., p. 07.
[231] EUROPEAN COMMISSION. *Risk management guide for tax administrations,* op. cit., p. 14.
[232] OECD. *Fighting Tax Crime – The Ten Global Principles*. Second Edition. Paris: OECD Publishing, 2021, p. 23.

> For higher risk areas, specialist tax knowledge may be required in the development of risk assessment methodologies to ensure specific tax factors and their interconnectedness are appropriately considered in the design stage (for example, considering the impact and efficacy of various tax transparency regimes in particular business lines and geographies). The risk assessment may also consider key risk indicators specifically addressing tax evasion facilitation risks.[233]

And as consequence, carrying out compliance programs observing the risks, requires knowledge of the laws applicable to the business; and this will make the compliance program's policies compliant with the law – "An effective compliance programme should leverage existing financial crime compliance, conduct and tax (including tax transparency regimes) procedures and controls, in order to address the risks of customer tax evasion, and the facilitation thereof"[234].

And that leads to the second point, which is the creation of compliance policies. The policies chosen for the compliance program will be established taking into account the specific needs of the business in conjunction with external legislation, and always on an ethical basis. As an example, the American companies Philip Morris International and GitLab codes of conduct and ethics are used.

Among several determinations of the Code of Business Conduct and Ethics for Directors from Philip Morris International[235], some that are directly linked to tax fraud stand out. Protection and Proper Use of Company Assets[236] is the first topic. It ensures that protecting the assets against loss, theft or other misuse is everyones responsibility, meaning that when someone practices any type of tax fraud, this person will be held responsible for not protecting the business assets. The second relevant topic is Compliance with Laws, Rules and Regulations[237]; this one is the maybe the most important, once it ensures that every decision must be taken with integrity, following the laws applicable to the company (this reinforces the need to know the risks so that this policy can be put into practice). Thirdly, the Other Legal Standards stand out, a topic in the Code that determines that "there are many legal and ethical standards that apply to those who act for the Company"[238]. Basically, this topic lists conducts that are the organizational culture of the business, and reinforces that the decisions taken by someone as a business

[233] THE WOLFSBERG GROUP. *Wolfsberg Guidance on Customer Tax Evasion*. 2019. Available at: <https://www.wolfsberg-principles.com/sites/default/files/wb/Wolfsberg%20Guidance%20on%20Customer%20Tax%20Evasion.pdf>, p. 03.

[234] *Idem, ibidem*, p. 02.

[235] PHILIP MORRIS INTERNATIONAL INC. Code of Business Conduct and Ethics for Directors. *Philip Morris International*, n. d. Available at: <https://www.pmi.com/resources/docs/default-source/our_company/code-of-business-conduct-and-ethics-for-directors.pdf?sfvrsn=0>.

[236] *Idem, ibidem.*

[237] *Idem, ibidem.*

[238] *Idem, ibidem*, p. 05.

employee must be in conformity with the standards. The last topic highlighted here is the Compliance with This Code and Reporting of Any Illegal or Unethical Behavior[239]. This is related with the whistleblowing strategy that compliance programs have, to ensure that if the prevention fails, problems will be found.

The GitLab Code of Business Conduct and Ethics for directors, officers, employees and contractors is no different, emphasizing the same points. The code reinforces the organizational culture and the tone at the top (strategy explained in the first chapter): "The Chief Executive Officer, Chief Financial Officer, and members of the Finance Department have a special role not only to adhere to these principles themselves but also to ensure that a culture exists throughout GitLab as a whole that ensures the fair, accurate, comprehensive and timely reporting of financial results"[240]. Also, the code emphasizes that in fact it is not possible to know all the laws in their entirety, but that the general idea must be known by employees - always in case of doubt, the compliance professional should be consulted[241]. However, the entirety of the company's code and values will always reflect the laws and following them is synonymous with acting in compliance with the law.

After the risk assessment and the elaboration of codes of conduct, the practical application of the compliance programs takes place, which will be carried out according to the needs of the business, choosing the model preferred by the compliance officer (as one of the several models presented in the first chapter).

> Generally, there should be an overall tax compliance strategy that covers the full range of compliance, from encouraging voluntary compliance, dealing with inadvertent non-compliance, to avoidance, evasion and serious crime. However, the specific strategy would be based on each jurisdiction's legal system, policy context, legislative environment and general structure of law enforcement.[242]

Through this, the legislation is enforced in a preventive manner, even if it was originally of a sanctioning nature. Compliance programs guide the laws as prevention, as they aim to prevent any type of tax fraud from occurring - there is no sanction, as prevention takes effect beforehand.

