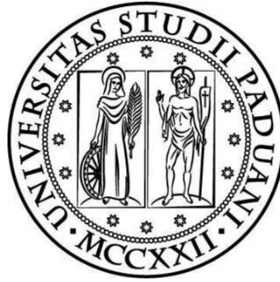

UNIVERSITÀ DEGLI STUDI DI PADOVA

DIPARTIMENTO DI SCIENZE ECONOMICHE E AZIENDALI

"MARCO FANNO"

CORSO DI LAUREA "ENTREPENEURSHIP AND INNOVATION"

TESI DI LAUREA

THE TAX AVOIDANCE DILEMMA: TAXPAYERS AND GOVERNMENT RECONCILIATION IN CO-OPERATIVE COMPLIANCE REGIMES

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MATRICOLA 2017897

ANNO ACCADEMICO 2022 – 2023

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INTRODUCTION

Academic research on taxes has historically been a primary matter of interest for many disciplines: contributions from finance, economics, law and accounting fields have provided, in the years, a *multidisciplinary nature* to tax research. One of the main areas of interest – especially for the accounting viewpoint – in the body of tax research literature is focused on tax issues faced by businesses: in particular, many events and trends of the last decades have contributed to give rise to worldwide important concerns regarding corporate *tax avoidance* behavior. In fact, tax avoidance, despite being a quite young area of research, has received increasing attention in recent times not only from academic tax researchers but also from governmental and supranational institutions and policy makers all over the world, with regard to the magnitude and relevance of tax avoidance practices as well as its determinants and consequences. The aim of the first part of this paper is, actually, to provide a clear view – by integrating the contributions from different fields of study to tax avoidance research – on the main determinants which encourage tax avoidance behavior and aggressive corporate tax planning inside organizations, with a particular focus on non-tax determinants. The second part of the paper, instead, concentrates on the opposite side of tax avoidance: tax compliance. Specifically, it investigates the main factors that influence and foster taxpayers' compliance level towards their tax obligations, and examines the practical responses that governments and tax authorities have implemented in the past, with the aim of ensuring an adequate level of compliance to the tax system and its provisions. In this context, evidence is presented over the fact that the *basic relationship* – which refers to the deterrent and punitive approach historically kept by tax authorities in their relationship with (non-compliant) taxpayers – has failed to reach the aforementioned objective. Nevertheless, thanks to the prominent work of the Organization for Economic Co-operation and Development, a renewed concept of relationship between revenue bodies and taxpayers, inspired to principles of openness, transparency, trust and co-operation between the involved parties has taken shape, coined by the OECD as *Co-operative Compliance*, and subsequently adopted by several countries all over the world in slightly different ways. The ultimate scope of this work is, then, to test – by selecting a company participating in the Italian Co-operative Compliance program, namely *Regime di Adempimento Collaborativo*, as a case of study – whether the evolution of the basic relationship, and the development of this new framework of interaction between taxpayers and the tax authority, could hinder corporate tax avoidance behavior and their attitude toward aggressive tax planning, encourage voluntary compliance and disclosure of relevant tax risks, and benefit to the whole national tax system.

Chapter 1

TAX AVOIDANCE

1.1 Tax research directions – 1.2 The emerging interest towards tax avoidance and its consequences – 1.3 Valuable insights and limitations of Accounting For Income Taxes literature

1.1 Tax research directions

Tax research has gained increasing attention as a topic of study from many disciplines in the last decades. Economics, finance, law and accounting scholars have addressed the argument from different perspectives, although not always harmonizing their views in the early stages of development of this theme.

Over the years, the need for coordination among these different spheres became evident, with the result that nowadays is very difficult to delineate the boundaries of tax research in one field or another. The accounting viewpoint – inevitably influenced by other disciplines contributions – will be an active concern throughout my paper.

As Shackelford & Shelvin (2001) point out in their review of the development of tax research in accounting, the first inclusive and, with hindsight, widely-accepted framework of study developed in order to address the main questions of tax research (*Do taxes matter? If not, why not? If so, how much?*) comes from the joint work of Scholes, a finance professor, and Wolfson, an accounting professor.

Their homonymous paradigm, often summarized as "*all parties, all taxes, all costs*" tries to combine the microeconomics and tax law perspectives to explain the prominent of role of taxes inside organizations, claiming the need for the tax planner to take into consideration different factors that shape organizations' tax behavior, specifically: all the tax implications for *all the parties* involved in a specific transaction, *all the taxes* – not only those directly paid to authorities – but also non-explicit taxes (e.g. the reduction in the return of a tax-favored investment) and *all the costs* that arise when implementing a business' tax plan, concluding that tax minimization might not always be the purpose of efficient tax planning.

The ease of this structure represents at the same time its strong point when evaluating the quality and reliability of research design, but also its limits when building scrupulous tests. Anyway, the Scholes-Wolfson framework laid the foundations for the development of tax research in

accounting in the subsequent years, and contributed to the rise of the three main areas of interest in the current scenario: multijurisdictional research, that investigate the role of taxes across political borders and their impact on MNE's decisions on their global tax planning schedule; tax and asset prices, which examines to which extent price adjustments are tax-motivated; tax and non-tax tradeoffs, that inquires how much these factors influence business choices and tax behavior. This last aspect will be further analyzed later.

Although being accurate and exhaustive within its stated scope, Shackelford and Shelvin review is not without criticism: while he supports the argument of the multidisciplinary nature of tax research, Maydew (2001) emphasizes that excluding a relatively large branch of research conducted by non-accountants – published in economics and finance journals – could be disadvantageous and bears the risk that readers are left with a partial picture of the topic. In fact, most of research in accounting focuses on the role and relevance of data and information in the decision-making process carried out by managers, owners, etc. in conditions characterized by a high grade of uncertainty; since information asymmetries are hardly to be quantified and indeed are involved in tax research only as non-tax factors, these might be left out of sight from the accounting perspective.

On the other hand, the trade-offs body of literature helps us to understand the magnitude of taxes – precisely, whether they play a major or slightly insignificant role – in making decisions, and allows to monetize non-tax costs by quantifying the amount of tax savings a firm must achieve before running into specific non-tax costs. Their degree of importance, however, is still an open question.

1.2 The emerging interest towards tax avoidance and its consequences

The improvements that contributions from each field of study can bring to tax research are clear, as Hanlon and Heitzman (2010) highlight throughout the course of what is, as of today, the most complete and comprehensive review of tax research, gathering evidence of theoretical and empirical studies from accounting, finance and economics.

Over time, accountants have leveraged the comparative advantage they possess as superior knowledge of institutional factors, such as tax law and financial reporting, and as a consequence, researchers have focused their effort towards topics involving corporate taxation, where a deeper understanding of law and institutional settings is requested (e.g., M&A, international taxation, etc.). Still, information contained in the financial statements, specifically in the income tax disclosures and other tax accounts, has raised researchers' interest, testing not only, for example, whether financial accounts could provide accurate forecasts about present

and future firm value or cash flow, but also if data contained in the tax return – compared to the information disclosed in the financial reports – could provide elements to detect firms' tax avoidance activities, and to shed light on its determinants and consequences.

Corporate tax avoidance is a relatively young body of literature, but very dynamic and full of contributions from many research fields, even outside the economics scope: this is because firms' tax avoidance behavior is not observable and determined only by data and information outcomes, but many social and psychological issues have to be taken into consideration, such as managers-owners agency conflicts, reputational concerns and family involvement, to mention a few.

In order to maintain a coherent and non-dispersive dissertation, I will analyze tax avoidance research and its findings by steps, starting from what has been – and maybe still is – a matter of debate among researchers: its definition. In fact, the term has different meanings for different people, and a universally accepted definition is lacking. First of all, tax avoidance must be kept well distinguished from tax evasion: while both practices share a common purpose – the reduction of a firm's tax burden – the latter achieve this target through *illegal* means. Instead, I will not focus on conducts that are manifestly against the law, since quite frequently tax avoidance transactions fall somewhere in-between legality and illegality, the so-called *grey area*. Indeed, following Weisbach (2003) line of reasoning, the lawfulness of a tax avoidance operation is often determined after the fact occurs: this is because a single transaction may be made up of many single, although complex, steps that taken individually are complying with the law, while the overall outcome might raise some doubts about its conformity.