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[239] *Idem, ibidem.*

[240] GITLAB. Code of Business Conduct and Ethics for directors, officers, employees and contractors. *GitLab*, 2021. Available at: <https://ir.gitlab.com/static-files/7d8c7eb3-cb17-4d68-a607-1b7a1fa1c95d>, p. 06.

[241] *Idem, ibidem.*

[242] OECD. *Fighting Tax Crime – The Ten Global Principles*. Second Edition, op. cit., p. 22.

It is apparent that compliance programs can act as tax fraud reducers through the use of tax legislation in their structure.

1.3 Risk management mechanism: transparency through compliance programs

Transparency is one of the principles from public administration necessary to its correct functioning. It is a general principle, which must be applied to all public authorities: "as a general rule, the conduct of public administration should be transparent and open. Only exceptionally should matters be kept secret or confidential, such as those truly affecting the national security or similar issues"[243].

Considering the tax administration as a part of the public administration, transparency is also a necessary element of tax administration. In that regard, there is no confusion between transparency and fiscal secrecy. Fiscal secrecy is related to sensitive information, easily protected such as names, equity values... which do not affect the disclosure of normative understanding[244]. It is possible to act transparently and at the same time maintain fiscal secrecy.

This transparency extends to the taxpayer, as the tax administration needs the taxpayer's help. Transparency is a two-sided relationship, in a way that the principle of transparency also belongs to the private sphere.

> Tax administrations rely on taxpayers to provide them with correct information on their taxable income and taxable events. Actions to promote and sustain voluntary compliance and increase trust between tax authorities on the one hand and taxpayers on the other hand can increase the effectiveness of reporting[245].

In addition to being important because it is a principle of public administration extended to the private sphere, transparency has already been directly related to tax fraud. Throughout the work it was noted that it is difficult to measure the levels of tax fraud, as well as it is difficult to combat it; in this regard, the European Parliament highlights that: "The main salient issues relate to providing enough

[243]OECD. European Principles for Public Administration, op. cit., p. 12.
[244]VETTORATO, Gustavo. A transparência tributária e compliance. *Revista de Direito Recuperacional e Empresa*, vol. 14/2019, 2019.
[245]EUROPEAN COMMISSION. *Communication from the commission to the European Parliament and the Council an action plan for fair and simple taxation supporting the recovery strategy.* Brussels, 2020. Available at: <https://ec.europa.eu/taxation_customs/system/files/2020-07/2020_tax_package_tax_action_plan_en.pdf>, p. 08.

transparency to tax authorities in order to enable them to fight against tax fraud. This can be complemented by broader transparency, given that significant tax fraud has been uncovered by individuals (whistle-blowers) or journalistic investigations"[246].

This means that the lack of transparency has its responsibility for the obstacles in measuring and combating tax fraud, and that greater transparency can help in whistleblowing and investigations. Not only that, but lack of transparency can also increase tax fraud because without it Member States cannot communicate properly among themselves.

> In particular, national administrations often lack the necessary information about the impact of other countries' tax regimes and practices on their own tax systems. Preliminary investigations by the Commission, work carried out by the Code of Conduct for Business Taxation Group and recent public revelations provide real evidence of the need to introduce greater transparency into Member States' corporate tax regimes, for the sake of fair tax competition.[247]

For these reasons transparency is one of the anti-tax fraud measures that appears most in the European Union's initiatives, breaking bank secrecy, the exchange information network... there are several suggestions in this regard. These suggestions are all at the tax administration level and have an impact on the taxpayer. Once again, compliance programs manage to reverse the direction, bringing taxpayer transparency to impact tax administration.

As mentioned several times in the first chapter, transparency is one of the foundations of any compliance program. There is no way to have an effective program if there is no transparency on part of all involved. It is evident that the compliance program will encourage and provide transparency to the taxpayer.

A transparent compliance program makes all the tax activity of the business accessible to the tax administration: "In a transparent and co-operative relationship it is expected that relevant documents would be made available to the revenue body for open discussion"[248]. If the documents are available for audits and investigations, the probability of tax fraud in the business is reduced, because nobody wants to be caught. A business without transparency can much more easily hide fraudulent practices.