Thus, tax avoidance needs to be defined as broadly as is the variety of transactions that could influence a firm's explicit tax liability, and Hanlon and Heitzman (2010) hit the target: they conceptualize tax avoidance as a *continuum* of tax planning strategies, where at one end are those operations that are perfectly legal and allow to obtain legitimate tax savings (e.g., tax-exempt investments), and closer to the other end are, of course, those behaviors labelled as more "aggressive", such as income sheltering practices and non-compliance with the tax law. On top of that, I put the word "aggressive" in quotes intentionally, because, as the authors point out "*[…] much like art, the degree of aggressiveness (beauty) is in the eye of the beholder*": indeed, different researchers have given different definitions of the topic, based on their personal perspectives, and elaborated different measures able to capture a firm's level of tax avoidance (Dunbar et al. (2010)). To overcome this obstacle, I will refer to tax aggressiveness taking into consideration all the characteristics that the different definitions have in common: the engagement in tax planning activities close to the end of the tax avoidance continuum, whose outcome is uncertain and risky; in other words, there is a high degree of probability that the

conduct will be challenged by the tax authority. Anyway, this lack in conceptual definitions has not prevented tax avoidance literature to thrive, and, actually, the more research is done on the subject, the less confusion will arise around the terms.

From Shackelford & Shelvin (2001) early portrait of income tax research developments, which identified the emerging interest of literature towards tax avoidance, to Hanlon and Heitzman (2010) recognition of corporate tax avoidance as one of the main active areas of tax research in accounting, several empirical studies have been concentrated on the determinants and consequences of tax avoidance, while research on this topic is still active and suggesting interesting avenues for future investigations. Extending their previous work, Lietz (2013) provides an up-to-date overview of the most relevant literature on the argument and aims to conceptualize the main determinants and costs related to corporate tax planning and tax avoidance, motivated by the urge to shed light on the various factors that might explain the relevant cross-sectional and within industry variations of firms' cash effective tax rates, documented by many empirical studies, as well as the reasons that shape firms' preferences toward their tax planning efforts. The author identifies the following topics, which will be furtherly investigated and explained later, as the main determinants of tax avoidance in corporate settings which have raised the interest of significant streams of literature:

- *After-tax performance measures and incentive-based compensation:* several studies concern the extent to which managerial compensation schemes could help to explain variations in firms' tax avoidance behavior: compensation contracts features may bind or incentivize managers to engage in tax planning strategies aimed at maximizing the firm's after-tax cash flows, in line with owners' interests.
- *Managerial opportunism and corporate governance in extended agency settings:* prominent research has documented potentially relevant interdependencies between corporate governance arrangements – designed to efficiently govern the relationship between shareholders and managers – and the firm's tax avoidance activities. In the agency view of corporate governance, the complex and obfuscating aspects of tax avoidance are considered a mean through which managers can pursue self-serving objectives at the expense of shareholders' interests.
- *Ownership structures:* the impact and the effects of tax avoidance practices differ among different ownership structures, which are a fundamental element of corporate governance. Numerous academics argue that diverse degrees of ownership concentration and its composition characteristics play a relevant role in shaping tax avoidance decisions.

- *Board of directors' formation:* based on prior literature which demonstrates how particular board of directors compositions mitigate agency problems and thus improve firm's performance, some researchers provided evidence of a potential relationship between this dimension of corporate governance and the firm's tax avoidance attitude.

At the opposite end of the flow are the consequences of tax avoidance. The purpose of the following sections is to highlight the principal threats which inevitably emerge when engaging in tax avoidance practices, as well as the related benefits that this behavior may bring to the firm's wealth.

1.3 Valuable insights and limitations of Accounting For Income Taxes literature

In the last decade, accounting for income taxes (AFIT) has become the cornerstone of studies conducted by tax researchers and accountants testing the informational role of the tax accounts and their involvement in earnings management (Graham et al. (2012)). Since corporate tax returns are not publicly available, tax information contained in the financial statements are usually the sole source of information about corporate taxation and thus, its understanding is crucial for many reasons: first, income tax expense – the amount of taxes owed by firms to the tax authority in a given accounting period – is a relevant cost that often exceeds one-third of pre-tax profits, and, consequently, tax planning involves several activities of the firm. Second, policy makers make use of tax information disclosed in the financial statements in order to set tax and other policies. Third, since taxes are determined using different rules than those of accounting (so-called *book-tax differences*), they could highlight existing differences and provide additional interesting insights; indeed, given that the income tax expense is accrual-based, it can possibly be object of manipulation by managers in order to affect after-tax earnings.

In order to guarantee readers a full comprehension of the topic, a brief explanation of the main rules governing accounting for income taxes is needed. First of all, one should never forget that the main purpose of financial accounting is to provide relevant stakeholders useful information about the economic activity of the firm, and reporting rules are governed by the General Accepted Accounting Principles (GAAP)[1]. GAAP accounting is an accrual-based system

[1] Different countries apply their own domestic GAAPs, which may differ slightly in their rules and principles. In Italy, for example, financial reporting of most firms is governed by OIC principles. In recent years, the demand for comparability across different accounting systems and the necessity of creating a common "accounting language", able to standardize rules and facilitate international auditing processes, has set the basis for the creation of the International Accounting Standards Board (formerly, International Accounting Standard Committee), the international agency responsible for the issue of the International Financial Reporting Standards

(opposed to the cash system employed by smaller businesses) which is governed by two main principles: the first one, the *revenue recognition principle*, claim that revenue should be recorded when it is realized and earned. This means that, for example, if a firm sold goods on credit in a determined accounting period, but cash related to the transaction is not collected until the subsequent period, revenue is anyway recorded when the transfer of the goods – or the completion of a service – occurs. The *matching principle* take the same view, stating that expenses are recognized, and then recorded, when the revenues to which they are related are recognized too. This way, expenses recorded in the income statement of the firm are only those related to revenues recorded in the same accounting period, and this is valid also for the income tax expense: following the accrual-based system, indeed, the item does not reflect the actual income taxes paid during the period, but is conditioned by taxes paid in prior periods or to be paid in the future – taking into consideration the revenue recorded in the present.

In order to estimate a firm's effective tax liability, AFIT researchers computed different measures able to capture their average tax rate per dollar of income or cash flow. Of course, the need to assess a firm's effective tax rate starting from values included in its financial statements comes from the fact that tax returns are not accessible from the public. Anyway, even if this data were available to researchers, many other obstacles would arise: above all, the different treatment reserved to many transactions under book and tax consolidations rules nearly prevents any possible match between any one set of financial statements to any one tax return. Not less, data available to the market must be used by any researcher whose aim is to determine the market's interpretation of the information contained in firms' taxable income.

Hanlon et al. (2010) provide a comprehensive summary of the most popular measures employed in literature, suggesting that depending on the research question one measure may be more appropriate than another, since values included in the numerator/denominator may be affected (or not be affected) by tax deferring strategies or changes in the accounting tax accruals. For instance, consider the *annual Cash Effective Tax Rate (Cash ETR)*: this measure is computed by dividing the cash taxes paid during the year by the pre-tax accounting earnings of the period. These values may not be compatible with each other, and could lead to misunderstanding, if the numerator includes taxes paid on earnings of a previous period (due to, for example, and audit completed from the tax authority).

(prior to 2001, International Accounting Standards). The aim of the IASB is to develop internationally accepted accounting principles, replacing or minimizing differences between countries GAAPs, in order to make financial information more comparable and transparent. European listed companies, for instance, are required to adopt IAS/IFRS accounting principles; again, in Italy, companies that produce consolidated financial statements can choose to adopt international accounting principles, although the vast majority of national firms are still OIC adopters.

Among all the possible combinations, the most followed statistic by scholars is the *Effective Tax Rate* (ETR) which is computed by dividing the total income tax expense by net income before taxes (NBIT). In the simplest scenario, the ETR matches the statutory tax rate: this result is always achieved when revenues are calculated, under GAAP rules, in the same way as the tax law calculate taxable income, and when GAAP expenses and tax law deductions are recorded likewise – unfortunately, this is not always the case.

The separation that arises between the two sets of rules is called *book-tax differences* (BTDs) and is determined by the different purposes followed by each set (Scholes et al. (2015)): while the main objective of financial accounting rules is to provide useful financial information to shareholders, lenders and other interested parties in order to make decisions about providing resources to the firm, the tax law mandates departures from GAAP accrual accounting for many, sometimes conflicting, different objectives that go from raising revenue to support government activities, to re-allocate wealth or, still, to stimulate particular economic activities.

BTDs can be split into two major categories, *permanent differences* and *temporary differences*: a permanent difference arises when a transaction affects taxable income but never affects book income, and vice versa. The typical example of a permanent difference is the yield on municipal bonds, which is tax-exempt; the following Figure 1 compares two different, yet very simple, scenarios: the statutory tax rate is 35% in both cases, but while in the first one the ETR matches the statutory tax rate, in the second situation the ETR declines. This is because the Municipal Bond Interest increases NBIT, but is not accounted for tax purposes – and never will be. The outcome, here, is a smaller percentage claim on the firm's profits by the government and a higher net income reported to shareholders.

Income Statement	**Conformity Scenario**	**Permanent BTD Scenario**
Sales Revenue	1,000	1,000
Cost of Sales	500	500
Municipal Bond Interest		50
Net Income Before Taxes	500	550
Income Tax Expense	(175)	(175)
Net Income	325	375
ETR	35%	31.8%

Figure 1. Permanent BTDs Income Statement example

On the other hand, a temporary difference occurs when an item is accounted in both set of books but in different time periods, although having the same cumulative effect over the life of the firm. Suppose, for instance, a firm buying an asset that costs €200. Over the life of the item both total book and tax depreciation must equal €200, but during the life of the asset the rate of depreciation for book and tax might not be the same, since they follow different principles: book depreciation observe the actual deterioration of the asset, while for tax purposes statutory depreciation rates are applied. In the following example the asset is expected to last two years, and the firm will record €100 of depreciation expense in both years. Conversely, the depreciation required by the law equals €150 in the first year, and then depletes the residual value of the item in the subsequent period (€50). Even though the outcome is the same in both cases when the asset is completely deteriorated (which, for the sake of simplicity, is assumed to have no residual value), the difference between book depreciation and tax depreciation reflects a disparity between book income and taxable income and, moreover, since the income tax expense reported on the financial statements is calculated on book income, this will differ from the actual amount of taxes paid to the government – which is computed on taxable income.

Income Statement	**Book Depreciation** ***year t***	**Tax Depreciation** ***year t***	**Book Depreciation** ***year t+1***	**Tax Depreciation** ***year t+1***
Sales Revenue	1,000	1,000	1,000	1,000
Cost of Sales	500	500	500	500
Assets Depreciation	100	150	100	50
Net Income Before Taxes	400	350	400	450
Income Tax Expense	140	123	140	158
Net Income	260	228	260	293
ETR	35.00%	30.63%	35.00%	39.38%

Figure 2. Temporary BTDs Income Statement example

Although I recognize the above-mentioned cases are too simplistic to draw conclusions on the importance of AFIT studies in tax avoidance literature, and should be analyzed in depth in order to have a full understanding of the complexities that differences between tax and accounting rules provide, they are sufficient to highlight two major issues related to AFIT. The first one concerns the approximation of actual tax return information based on financial statements data: several studies attempted to measure the reliability of this source to estimate the actual taxes

paid by firms, but the evidence is mixed. Hanlon (2003) emphasizes three main complications with this approach:

- Current tax expense rarely matches the actual taxes paid, and this is due to several items that lead its value to be under- or overstated, causing erroneous inferences about the actual tax liability of the firm (e.g., tax "cushion", intraperiod tax allocation);
- The estimate of a firm's taxable income done by extrapolating the current tax expense (a common method used in literature) leads to measurement error in presence of tax credits (e.g., foreign tax credits, research and development credits), since these are subtracted from the current tax expense reported in the financial statements (and in many cases, not even separately disclosed);
- Tax and book rules for consolidation of entities differ from each other (different levels of ownership are used as a measure of control), and in some situations this results in different groups of related corporations to be included in the financial statements rather than in the tax return. In this case, the tax expense reported in the income statement does not reflect taxes of excluded entities.

Despite these many limitations, in some circumstances book numbers may still provide a reasonable approximation of tax return information: Graham & Mills (2008) use a panel of confidential U.S. tax return data from 1992 to 2000 to estimate corporate income Marginal Tax Rates (MTRs, defined as "*the present value of current and expected future taxes paid on an additional dollar of income earned today*") for the years 1998 to 2000, and compare this benchmark to several MTRs calculated on financial statement data, finding that the book simulated MTR has a strong and positive correlation with the tax return benchmark. They conclude that book MTRs can be used as a reliable proxy in estimating the tax return variable when this – as often happens – is unavailable: in the lack of valid alternative sources, indeed, researchers must continue to rely on the tax information reported in the financial statements, while being aware to its limits and interpreting their findings with the appropriate discretion.
The second issue questions AFIT's ability to produce sufficient information in order to assess a firm's tax choices: the reason behind these concerns is that financial statements do not report – and nor they are intended to – any information about non-tax costs and implicit taxes; also, AFIT does not take into account the time value of money: since deferred tax accounts, which represent a tax liability (benefit) that will be paid (occur) in future years but are included on the income statement in the current year (originating from BTDs), are not discounted when reported, it is difficult to assess the precise timing of future tax payments. Implicit taxes, on the other hand, are often referred to as the reduction on the returns that an investor earns on

favorably taxed investments. For instance, consider the previous example reported in Figure 1.: in the second column scenario, the firm invests in tax-exempt municipal bonds, and earns interest income which is not accounted for tax purposes. This way, the resulting ETR is lower, and a rushed interpretation based on financial statements' tax information might lead to misconceptions about the firm's management from a tax perspective: suppose, instead, that the firm invests in equally-risky and fully taxable obligations, yielding a higher interest income at the cost of an increased tax expense. In this case, imagine the firm increases its after-tax income as long as its ETR: the difference between income reported in the two examples above represent an implicit tax ignored by AFIT and subsequently, can result in erroneous conclusions about the effectiveness of a tax plan – in fact, paying less taxes do not imply that tax obligations are better managed.

The last sentence shed light on the last, crucial issue: investment, financing, organizational form, mergers are only some of the many business decisions that are affected by taxes, but at the same time they are only one of many factors that enters managers' decision-making process, where different considerations arise and trade-offs must be made – many of which fall outside the scope of AFIT, and leave no trace on the firm's books.

Chapter 2

NON-TAX DETERMINANTS

2.1 The imposed trade-off of financial reporting – 2.2 Agency view of tax avoidance – 2.3 The mediating role of Corporate Governance – 2.4 The distinctive behavior of (private) family firms

In almost every business decision, no benefit comes without drawbacks. Uncertainty and information asymmetries characterize contractual relations, and these non-tax cost oftentimes come in conflict with tax implications when shaping an efficient organizational design (Scholes et al. (2015)): the best way to understand the influence of taxation in making business decisions is to understand those factors to which it is balanced for. I will structure this section by describing the principal non-tax factors that influence managers' decisions and their implications with tax avoidance practices and managerial opportunistic behavior.

2.1 The imposed trade-off of financial reporting

Financial reporting itself, of which I have discussed so far, put managers in front of a substantial trade-off between reaching two mutually exclusive objectives: book earnings maximization on one side, and taxable income minimization, on the other. Guenther et al. (1997) conduct a clever study that investigates how book-tax conformity rules influence firms' financial reporting and tax planning activities: specifically, they use a unique set of publicly traded U.S. firms that before the 1986 Tax Reform Act (TRA 86) could freely choose to adopt the accounting cash-system for tax purposes, while following GAAP's provisions for financial reporting purposes: under these circumstances, firms could accelerate financial statements income at the year's end and at the same time not incur in increased tax costs, since collection of cash related to those transactions were not also accelerated. This way, when the relation between tax and book income was relatively weak, firms were able to defer taxable income by simply deferring the collection of sales cash, without affecting income reported in the books. After TRA 86, book-tax conformity was strengthened, by requiring firms exceeding the threshold of $5 million in sales to adopt the accrual-system also for tax purposes; the authors compare the behavior of firms that were forced by statute to switch to the accrual method of accounting for tax reporting after 1986, to that of those adopting the system for both purposes pre and post-1986: their main aim is to analyze if the increased trade-off between tax and book earnings objectives faced by

the first group of firms, after the reform, influenced managers' choices to undertake activities that modified the timing of income and cash flows. They find, consistent with their hypothesis, that firms adopting the cash system before 1986 had higher ratios of accounts receivables to accounts payable and sales to expenses, compared to a sample of firms of the same industry under the accrual method – furthermore, these ratios decreased more significantly for the firms forced to change after 1986, suggesting they had no longer the tax-based incentive to postpone cash collection and anticipate cash payments in order to delay their tax liability.