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[246]EUROPEAN PARLIAMENT. *The fight against tax fraud*, op. cit., p. 10.

[247]EUROPEAN COMMISSION. *Communication from the Commission to the European Parliament and The Council on tax transparency to fight tax evasion and avoidance*, op. cit., p. 04.

[248]OECD. *Building Transparent Tax Compliance by Banks*. Paris: OECD Publishing, 2009, p. 61.

In the event of a failure, which happens, the compliance program will allow the problem to be quickly found. That's because with a transparent tax process, it's easy to find evidence of fraud.

> Rather than the tax administration having to invest substantial resources to uncover whether there is an issue and then seeking to establish the issue, it is the taxpayer (and in certain cases the advisor) that discloses or "volunteers" the issue. This enables the tax administration to proceed immediately to an assessment of the issue and its resolution. Early detection and resolution create benefits for both the taxpayer and the tax administration, such as fewer routine audits, increased transparency, and a positive impact on compliance culture in general.[249]

In this way, compliance programs through transparency allow less room for tax fraud, and easier identification of fraudulent activity. When the importance of transparency in fiscal relations is understood, it becomes even more evident how using compliance programs to implement this principle is necessary.

2. The benefits of risk management regarding tax fraud through compliance

In the previous section, some benefits were already made explicit, such as lower probability of fraud, increased *tax morale*, compliance with tax legislation, lower tax administration costs to find fraud, easier access to tax documents, among others. This second part of the chapter goes deeper into the benefits of enforcing compliance in the context of tax fraud, both for tax administration and taxpayers.

The environment between tax administration and taxpayers is much more pleasant with the initiatives of risk management. There is greater trust between both sides, which makes it easier to be compliant with tax obligations.

> Countries that have engaged in such initiatives generally do so as one important component of a wider compliance strategy which encompasses a balance between guiding and supporting risk management by taxpayers, alongside audit and other enforcement actions. Countries that have developed business models aimed at improving tax risk management and compliance by large business taxpayers through greater co-operation include Australia (Annual Compliance Arrangement), Ireland (Co-operative Approach to Tax Compliance), Italy (Risk Management Monitoring), the Netherlands (Horizontal Monitoring, New Zealand (Co-operative Compliance

[249]OECD. *Tackling aggressive tax planning through improved transparency and disclosure*. Paris: OECD Publishing, 2011. Available at: <https://www.oecd.org/ctp/exchange-of-tax-information/48322860.pdf>, p. 13.

> Initiative), Spain (Forum for Large Taxpayers), the United Kingdom (Tax Compliance Risk Management Process) and the United States (Compliance Assurance Process).[250]

This means that the use of compliance programs brings the businesses closer to the tax administration, as they understand what is happening, the reason for taking a tax, and the consequences of not paying. At the same time, tax authorities have greater confidence in the taxpayer, being able to invest less resources in tax fraud remediation and be concerned with investing where it is really needed - the return to taxpayers. In this sense, the tax administration can "improve their selection of issues for intervention or audit, and better target questions and information requests"[251].

There is a problem that harms both the tax administration and the taxpayers, the constant changes in tax legislation and different understandings in different jurisdictions. For the tax administration, the change naturally represents a risk: "the changing tax environment presents particular challenges for revenue bodies as, for instance, it can provide greater opportunities for aggressive tax planning. Detecting and responding to these challenges makes revenue bodies' task more difficult and more costly"[252]. Likewise, for the taxpayer, this type of situation makes it difficult to pay taxes correctly, after all, the more complex the tax system, the more difficult it is to be compliant with everything.

An example of this is the strategy used by EY presented in a case study on banks: "For example, if tax regulation changed in Malaysia, the regional EY teams would flag this, and update the impacted solutions. The bank's compliance would be guaranteed, without internal stakeholders needing to lift a finger"[253]. Compliance programs also have their relevance in this part, as they are concerned with these aspects. And this is exactly the spirit of compliance programs in this sense, which will be beneficial to both tax administration and taxpayers.