This is a clear example of how changes in the economic environment can change the trade-offs faced by managers when making tax and financial reporting decisions, constraining firms to alter their behavior in order to offset costs on both sides. However, an important question raises spontaneously: do managers always have to sacrifice their efforts in one area rather than the other, choosing which measure of income is more important to manage? Recent accounting scandals – one above all, Enron revelations in 2001 – have led tax authorities to focus on numerous cases of accounting fraud and aggressive tax sheltering. Also, many journalists highlighted cases of companies reporting substantial income differences for financial rather than for tax purposes. Frank et al. (2009) investigates this issue in the light of anecdotal evidence that testifies to increasing discrepancies, reported by U.S. corporations since the early 1990s, between income reported to shareholders and income reported to the government. They argue that recent trends testify that firms may not always trade-off financial and tax reporting decisions, since rules governing these environments create areas of non-conformity which offer firms the opportunity to manage income in order to get the best of both worlds, and define these practices as *aggressive financial reporting* and *aggressive tax reporting*, in order to emphasize the degree of uncertainty that characterizes upward earnings manipulation and downward taxable income management from the law standpoint. In their study, the authors search for relations between aggressive financial and tax reporting by examining firms reporting significant pre-tax accruals, and build a particular proxy to detect tax shelter activity which relies on discretionary permanent book-tax differences, computed by regressing total permanent BTDs on those non-discretionary items that originate permanent differences and other statutory adjustments but are expected to be unrelated with aggressive tax reporting (e.g., intangible assets, PP&E). First, they validate their measure of tax reporting aggressiveness by linking it to a sample of firms, identified in Graham & Tucker (2006), involved in tax shelter cases against the U.S. government or served with a Notice of Deficiency by the IRS, and they find their proxy to be an accurate predictor of tax shelter activity. Then, they select another sample starting from Compustat's annual industrial file for the years from 1991 to 2005, and after eliminating uncomplete or biased observations they obtain a final sample representative of 49,886 firm-

years (8,100 firms); again, they introduce another variable as a proxy for financial reporting aggressiveness. In conclusion, they find a positive and robust correlation between their measures, even after controlling for incentives for tax planning and earnings management (e.g., NOL carryforwards, leverage, market-to-book ratio) and despite alternative specifications; these results suggest that financial and tax reporting incentives may exceed the related costs allowing firms to report differences in their book and taxable income in the same reporting period. Anyways, firms that have opportunity to engage in such aggressive behavior will not automatically follow this route, since large book-tax differences may draw regulators attention and subject the firm to a greater degree of scrutiny, as prior research documents (Badertscher et al. (2009)).

Since tax and financial reporting incentives derive mostly from book-tax rules divergence, a possible solution to impede managers' aggressive reporting practices may be conforming the two sets of income measures into one common measure for book and tax purposes. This is, actually, a long-standing matter of debate in the tax literature and among policy makers and regulators worldwide: on one hand, proponents of increased conformity claim many benefits such as (Desai, (2005)):

- *Improved earnings quality and increased tax compliance:* the adoption of a common measure for book and tax profits would provide managers incentives to reduce tax avoidance and decrease reporting aggressiveness;
- *Increased managerial opportunism cost:* the book-tax trade-off faced by managers would increase if book and tax income measures were to converge, since book income overstatement would lead to higher income taxes. Similarly, downward taxable income management would result in lower book income reported to shareholders;
- *Hindered managerial opportunism:* increased conformity would allow shareholders to precisely observe firms' tax burden, and would ease tax authorities' monitoring process making it more effective.

Opponents, on the other hand, claim that conformity would bear a substantial and not indifferent cost: the restricted flexibility of financial reporting would negatively affect the information contained in the accounting earnings number. For instance, Hanlon et al. (2005) estimate that the loss of information resulting from conforming book income to taxable would be in the order of 50 percent based on the relative explanatory power of the two distinct income measures. Furthermore, managerial reporting incentives would change too: if the rules were designed primarily for tax purposes, managers would likely report a lower book/taxable income (assuming that managerial compensation schemes would follow this line of reasoning) in order to maximize the after-tax residual for investors. Similarly, investors would expect management

to minimize the amount of income going to government, but at the same time they would be forced to gather information about firm performance elsewhere than in the financial statements, likely incurring in additional costs. As in Hanlon (2003), the author claims that additional disclosure, such as providing more information about book and taxable income reconciliation or providing more detailed disclosures about the determinants of book-tax differences, would, on one side, safeguard investors' interests by supplying them useful information and, on the other side, help researchers to get a better understanding of tax information contained in the financial statements. Testing whether the cost of conformity – the information loss to capital markets – may or may not be overridden by the over-mentioned benefits is a difficult task to achieve, since the ideal starting settings are not easily observable (e.g., the U.S., as many other countries, have never experience a switch from a full book-tax conformity system to a less conformed system). A recent study from Tang (2015) takes an international perspective and investigates whether conformity can actually restrain managerial opportunism, and reduce tax avoidance activities, by introducing a quantifiable country-specific conformity measure different from those used in a few concurrent previous studies, which is capable of determining a country's mandatory conformity level in a given year by isolating differences between book income and taxable income due only to rule differences. The author's study is then designed to capture different opportunistic practices, defined as *overall* accrual-based based earnings management and tax avoidance (which comprehends also types of opportunism judged as "less aggressive", for instance, earnings management that imply no tax consequences), and after analyzing firm data gathered across 32 different countries from 1994 to 2007 (144,234 firm-years in total) her results provides strong evidence that earnings management and tax avoidance practices are extensively reduced in high-conformity contexts. Although this study contributes to the unsolved debate over tax and financial income alignment by highlighting its major benefits and suggest that stakeholders may be better off in a higher conformity system – even at the cost of losing financial statements' informative function – many other issues remain to be investigated thoroughly (as Hanlon et al. (2010) claim), given the scope and the magnitude of policy implications that would arise if countries were to reform worldwide reporting systems.

2.2 Agency view of tax avoidance

The classical articulation of agency theory in economics dates back to the 1970s, when Jensen & Meckling (1976) laid down the theoretical foundations of the "*theory of the ownership structure of the firm*". The authors introduce, for the first time in the literature, a disruptive definition of organizations, by describing them as "*[...] legal frictions which serve as a nexus*

for a set of contracting relationships among individuals" (p. 310), in which the private corporation is only one form (the *legal friction*) among the set of entities that individuals can employ in order to reach the common purpose of balancing their conflicting objectives within a framework of contractual relations.

Although the fundamentals assumptions of agency theory are well-known to nearly everyone who has undertaken studies in economics sciences, I will anyway outline the principal aspects which characterize it, as these may be helpful to better understand the following concepts. In the words of the authors, an agency relationship is defined as "*[...] a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent.*" (p. 308). The theory, which assumes that inside the relationship both parties are utility maximizers, lead to believe that the agent's actions will not always satisfy the principal's best interests – since their respective best interests are divergent[2]. Given these assumptions, the principal would certainly act in a way that could reduce this divergence: he can monitor the agent's activities (bearing the relative costs) or introduce particular incentives to deter the agent from undertaking activities that could harm his interest (so-called *bonding costs*). Finally, the welfare reduction experienced by the principal whenever the agent takes decisions which not maximizes his utility, are referred to as the *residual loss*. The monitoring expenditures, the bonding costs and the residual loss altogether sum to the *agency costs* of the relationship.

In this view, which emphasizes the essential contractual nature of the firm, the agency relationships are contracts and all the actions undertaken in order to minimize agency cost are the elements that constitute the contract (Shapiro (2005)). Although they apply the agency theory primarily to the stockholder-manager relationship, the authors argue that their implicit contract is just one among the nexus of contracts that form the modern corporation: in fact, this intuition led to the development of the *stakeholder-agency theory* (Hill et al. (1992)) which extended the principles of agency theory to all the exchange relationships maintained among the firm and its legitimate claimants – homogeneous groups of individuals, organizations and institutions which provide the firm critical resources, expecting their interest to be satisfied in return. In this comprehensive view, managers are viewed as the center of the nexus of contracts, since they are the only group of stakeholders which entertain contractual relationship with all

[2] The divergence between the parties' interests and actions is due to information asymmetries, that characterize all contractual relations, which can be divided into two main types: the first one arise when the agent has control over an action that affects the outcomes of the relationship, where the action choice is unobservable to the principal (so-called *moral hazard*); the second one arises when the agent possess superior knowledge over facts that will influence the contractual relationship, where the principal cannot perfectly observe these characteristics (it is impossible for the principal to know a priori if the agent will use this knowledge in a way that serves his best interests – so-called *adverse selection*) (Arrow (1985)).

the other stakeholders of the firm; moreover, they are the only group with direct control over the strategic decisions of the firm, including resources allocation decisions which impact directly on the claims of other stakeholder groups: for this reason managers are viewed, inside the stakeholder-agency theory, as the agents of other stakeholders[3].

The main agency conflict between managers and all other stakeholders concerns the trade-off between growth maximization and efficiency (wealth) maximization: on the one side, satisfying management's claims – which the literature identifies in remuneration, power, job security, status the main ones – requires the size of the firm to increase; on the other side, to embrace stockholders' (as well as other stakeholders) interests managers must divert resources that could otherwise be invested in order to maximize the growth rate of the firm. As a consequence, stakeholders' effort to maximize their utility will result in a failure if the appropriate monitoring, incentive, and enforcement mechanisms are not employed.

It must be noted that agency costs are most likely to arise when there is a separation between ownership and control, that is, the equity ownership is kept distinct from the day-to-day operating decisions: consider, for instance, a wholly owned firm managed by the owner; in this case, there is no interest divergence since both functions are concentrated under the same subject, and the manager will engage in those operations that maximizes his own personal utility. Agency costs arises in the moment that outside shareholders purchase equity claims on the former wholly owned corporation, as their interests diverge, and will continue to rise as the equity fraction of the owner-manager falls; additionally, as the owner-manager's residual claim on the outcomes decreases, he will tend to divert firm's resources for his own consumption in the form of perquisites, while minority shareholders, on their side, will tend to protect themselves from opportunistic behavior by increasing the resources spent in order to monitor his activity. Ang et al. (2000) study build on this example of a zero agency-cost firm, taking it as a reference point of comparison to provide a measure of equity agency costs for corporations with different ownership and management structures. The authors lay down the following hypothesis:

- Firms where managers own none of the firm's equity experience higher agency costs;
- Agency costs and the managers' ownership stake are inversely related;
- Agency costs increase alongside the number of nonmanager stakeholders;

[3] It is incorrect, anyway, to consider all the other stakeholder groups to be *principals* in the strict sense entailed by agency theory: the classical definition of "*engaging another person to perform some service on their behalf*" does not fit perfectly with contractual relationships entertained between managers and customers or suppliers, for instance. However, both stakeholder-agent relationships and the ideal principal-agent relationships share some common characteristics, and many important concepts are common to each category. Hill et. al (1992), argue that the principal-agent relationships can be viewed as a *subset* of the broader class of stakeholder-agent relationships.

Although information on sole-ownership firms is difficult to gather, since these types of firms typically are not publicly listed and their relative financial information is usually not available to the public, the authors make use of data disclosed in 1997 Federal Reserve Board's National Survey of Small Business Finances (NSSBF), which collected information from a sample of representative U.S. small businesses, including groups of firms managed by the sole owner, and use it as a benchmark for the no-agency-cost base case firm. In order to measure agency costs, they employ two popular efficiency ratios: the first one is the expense ratio, computed as operating expenses scaled by the annual sales, where the operating expense reflects excessive disbursement in the form of perks and other nonessentials elements; the second one is the sales-to-asset ratio, which is inversely related to agency costs since a low value in this proportion reflect managers' poor investment decisions and insufficient effort toward operational challenges (so-called *management's shirking*).
Agency costs directly related with the separation of ownership and control are then calculated by setting the efficiency of firms managed by its own shareholders against the efficiency of firms handled by outsider-managers at different levels: the authors' finds are consistent with their initial hypothesis, and are in line with the predictions of the theories of Jensen & Meckling (1976) about ownership structure and shareholders' and managers' interests divergence; specifically, their results demonstrate that agency costs are higher when the firm is managed by an outsider, and increase with the number of shareholders not involved in operational decisions. Finally, these costs are found to be inversely related to the proportion of managers' residual claim on the firms' outcomes – their ownership stake.

2.3 The mediating role of Corporate Governance

Agency considerations, along with closely-related corporate governance issues, pervade modern organizations' environment, and, of course, influence firm's tax planning behavior and corporate tax avoidance practices. The connection between agency conflicts and corporate tax avoidance – so-called *agency view of tax avoidance* – has received particular attention in recent years literature, and yield interesting analyses. A brilliant study from Desai and Dharmapala (2006) investigates the relation between corporate tax avoidance, the experienced growth in managerial incentives, and the relevance of corporate governance structure. Their theoretical framework is developed assuming the ability of the manager to divert and extract firm's resources in the form of rents. Moreover, they argue that the effectiveness of incentive compensation schemes depends on the extent of *technological complementarities* between earnings diversion and corporate tax sheltering. This concept reflects the complementarity that

exists between these activities when the level of income sheltering from the tax authorities – and thereby, from shareholders too – is high and the relative cost of diversion faced by managers is relatively lower, and vice versa. When these complementarities are weak, principals can induce managers to reduce rent diversion through greater incentive compensation and, at the same time, lead them to engage in more tax sheltering activities. On the other hand, when technological complementarities are strong, high-powered incentives reduce managerial diversion of rents while managers' aggressive tax behavior – specifically, those activities used to achieve the diversion – may also be limited.

Holding on these assumptions, the authors hypothesize that the impact of managerial incentives is strictly mediated by corporate governance environment. Specifically, they argue that in well-governed firms – where diversion levels are lower, and complementarities are then weak by definition – higher-powered incentives should have a stronger effect in increasing tax avoidance activities than in poorly-governed firms, where managers can more easily divert income and thus complementarities are stronger. Their analysis, conducted on data regarding tax sheltering, managerial compensation and corporate governance over a panel 943 firms across the period 1993-2002, shows that the theoretical intuition that increasing the alignment of interest between mangers and shareholders would result in greater tax sheltering activity does not hold empirically: this result is in fact in line with what Weisbach (2002) defines as the *undersheltering puzzle*, namely, the limited usage of tax shelters by firms considering the low costs associated to these activities. The main contribution here, is the intuition that shareholders might not always want managers to engage in increased tax sheltering activity – despite these practices increase after-tax firm value – since greater opportunities of rents diversion may also be created.

This last meaningful aspect is, in fact, recalled by the same authors in a subsequent study (Desai & Dharmapala (2009)) where they further investigate the relationship between corporate tax avoidance and firm value. Specifically, they argue that for a long time a large body of literature, regarding in particular the effects of taxes on financial decision making, has alleged that avoidance activities are costless to investors, and is in fact a transfer of value from the state to shareholders. However, the critical factors highlighted so far raise some legitimate doubts about the degree to which corporate tax avoidance is valued by shareholders and investors in general. The main question on which this study is built upon is whether the positive effects of increased tax avoidance activity – which on one hand, increases after-tax firm value but, on the other hand, provides managers greater opportunities of rent extraction – can be offset by, precisely, the major chances of managers to pursue self-serving objectives. To shed light on this issue, the authors utilize observations on 862 firms over the period 1993-2001 (4,492 observations in

total), merged with data on institutional ownership as a proxy for governance quality. Tax avoidance is then measured, in line with previous studies, by controlling firms' book-tax gap for discretionary accruals and other factors related to earnings management. Accordingly with their predictions, they find that the simple assumption under which corporate tax avoidance constitute a transfer of value from the state to shareholders is not validated empirically: their findings, instead, support the agency view of corporate tax avoidance and the mediating role of corporate governance. The latter, indeed, plays a fundamental role in preventing the increased resources – acquired through tax avoidance activities – to be extracted by managers and employed for their self-interests. The *undersheltering puzzle* seems now less complex, in light of these results, since empirical evidence demonstrates that in the absence of a good governance structure, investors and shareholders may doubt that tax avoidance activities are designed solely to advance their individual interests; this is also the main reason why I could not exempt myself to evaluate the consequences of tax avoidance activities in an agency perspective, without taking into consideration the importance of corporate governance implications.

A consecutive study from Blaylock (2011), however, argues that whilst this theory has received particular attention in recent literature, evidence supporting a direct link between tax avoidance and managerial rent extraction is still missing, since the settings used in most of the extant research utilizes data from countries adopting different regulatory and tax settings than the US (e. g., Desai et al. (2007), analyze the interaction between corporate taxes and corporate governance in Russia, a country where both managerial diversion and tax avoidance are at the extreme), and thus the subsequent results cannot be generalized. Using a different setting – a large panel of US firms – the author is unable to find any consistent evidence between tax avoidance and three proxies (low future performance, overinvestment and low payouts to common shareholders) that measure managerial opportunism. Results demonstrate a generally positive association between tax avoidance, firm performance and optimal investment policy, even among poorly governed firms; in addition, the author finds that, independently from governance settings, firm associated with high levels of tax avoidance distribute less cash to shareholders. Anyway, no significant and general evidence of a relation between tax avoidance and managerial rent extraction among US firms is documented. In conclusion, the author suggests the results in subsequent literature to be interpreted with caution, and to consider carefully if the theory could be appropriately applied to the firms that compose the sample, since in an environment where external and internal controls over the firm are weak, managers are more likely to exhibit the above-described behavior, with respect to those working in contexts with stronger legal protection and managerial monitoring.