The OECD Study on the Role of Tax Intermediaries brought together some of the benefits of using risk management for tax administration and taxpayers. In relation to the first one:

> The key benefits of the approach for revenue bodies can be summarised as:
> • a structured basis for strategic planning, including resource allocation;
> • a process for identifying systemic risks to the tax system – for example, areas where the law is not operating satisfactorily or is producing unacceptably high compliance costs;

[250] *Idem, ibidem,* p. 15.
[251] OECD. *Building Transparent Tax Compliance by Banks*, op. cit., p. 61.
[252] OECD. *Study into the Role of Tax Intermediaries*. Cape town: OECD Publishing, 2008. Available at: <https://www.oecd.org/tax/administration/39882938.pdf>, p. 23.
[253] EY. How banks can fight tax crime, be compliant and reduce costs parallelly. *EY*, 2018. Available at: <https://www.ey.com/en_lu/financial-services-emeia/how-banks-can-fight-tax-crime-be-compliant-and-reduce-costs-parallelly>.

> • a collection of evidence to allow revenue bodies to determine their response to risk – whether it is the deployment of additional resources or a legislative change; and
> • a defensible approach to managing taxpayer compliance that can withstand external scrutiny (e.g. by external audit officials).[254]

For the second ones:

> It will be in the interests of the large majority of taxpayers (at least those whose activities and behaviours do not demonstrate significant risk) to help revenue bodies become better at risk assessment, better at recognising lower risk, better at not initiating unnecessary audits and, hence, better at minimising those taxpayers' compliance costs and helping them achieve certainty.[255]

Considering the benefits on both sides, compliance programs generate mutual help, in which everyone wins. This synergy brings only positive results:

> Good working relationships that allow open dialogue between banks and revenue bodies have had a positive impact on overall compliance behaviour and a reduction in compliance costs. The relationships:
> • have as a rationale the creation of a joint approach to improving tax risk management and overall tax compliance;
> • involve engagement with the top management of large businesses, including banks, and commitments by both parties to improve tax risk management; and
> • are characterised by increased trust and transparency and lower levels of confrontation rooted in a deeper understanding of each others' business and roles.[256]

As a side effect of fighting tax fraud through risk management and its forms, other practices can be reduced: "Good governance in the tax area is not only an essential means for combating cross-border tax fraud and evasion, but can strengthen the fight against money laundering, corruption, and the financing of terrorism"[257].

Considering the above, there is no doubt that the application of compliance programs in businesses will bring benefits to tax administration and taxpayers, reducing tax fraud practices.

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[254] OECD. *Study into the Role of Tax Intermediaries*, op. cit., 24.
[255] *Idem, ibidem.*
[256] OECD. *Building Transparent Tax Compliance by Banks*, op. cit., p. 61.
[257] COUNCIL OF THE EUROPEAN UNION. *Press release 2866th Council Meeting - Economic and Financial Affairs*. Brussels, 2008. Available at: <https://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/100339.pdf>, p. 22.

3. Tax compliance mechanisms

As discussed in the first chapter, the laws do not oblige businesses to have compliance programs. Some jurisdictions grant benefits to those who have them, but the decision to have them or not remains a business decision. However, as shown in the first chapter, legal provisions that promote the use of risk management and compliance programs have started to emerge.

Most of these provisions are related to compliance and the reduction of corruption, but at the same time there are legal documents aimed at the use of risk management to reduce tax fraud, "the EU has worked to promote higher levels of tax good governance internationally too. It has strongly supported the OECD's work on tax transparency and Base Erosion and Profit Shifting (BEPS), and set an example globally by integrating the new global norms into EU law"[258].

These documents have an important role as they promote the use of compliance programs, and maybe can be the opening for the reduction of tax fraud through risk management to be regulated through hard law. Thus, some initiatives are presented.

The Code of Conduct for Business Taxation, born from the Conclusions of the ECOFIN council meeting on 1 December 1997 concerning taxation policy[259], was the first EU document that addressed compliance principles although not aiming to establish risk management practices - the bases that this Code establishes have compliance traits. This is because the Code "works on the premise that, whilst tax competition among countries is not problematic per se, there need to be common principles on the extent to which they can use their tax regimes and policies to attract businesses and profits"[260]. The common principles are those that enable correct decisions, that is, ethical ones. Thus, in 1997, compliance policies were already applied, even if the objective was not to apply the tool.

The OECD has made public, in 2004, the guidance note on Compliance Risk Management: Managing and Improving Tax Compliance. The purpose of the guidance note is to "provide a framework for the application of modern compliance risk management principles to the management of tax

[258] EUROPEAN COMMISSION. *Communication from the Commission to the European Parliament and the council on Tax Good Governance in the EU and beyond*, op. cit., p. 03.
[259] ECONOMIC AND FINANCIAL AFFAIRS COUNCIL. *Conclusions of the ECOFIN council meeting on 1 December 1997 concerning taxation policy*. 1997. Available at: <https://eur-lex.europa.eu/resource.html?uri=cellar:d2cdddef-e467-42d1-98c2-31b70e99641a.0008.02/DOC_1&format=PDF>.
[260] *Idem, ibidem.*

compliance risks. It identifies and discusses the general principles found in both the identification and treatment of compliance risks within a wide variety of taxation jurisdictions"[261].

The document is a guide to implement compliance programs in the tax scope, and for that purpose it brings the process in stages, which are establishing the context, identifying risks, assessing and prioritising risks, analysing compliance behaviour, determining the treatment strategies, applying the strategies and evaluating the outcomes[262]. Across these groups, the document mentions tax fraud in various forms such as aggressive tax planning, VAT refund fraud and carousel fraud.

In 2006 the Risk management guide for tax administrations[263] was published, within the scope of the already discussed Fiscalis Risk Analysis Project Group. The Guide is very well formulated and contains all the information on risk management, from its origins to its current concept (already presented in the first chapter). The document also includes strategies, practical examples, and an overview of risk management in several countries. This Guide is an excellent option for knowledge of risk management focused on tax administration, since all its content is focused on this relationship (with emphasis on risk management within the tax administration itself).

Subsequently, in 2009 was released the Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee Promoting Good Governance in Tax Matters, which reads:

> This Communication aims to identify the particular EU contribution to good governance in the area of direct taxation. It considers:
> • how good governance could be improved within the EU,
> • the particular tools that the European Community and EU Member States may have at their disposal to promote good governance internationally, and
> • the scope for more co-ordinated action by EU Member States, so as to support, streamline and complement international action taken in other fora such as the OECD and the UN.[264]

To meet the objectives, the Communication sets out some steps, such as improving internal good practices in the EU so that Members benefit; broadening the geographical scope of good governance to reach third countries; and greater coordination among EU Members on good governance in tax matters.

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[261] OECD. Compliance Risk Management: Managing and Improving Tax Compliance, op. cit., p. 04.

[262] *Idem, ibidem.*

[263] EUROPEAN COMMISSION. *Risk management guide for tax administrations,* op. cit.

[264] COMMISSION OF THE EUROPEAN COMMUNITIES. *Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee Promoting Good Governance in Tax Matters*. Brussels, 2009. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52009DC0201&from=EN>, p. 05.

The Communication from the Commission to the European Parliament and the Council An Action Plan to strengthen the fight against tax fraud and tax evasion from 2012 is an "action plan setting out concrete steps to enhance administrative cooperation and to support the development of the existing good governance policy, the wider issues of interaction with tax havens and of tackling aggressive tax planning and other aspects, including tax-related crimes"[265].

Among the proposed measures, the measures encouraging third countries to apply minimum standards of good governance in tax matters and creating a platform for tax good governance stand out. In this way, the legal device addresses practices and structures of a compliance program.

The first point refers to the fact that as long as third countries do not have the same level of good practices as Member States, problems will continue to exist. For this reason:

> The Commission recommends the adoption by Member States of a set of criteria to identify third countries not meeting minimum standards of good governance in tax matters and a 'toolbox' of measures in regard to third countries according to whether or not they comply with those standards, or are committed to comply with them.[266]

The second point addresses the creation of a Platform for Tax Good Governance, which, with the joint work of Member States and stakeholders, aims to ensure the effectiveness of this Communication and good governance in tax matters[267].

Accompanying the previous one, still in 2012 and addressing the same theme, a Recommendation was issued - the Commission Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters. The document is based on the fact that:

> it is necessary to clearly spell out minimum standards of good governance in tax matters, both in regard to transparency and exchange of information and in regard to harmful tax measures, and a number of measures to be taken vis-à-vis third countries, with a view to encouraging those countries to comply with those standard.[268]

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[265] EUROPEAN COMMISSION. *Communication from the Commission to the European Parliament and the Council An Action Plan to strengthen the fight against tax fraud and tax evasion*. Brussels, 2012. Available at: <https://ec.europa.eu/taxation_customs/system/files/2016-07/com_2012_722_en.pdf>, p. 02.

[266] *Idem, ibidem*, p. 06.

[267] *Idem, ibidem*.