Chyz & White (2014), following Blaylock's (2011) advice address this gap and utilizing a measure of CEO centrality developed in the literature document a direct link between tax avoidance and the presence of agency conflicts. The authors acknowledge that under the scope of the agency view of tax avoidance, this last factor is only a necessary but not a sufficient condition in order to document the existence of agency conflicts, and attribute this fact as the reason why prior studies have been unable to report any economically or statistically significant relation between tax avoidance and managerial rent extraction. In contrast, the authors develop a direct test relying on a measure of CEO centrality as a proxy for the presence of high agency conflicts, introduced by Bebchuk et al. (2011), and defined as "*the fraction of the aggregate compensation of the firm's top-five executive team captured by the CEO (CEO pay slice)*", arguing that this measure could reflect the degree of influence the CEO is able to exert over the other components of the top management team, and, as a consequence, his own likelihood of engaging in detrimental activities such as rent diversion.

The authors hypothesize a positive association between firm level tax aggressiveness and CEO centrality and test it on a sample of 993 firm over the period 1992-2011 (4,149 firm years), using the same measure of residual book-tax differences introduced by Desai & Dharmapala (2006) in order to detect tax avoidance activities, and thus being able to compare their results with prior research regarding the agency view of tax avoidance. Their primary results illustrate a positive pattern in the data when plotting the mean level of residual BTD across annual quartiles of CEO centrality, and thus is aligned with the authors' conjecture over the existence of a positive association between tax avoidance and the presence and relevance of agency conflicts. Additional tests further confirm this relation, providing evidence of the prevalence of tax avoidance activities in high agency conflict contexts, even after including controls for the role of institutional investor monitoring of executives: following Desai & Dharmapala (2009) assertions regarding the detrimental role of tax avoidance activities in the absence of strong governance mechanisms, the authors include data on the average annual percentage of institutional ownership for the firms in their sample and find that stronger CEO monitoring weakens the relationship between the existence of agency conflicts and tax avoidance. Finally, the authors examine whether, in the presence of high agency conflicts, tax avoidance is associated with both future accounting performance and firm value: recalling the technological complementarities – those means who allow managers to obfuscate rent diversion – of which I have discussed above, they presume firm value to be negatively affected in those context where shareholders' and managers' interest are not aligned, as these firms are the most likely to suffer from rent diversion. At the same time, future accounting performance is expected to improve, as managers may use tax avoidance to manipulate earnings for tax and accounting purposes.

Their subsequent results are interesting: the traditional agency view of tax avoidance would certainly predict a negative relation between future firm value and performance, as rent extraction would represents an important issue for firms where agency conflicts are high. Instead, findings on firm value conjectures document no reliable association between rent extraction and tax avoidance, and thus are in line with Blaylock (2011) prior study. Moreover, for what concerns future firm performance, results suggest that in settings where agency conflicts are higher, the CEO, along with the top management team, are more likely to achieve higher accounting realized performance by manipulating GAAP earnings through tax avoidance strategies. However, evidence shows that, in these contexts, investors may fear rent extraction and managerial self-interest pursuing, and thus investors', through price protection, counter-balances those financial accounting earnings enhancements which do not translate into higher market-based measures of firm value.

2.4 The distinctive behavior of (private) family firms

While late economic and political developments have increased the attention of academics, journalist and the general public in corporate tax avoidance, some researchers (see, for example, Brune et al. (2019)) argue that the literature has concentrated its efforts mainly on the behavior of public rather than private firms, even though the majority of worldwide firms are privately-held – and family-owned[4] – and thus, their economic importance should not be underestimated. In this paragraph, I will outline the main recent contributions in the tax avoidance literature concerning family firms (public and private) and highlight the interesting reasons for which these particular organizations deserve a separated treatment.

First of all, the main reason why I have decided to discuss this topic directly after having dealt with agency theory considerations on tax avoidance, is that family firms represent – as Le Breton-Miller et al. (2009) extensively argue – a unique case of a low agency cost firm, which implications goes even beyond the traditional agency threats identified by Jensen and Meckling (1976) agency model. In fact, according to classical agency theorists, family firms – due to intra-familial altruism, and the pursuit of the common goal of maximizing family income and consumption – are considered to be exempt from agency costs, since the congruence of interests

[4] There are actually some definitional divergences around the term *family firms*: some researchers define a family firm to be any private or public company in which a family has an ownership stake of at least 5%.; other studies define as family firms only second-generation businesses, while someone argues that a family business must be characterized by the same family members serving as owners or officers (Le Breton-Miller & Miller, (2009)). Despite these differences, I will consider - as several tax avoidance studies do - family businesses those organizations on which a family controls enough votes to exert a significant influence on corporate conduct, including tax planning decisions.

between ownership and control structures mitigates selfish behavior problems and reduces the need to monitor director's activity and firm's outcomes. However, as Chrisman et al. (2004, p. 338) point out, "*a family […] is not a monolithic or homogeneous group of people with congruent interests, nor are all family businesses identical with respect to organizational characteristics and behaviors*", and thus, family firms may be instead subject to particular problems of agency. In their study, the authors identify some issues highlighted in the literature that challenge the traditional view of family firm as a low agency cost case: for example, they stress that family businesses are predisposed to internal dysfunction, since the autonomy of controlling shareholders in decision-making processes keeps out from corporate decisions potential whistle-blowers, reducing the risk of getting caught. Again, parental altruism may lead firm's owners to provide relatives with prominent positions inside the organization, notwithstanding their potential lack of competencies or willingness to pursue organization's wealth creation processes, and thus suffer from management shirking or free-riding related problems. Lastly, since family relationships survive outside the business boundaries, punishment of family agents' poor performance is not easy to achieve without incurring in negative spillover effects that may ruin these relations. These common examples lead altogether to a fundamental intuition: agency costs in family businesses cannot be evaluated, and then measured, without taking into consideration those benefits unrelated to strict economic and financial performance (*non-economic goals*) that characterized family-held and managed firms. Building on the foundations of prior family firm studies, which were considered only an extension of already-existing paradigms (e.g., stewardship theory, resource-based view of the firm), Berrone et al. (2012) conceptualize the newborn theoretical approach of *socioemotional wealth* (SEW) framework: this novel perspective, based on behavioral agency theory, argues that family members main concern is to preserve the non-economic utilities – SEW and affective endowments – they receive from their businesses, even against financial and economic objectives. There are several social and affective endowments that pertain to family businesses members, which differ among firms and family members themselves, and also during the life cycle of a family inside its organization; these include family reputation and social status of the firm inside the community, the use of firm resources to the benefit of the family or, moreover, to provide family members interesting career opportunities (Miller et al. (2014)). All of these different motives lead to the general agreement that family firms behave distinctively from their nonfamily counterparts, and that family firms' choices and outcomes have to be evaluated in light of these several non-economic factors that shape their decision-making process, embedding the traditional view of the results-oriented business system to the emotion-oriented family system.