[268] EUROPEAN COMMISSION. *Commission Recommendation of 6 December 2012 regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters*. Brussels, 2012. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012H0771&from=en>, p. 38.

In 2015 the Commission Decision of 17.6.2015 establishing the Commission Expert Group "Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation" and replacing Decision C(2013)2236 was issued. The Platform was created from the aforementioned Action Plan to strengthen the fight against tax fraud and tax evasion from 2012 and began to take shape in the 2013 repelled decision[269]. The proposal was taken forward once the Platform proved to be effective, and once it needed to be revised and adapted the 2015 Decision came precisely to establish the Platform. One of the main tasks of the Platform is to "encourage discussion between business, civil society and national tax authorities' experts on issues in the field of good governance in tax matters, aggressive tax planning and double taxation"[270].

Also in 2015, the Communication from the Commission to the European Parliament and the Council on tax transparency to fight tax evasion and avoidance was issued. This legal document focuses on promoting transparency as a way to avoid some types of tax fraud, and for that, it chooses the use of governance practices as one of the tools. By recapitulating that the EU over the years has been a great enthusiast of good practices, this Communication emphasizes that "The EU must continue to invest heavily in this project and push for an ambitious new international tax framework"[271].

In the following year, 2016, the scenario of good governance practices continued to demand actions, and the difference in understandings of minimum standards of good practices was a problem:

> The diversity in Member States' approaches sends mixed messages to international partners about the EU's tax good governance expectations and creates doubts about when defensive mechanisms will be triggered. A coordinated EU external strategy on tax good governance is therefore essential to boost Member States' collective success in tackling tax avoidance, ensure effective taxation and create a clear and stable environment for businesses in the Single Market.[272]

[269]EUROPEAN COMMISSION. *Commission Decision of 23 April 2013 on setting up a Commission expert group to be known as the Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation*. Brussels, 2013. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013D0426(02)&from=EN>.

[270]EUROPEAN COMMISSION. *Commission Decision of 17.6.2015 establishing the Commission Expert Group "Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation" and replacing Decision C(2013)2236*. Brussels, 2015. Available at: <https://ec.europa.eu/taxation_customs/system/files/2016-09/platform_en.pdf>, p. 03.

[271]EUROPEAN COMMISSION. *Communication from the Commission to the European Parliament and The Council on tax transparency to fight tax evasion and avoidance*, op. cit., p. 06.

[272]EUROPEAN COMMISSION. *Communication from the Commission to the European Parliament and the Council on an External Strategy for Effective Taxation*. Brussels, 2016. Available at: <https://eur-lex.europa.eu/resource.html?uri=cellar:b5aef3db-c5a7-11e5-a4b5-01aa75ed71a1.0018.02/DOC_1&format=PDF>, p. 02.

And that's why the Communication from the Commission to the European Parliament and the Council on an External Strategy for Effective Taxation was published. This Legal Document is based on the need for greater harmonization in tax matters and sets out good practices as a strategy for this: "A common external strategy for effective taxation must be founded on clear, coherent and internationally recognised tax good governance criteria, which are consistently applied in relation to third countries"[273]. The criteria addressed in the Communication are shared with compliance programs structures (transparency, information exchange and fair tax competition).

In 2019 the Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation was once again renewed through the Commission Decision of 16 December 2019 on the renewal of the Commission Expert Group 'Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation'. After a few years of the Platform's activity, its effectiveness and necessity were verified:

> The Platform has been an efficient tool in increasing such transparency in tax policy-making while encouraging and enabling constructive dialogue between the Commission and the different tax stakeholders, as well as among the different tax stakeholders themselves. The Commission needs to rely on the expertise of specialists and stakeholders. The Platform has been a valuable source of such expertise in the field of tax.[274]

In 2020, The Communication from the commission to the European Parliament and the Council - an action plan for fair and simple taxation supporting the recovery strategy, instituted a new tax package. This package is divided in three components, an action plan for a fair and simple taxation; better administrative cooperation; and good governance in the EU and beyond. Compliance programs fall into the latter group.

The last group of the package determines a new communication regarding the subject, which has as objectives:

> • a reform of the Code of Conduct for Business Taxation,
> • a review of the EU list of non-cooperative jurisdictions for tax purposes,
> • improvements to reinforce tax good governance vis-à-vis EU funds and improved coordinated defensive measures by EU Member States, and
> • support to developing country partners in enhancing tax good governance.[275]

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[273] *Idem, ibidem*, p. 03.

[274] EUROPEAN COMMISSION. *Commission Decision of 16 December 2019 on the renewal of the Commission Expert Group 'Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation'.* Brussels, 2019. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019D1220(02)&from=EN>, p. 01.

[275] EUROPEAN COMMISSION. *Communication from the commission to the European Parliament and the Council an action plan for fair and simple taxation supporting the recovery strategy*, op. cit., p. 03.

And from that, came the Communication from the Commission to the European Parliament and the Council on Tax Good Governance in the EU and beyond, still in 2020. The Communication seeks to improve the four points aforementioned.

First, the Communication brings good governance practices as a de facto objective of the Code of Conduct for Business Taxation; through transparency and effectiveness, the Code intends to have a greater focus in this sense. Second, the Communication intends to review the EU list of non-cooperative jurisdictions boosting transparency and accountability, with the aim to:

> improve the global tax governance context, ensure a level playing field at international level and support third countries governments in their effort to implement commitments and actions taken at global level (for instance in the framework of the G20 anti-Base Erosion and Profit Shifting initiatives or the Addis Ababa Action Agenda).[276]

The third point is related to improving good governance measures, ensuring that good practices are actually implemented. Measures are the actions that must be taken in the event of non-compliance with good practices, and the Communication determines that EU funds should be properly applied in this scenario; and that defensive measures against EU listed countries are effectively applied.

The last point aims to establish a policy to support partner countries in tax good governance. The justification for this action is that "as the world's largest donor of development aid and supporter of global governance, the EU is conscious of the importance of good governance for developing partners"[277]. And as mentioned before, tax fraud is everyone's problem, so as long as some countries continue with misconduct, all the others will be affected.

And the most recent of the legal documents, Communication 645 of 2021 presents the Commission work programme 2022. Every year a programme is presented, which defines priorities and objectives that will be addressed over the years. The Programme for 2022, among its subjects, deals with governance by emphasizing the importance of an economy that works for people, in the sense that:

[276] EUROPEAN COMMISSION. *Communication from the Commission to the European Parliament and the council on Tax Good Governance in the EU and beyond*, op. cit., p. 05.
[277] *Idem, ibidem*, p. 12.

> [...] the Commission is relaunching the public debate on fiscal rules and on the economic governance framework. The Commission will consider all views expressed during the public debate. It will in the first quarter of 2022 provide guidance for fiscal policy for the period ahead, with the purpose of facilitating the coordination of fiscal policies and the preparation of Member States' Stability and Convergence Programmes. The guidance will reflect the global economic situation, the 6 specific situation of each Member State and the discussion on the economic governance framework. The Commission will provide orientations on possible changes to the economic governance framework with the objective of achieving a broad-based consensus on the way forward well in time for 2023.[278]

This demonstrates that the matter continues to be relevant, and that even more effort is needed so that good practices are implemented in the fiscal sphere; and which is also a priority on the EU's agenda.

The common factors observed with the analysis of these legal documents are that most of them still emphasize risk management within the tax administration, which is also important, and a minority directly address risk management in companies; also, basically all documents are soft law, being hard law used only to institute legal figures (such as the Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation). The constant publication of legal diplomas that bring risk management within the fiscal scope also indicates that more will come, and the subject will develop through evolution while there will be more evidence as a basis for legislation. It is also worth noting that none of the documents analysed specifically addresses compliance programs, but all their characteristics are present when risk management and corporate governance are named (and as explained in the first chapter, the nomination does not restrict the risk management tool to a single use, and a single strategy may have several tools).

Thus, the set of all legal instruments is a sign that risk management is indeed effective in reducing tax fraud. Great attention and budget have been allocated to these initiatives so that risk management is applied in the fiscal sphere in the EU and in third countries - resulting in a reduction in tax fraud.

[278]EUROPEAN COMMISSION. *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Commission work programme 2022 - Making Europe stronger together*. Strasbourg, 2021. Available at: <https://eur-lex.europa.eu/resource.html?uri=cellar%3A9fb5131e-30e9-11ec-bd8e-01aa75ed71a1.0001.02/DOC_1&format=PDF>, pp. 05 - 06.

CONCLUSION

Compliance programs arose from the need to combat corporate corruption triggered globally due to changes brought by globalization. The starting point of these programs was the concept of risk management, which is based on the possibility of preventing all consequences that may occur because of existing risks. Since risk, different from danger, is something that may or may not happen and that will bring consequences, a structure is needed that allows them to be identified and processed.