Starting from the assumptions of the SEW model, and considering the pivotal role which non-economic factors play in shaping family managers and owners' choices, Steijvers & Niskanen (2014) compare and investigate tax aggressiveness behavior of private firms with different family and nonfamily involvement. The authors, arguing that the preservation of socioemotional wealth is a key goal in family firms, and recalling empirical evidence which demonstrates how the need to maintain a positive family reputation and image towards the community lead these firms to exhibit higher levels of citizenship commitment, hypothesize that family private businesses – with respect to private non family firms – tend to be associated with a lower level of tax aggressive behavior. Although, on the one hand, the fact that family firms experience not only substantially lower traditional agency costs than their counterparts, but also a reduced financial reporting trade-off, may lead one to argue that family firms are provided better opportunities to engage in tax avoidance practices, on the other hand, the risk of detection and punishment that these activities bear, which could result in public condemnation and taint the firm reputation, lead to believe that family firms will strongly evaluate these factors and thus will behave in a less aggressive manner. In order to provide a full picture of the topic and in accordance with previous studies, the authors take also into account the CEO's ownership share, stating that its influence over corporate behavior, along with the degree of separation between ownership and control, are key drivers of agency costs and determinants of the extent of the firm's tax aggressive behavior. With respect to family firms and the SEW perspective, a CEO owning a high percentage of firm shares is expected to focus more on non-economic goals – at the expense of other financial goals – and to preserve and protect the social and affective wealth of the family by avoiding those practices which could harm and be detrimental to the reputation of the firm. At the same time, the board of directors is viewed as an essential instrument in order to monitor the firm's decision-making process and to align the interests of managers and shareholders: this includes controlling and reducing CEO's rent extraction possibilities, thereby lowering its incentives to engage in tax aggressive activities aimed to mask individual perquisites consumption. To test these assumptions, a total of 621 questionnaires (out of 3262 sent) address to SME's – accordingly with the EU definition – operating in Finland were collected. The firms were asked to provide information on their board composition and their ownership structure over the period 2000-2005, and were defined as family firms if more than half of the shares were owned by a family. The final panel dataset consisted of 1650 (of which 898 related to family firms) firm-year observations. This study, by implementing the agency view with the SEW perspective, provides stimulating results and helps to explain the behavioral differences between family and nonfamily firms by elevating SEW as a key distinctive element: the results support this view as family firms appear to exhibit

lower level of aggressive tax behavior, and to weigh more the costs associated with damaging the firm's reputation; also, the level of CEO's ownership seems to indicate its tendency to engage in tax aggressive practices, confirming the existence of the unique agency conflict between the top manager and other shareholders and, finally, findings suggest that the appointment of outside directors in private family firms' boards mitigate his aggressive behavior and limits rent extraction possibilities.

Although the results of their study are not without some limitations, as authors themselves admit, they argue that integrating the SEW perspective in existing theoretical frames could be beneficial to future research. In fact, based on the same assumptions, Brune, Thomsen & Watrin (2019) expand the previous settings to investigate whether, and how, tax avoidance varies across different firm types: filling previous research gaps, they account for the potentially relevant interdependencies between the two characteristics that distinguish modern organizations – capital market pressure, emerging from a firm's public listing, and the "family firm" attribute – and are thus able to identify four different firm types, precisely: private family firms, private nonfamily firms, public family firms and public nonfamily firms. They build their hypothesis as follows: in line with previous studies (Pierk, (2016)), the authors argue that, given the agency problems rising from the distinct separation between ownership and management, public firms' tax decisions are expected to follow private interests of managers more than those of owners, and that the exposure to capital market pressure may create the incentive to engage more in tax avoidance practices, in order to boost-up short term performance and thus advance shareholders' expectations. On the other side, following the SEW perspective predictions, the authors expect family firms to engage in tax avoidance less than nonfamily firms, and by combining these two different features they are able to state the hypothesis that private family firms are associated with lower tax avoidance compared with the other three groups of firms. In addition, the authors furtherly develop their assumptions by accounting for family firms heterogeneity resulting from varying ownership and management structures and nonfamily involvement: in particular, from the ownership side, they expect that the presence of outsiders in equity ownership – whom main concern is to increase shareholders' after-tax value, and are therefore more likely to engage in tax avoidance practices in order to save costs – and, from the management side, an increase in the proportion of nonfamily managers – which tend not to fear the negative consequences and risks that could harm non-economic aspects of the firm – are associated with an increase in tax avoidance, and, for this reason, so-called *pure* private family firms are expected to avoid less taxes than the others. The research is set in Germany, where a final sample of 4,141 firm years of German corporations between 2011 and 2016 is collected. Public firms are differentiated from private firms depending on their exchange quotation; in

addition, private firms are classified as family firms if the founders or family members own more than 50% of the firm's equity, while for public firms the same parameter is applied with a lower threshold (i.e., 5%). GAAP ETR is employed as the main proxy for tax avoidance. Preliminary results partially confirm the authors' hypothesis: estimated coefficients on public firms' variables indicates that both family and nonfamily public firms avoid taxes more than private family firms; instead, in contrast with their expectations, no significant results seem to suggest that private nonfamily firms engage more in tax avoidance than their family counterparts. Concerning the effects on private family firms of nonfamily ownership and management involvement, findings confirm the assumption that an increase in the proportion of nonfamily owners and managers is associated with a decrease of the GAAP ETR dependent variable, and thus, is related to more tax avoidance; moreover, these results are strengthened when the influence of both ownership and management spheres is investigated simultaneously, suggesting that pure private family firms exhibit the lower tax avoidance behavior among all the other firms types. This last intuition is particularly significant, and suggests that the sample including private family firms is a heterogeneous group; indeed, following this insight, the authors rerun their prior analysis considering a private firm as familial only if both nonfamily ownership and management are zero: with this new, stricter definition, private family firms are then found to engage significantly less in tax avoidance than all the other three firm groups. These results together, demonstrating that tax avoidance mechanisms are more likely to be adopted by public rather than private firms, and that tax avoidance increases in private family firms as increases the portion of individuals which – by ownership or management means – exert influence over the decision-making process of the firm, furtherly support the theoretical predictions which argue that (private) family firms behave distinctively from groups of firms where kinship ties among its key figures are totally absent – or any emotional and social bond is mediated by the presence of outsiders – and therefore, the trivial advantages of tax avoidance practices may be prioritized over the preservation of the firm's reputation.

Chapter 3

FORGING TAX COMPLIANCE

3.1 Critical aspects of taxpayers' compliance – 3.2 From an enemy to an ally: the reconciling view of Co-operative Compliance – 3.2.1 The Tax Control Framework – 3.3 International experiences: the Dutch Horizontal Monitoring model – 3.3.1 The Chinese "thousand companies' group" – 3.4 The Italian approach

3.1 Critical aspects of taxpayers' compliance

Tax law is a complex matter, many times ambiguous and subject to frequent changes. Early research examining the relationship between tax law complexity and taxpayers' compliance – which can be defined as the will of "*complying with the spirit as well as the letter of the law*" (James & Alley (2002), p. 31) – indicates that the complexity of tax law influences taxpayers' attitudes toward risk and have effects on their perception of the equity of the whole tax system as well as the related costs.

Evidence on the influence of tax law complexity on taxpayers' risk attitudes, however, is somewhat mixed: indeed, as reviewed in Nugent (2013), some researchers argue that a complex tax system, which may be perceived as uncertain, should induce taxpayers to be cautious and thus increase their compliance. On the other hand, other studies indicate that tax law complexity may lead to many difficulties in interpreting tax law, thereby creating opportunities for noncompliance, and providing taxpayers a broader scope for self-defense – in the case of scrutiny by the tax authority – that would not be present if tax laws were clear and precise. Still, studies concerning taxpayers' equity perception share different views too: while some researchers argue that tax law complexity is required in complex economies in order to encourage compliance, other suggest that in a complex tax system noncompliance serves as a mean to correct inequity and unfairness created by tax law complexity itself: in other words, when the tax system is perceived by taxpayers as unfair and complicated, some ambiguous practices, such as taking questionable deductions, may be considered as socially and morally acceptable forms of tax avoidance rather than intolerable tax evasion.

The hypothesis that differences in perceptions of morality, concerning tax law complexity, affect taxpayers' behavior and decisions is widely-accepted in the literature and has been deeply investigated as part of the *Deterrence Theory*, which affirms that the range of potentially

undesirable consequences resulting from doubtful actions may tend to deter and inhibit such uncertain behavior. In particular, deterrence factors can be divided into three major categories:

- *Formal punishment*, which concerns official punishment or penalties – in the form of fines, disciplinary actions or even imprisonment – issued by tax authorities after a taxpayer is convicted of an illegal or forbidden act;
- *Informal punishment*, which entails social punishment – disapproval, criticism, shaming – imposed on taxpayers when their law-breaking attitude and behavior is publicly exposed;
- *Social norms and moral commitment*, which regards taxpayers' belief that particular behaviors are contrary to their moral standards – shaped by the influence of family, school and religion, as well as other experiences – and, as a consequence, they would not be inclined to engage in actions that could violate their ethical principles.

The greater the perceived incidence of these factors, the greater the degree of deterrence. Whilst studies regarding the effects of deterrence on taxpayers' compliance often present heterogeneous results, in general, research findings (for instance, the prominent article by Andreoni, Erard & Feinstein (1998)) indicate that deterrence factors consistently affect taxpayers' behavior, in line with deterrence theory assumptions.