Compliance programs are the way to create this structure, generally making use of three main forms - prevention, detection, and correction. The risks associated with the business are identified, failures that occurred even after identification are detected, and then corrected. For this to work, the program must be built correctly, usually by a compliance officer, always observing ethical bases and the individual needs of each business. A compliance program will always be associated with ethics, as it should be impossible to separate corporate decisions from it, and therefore it should always be considered.

Over time, these programs became more used and developed, and legislation began to pay more attention to the tool. Mostly through soft law, such as the Commission Recommendation (EU) 2021/1700, legal diplomas have emerged to encourage and guide the use of compliance. Subsequently, some jurisdictions also did so within their hard law, mainly by reducing penalties for companies that made use of compliance programs (such as *Lei* nº 12.846 of 2013 in Brazil). It was noticed that compliance programs could be used for much more than just preventing and fighting corruption, other functions were allocated to it - this was also due to the tool acting subjectively (internally) and objectively (externally), internal as it works within the company, external as always will be based on the legislation applicable to the company. One of these alternative uses was compliance in the tax sphere.

The problems of escaping from taxes have already occurred since tax systems began to take shape, many do not want to fulfil their contribution obligation. In the European Union, where there is a semi-harmonized tax system in which the Member States make their decisions but always in conformity with the EU, the fight against different forms of tax fraud has been a matter of attention. The negative impact that tax fraud causes is high, and it has been difficult to reduce as there are many forms of fraud and their strategies have been developed. Along with tax fraud other abusive tax behaviours as tax avoidance, VAT fraud and avoidance, aggressive tax planning, base erosion and profit shifting and the use of cryptocurrency for tax fraud have been recurrent.

Many laws were published in the context of reducing tax fraud, with mostly punitive measures, and initiatives such as transparency, information exchange and fair tax competition. How to reduce tax fraud beyond these ways is an important and necessary question. The answer to assist the tax administration in the fight were the compliance programs applied to businesses.

When applying a compliance program in a company, there is a reversal of roles. The taxpayer starts to assist the tax administration, being a form of partner. This is because it is the taxpayer who will be making the effort, from the moment that the identification of risks made by compliance makes it possible to identify fiscal risks, all possible gaps are recognized, and a program is prepared to prevent these risks from materializing. Compliance programs assist the tax administration mainly in three aspects, ethics, transparency, and enforcement of legislation.

Ethics should be the basis of every business decision, and compliance programs are able to incorporate ethical foundations through the corporate culture. Still within this scope, ethics increases taxpayers' *tax morale* by increasing levels of voluntary compliance with tax obligations. Law enforcement is also encouraged through compliance programs. When a program is built, it will be based on the tax legislation applicable to the business, and the program will ensure that the legislation is complied with. The taxpayer thus acts as an enforcer of the tax law, sharing the role of tax administration. There is still the aspect of transparency, which is an essential element in the fight against tax fraud. This is one of the most discussed and defended points by the existing legislation in this area, precisely because it proves to be relevant and useful. Transparency that links directly to ethics is widely encouraged and enforced in compliance programs, so hiding fraud becomes more difficult, and finding fraud becomes easier.

The use of compliance programs in business brings benefits to the taxpayer and the tax administration. The relationship between elements becomes one of trust, and many benefits can be seen such as lower probability of fraud, increased *tax morale*, compliance with tax legislation, lower tax administration costs to find fraud, easier access to tax documents, and less costs for the taxpayer once there will be no fees for tax fraud. It is a synergetic relationship, beneficial for both sides.

And in this sense, legislation has already made progress in encouraging the use of good tax practices as a method of reducing tax fraud. Despite being mostly soft law (as the Communication from the Commission to the European Parliament and the Council on Tax Good Governance in the EU and beyond, and the Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee Promoting Good Governance in Tax Matters) each year more legal documents in this area stand out. The European Union's investment in legislation and resources for

greater use of risk management practices in the tax sphere is the greatest proof that it is a necessary and effective tool.

Thus, from an analysis of the European Union scenario but without failing to understand the problem at a global level, understanding that compliance programs are a risk management tool that when applied in business can be used to reduce tax fraud and other abusive tax behaviours, it is evident that risk management is an effective mechanism for collaboration between tax administration and taxpayers, being beneficial to both sides.

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