To be clear, I am now somewhat forced to expand the scope of the subjects and topics involved so far in order to give a simple but comprehensive view of the tax compliance theme: although, until now, I have considered studies concerning the behavior and decision-making processes – through the lens of tax avoidance – of firms and corporations, tax compliance research is mainly concentrated on the behavioral consequences over the individual taxpayer. Anyway, even if this could represent a problem and lead to be cautious in making any consideration, many of the assumptions outlined in the literature can be applied to both categories of taxpayers – firms and individuals – and lead to similar intuitions; on the other hand, some concepts may be found to be inappropriate for firms: for instance, consider the deterrence factor represented by norms and social commitment; since this element involves morality concerns and feelings, the firm, as an entity unable to feel emotions, is excluded from this observation. Instead, firms are interested, more or less than individuals, about the other negative consequences deriving from tax noncompliance: formal and informal punishment (the previous paragraph, for example, highlighted that this last aspect is of particular concern for family firms). For the sake of completeness, concepts and theories will be reported in their entirety, even though they may not be completely applied to firms, the main subject of interest of this paper.

Another similar issue is represented by the fact that the majority of studies investigating tax compliance include both tax avoidance and tax evasion data in their research settings, making it difficult to interpret which results are directly related to tax avoidance practices. This is, however, almost inevitable, since the two phenomena are closely related to each other and actually, their boundaries are often blurred. Anyway, the purpose of this section is to shed light on the determinants of tax compliance rather than its opposite consequences, that is, those factors that contribute most in reducing tax avoidance practices and firms' attitude towards aggressive tax planning.
A recent study from Dularif & Rustiarini (2022) systematically reviews and synthesize, using a vote-counting method, 279 studies investigating the impact of determinants factors on tax compliance, conducted over the period 1946-2017. The main purpose of their research is, precisely, to investigate the critical factors which contribute the most to the increase of tax compliance among five different determinants, which consists of: tax services, trust in government, personal norm, social norm and religiosity. The authors divide the determinants of tax compliance into three different subgroups, depending on the control power strength: the first category includes those factors under the direct control of tax authorities and the government – the statutory tax rate, auditing and the issue of penalties – then, the factors over which the government exerts remarkable influence, such as tax services and trust in institutions, and finally, individual factors influenced by taxpayers and their social communities, like norms, conducts and beliefs. Here, only the first group of factors (popularly referred to as *enforcement paradigm*) is included in the definition of *deterrence approach*, while the other two groups, known as, respectively, *service and trust paradigm* and *fiscal psychology paradigm*, fall under the so-called *non-deterrence approach*.
This partition is fundamental, as the authors point out, in order to understand the evolution of studies investigating the determinant factors on tax compliance: indeed, most of the early researches in this field have been focused on the enforcement paradigm, and prominent studies (one above all, the seminal work of Allingham & Sandmo (1972)) suggested that the decision to comply with tax law provisions is manly influenced by typical economic factors such as the income level, the probability of being audited and the harshness of penalties. Due to its simplicity and premises incompleteness, however, the model developed by Allingham & Sandmo (1972) (popularly known as EUT-AS model), along with its predictions, proved not to be in line with the data on the levels of tax compliance gathered during the last decades of the past century: in particular, the factual data represented situations characterized by high-degree of compliance ratios (defined as the percentage of taxes paid on the total estimated tax liability), in direct contradiction with the EUT-AS model forecasts. These differences between the

theoretical predictions and the tangible reality have stimulated, over time, a stream of literature focused on the investigation of other possible explanations and factors determining tax compliance: starting from the pioneering work of Spicer (1974) – who adopted, as he defined, a *behavioral approach* which is based on the psychological foundations of economic theory – there was an increasing tendency in tax compliance studies to shift from the deterrence approach to the non-deterrence approach, thereby switching the attention of researchers to the political and social aspects of the matter.

The paradigms which constitute the non-deterrence approach – service and trust, fiscal psychology – are not newborn concepts, but instead find their roots in Rosseau (1762) *social contract theory* and collective actions decisions: as Scholz (1997, p. 261) argues, "*tax collection provides perhaps the clearest and most important illustration of this collective action problem. Consider a society in which all taxpayers would be better off if all paid their taxes and enjoyed the collective benefits from public goods supported by taxes. Individually, however, each taxpayer would be better off cheating on taxes and free-riding on the contributions of the other taxpayers*". Following the deterrence approach, strict tax law provisions and harsh penalties are the only successful means of counterbalancing the profitability of this misconduct. Instead, as empirical research has demonstrated, "*a sense of duty to pay taxes is at least important as fear in predicting compliance*": in this *contingent compliance* perspective, taxpayers' willingness to pay taxes honestly originates from a voluntary and conscious decision, mediated by the degree of trust that taxpayers place towards the government, its institutions and the other citizens. Contingent compliance allows taxpayers to benefit from the cooperation in the provision of public goods, and, at the same time, grants them protection against the threat of free-riding and exploitation; the role of government and tax authorities, therefore, must not be to act as persecutors, deterring each taxpayer, but rather to enhance trust and credibility of the whole tax system, by constantly providing credible assurances that other taxpayers are not taking undue advantages at the expense of the others.

These last crucial aspects have been thoroughly investigated by researchers during the last decades, and the results of Dularif & Rustiarini (2022) study furtherly supports the view of the overwhelming importance these factors have in determining taxpayers' willingness to be compliant: specifically, out of a total of 119 non-empirical studies analyzed, 65 studies discussed tax service as a determinant factor of tax compliance and, surprisingly, 63 of them (approximately 97%) predicted that tax compliance increased in cases of higher quality service provided. Likewise, the totality of papers (14) examining government trust as the determinant factor demonstrated how increasing trust in institutions increased tax compliance. Similarly, almost all the empirical studies (97.47%) which included the service and trust paradigm as a

determinant factor (86 findings out of a total of 1,057, based on a sample of 160 studies) conformed to the related theories.

All of these findings, again, conform to the concepts of social contract theory, which relies on the fundamental assumption of cooperation between the government and the people: the government must be capable of providing and maintaining the public good, involving people in the public policy so that they would be willing to sacrifice part of their wealth to the benefit of the collectivity. Providing better tax services, encouraging transparency and enhancing reciprocal trust are without any doubt the key, successful ingredients to build a modern and efficient tax system; Following this perspective, government and taxpayers are not playing an elaborate cat-and-mouse game anymore, but both are part of mutual relationship addressed to the advantage of the whole system, where unlawful and doubtful actions are viewed as betrayal to society.

3.2 From an enemy to an ally: the reconciling view of Co-operative Compliance

Historically, modern tax systems have been built around the concept of an *obligation-based relationship* between the two principal parties – taxpayers and revenue bodies – which frequently translated into an adversarial and non-participating approach from both sides and where each participant limited itself to act inside the strict boundaries of their legal obligations (Bronzewska (2016)). On their side, taxpayers are required to file and submit a tax return, where the amount of taxes due are reported in accordance, and to pay the determined sum on time. Accordingly, tax authorities are given the power to inquire the taxpayer, in order to obtain more information about the contents of the tax return, and to ultimately employ the necessary enforcement measures aimed to collect the amount of taxes effectively due on the basis of their investigation.

In this kind of a relationship, information is the most valuable element tax authorities possess in order to evaluate and comprehend taxpayers' choices, and consequently, to manage the associated risks: however, an *adequate* flow of information is not required nor encouraged under these circumstances, with the result that only a negligible degree of co-operation is achieved between the tax authorities and the taxpayers, and where the traditional instruments of improving tax compliance – audit, enforcement, prosecution – gain the upper hand. In recent years, due also to the increasing complexity of the general economic environment and the proliferation of laws and norms which interested worldwide legal systems, the need to shift toward a more active and participated model of interaction between tax authorities and

taxpayers – based on principles of trust and reciprocal co-operation – became clear to policy makers from several different countries, as well as to intergovernmental organizations.

In fact, the Organization for Economic Co-operation and Development (OECD) played a pivotal role in shaping and setting the guidelines for the development of a novel, reconsidered relationship between taxpayers and revenue bodies; as a supranational institution, however, OECD has no legislative nor address power over member State governments, and thus, each participating country has always had the possibility to freely choose how – and whether – to adopt and conform to OECD's guidelines in respect of their policy and legislative environment. OECD's main objective, actually, has never been that of creating a worldwide suitable taxation system, but rather to provide meaningful suggestions and instruments in order to create a system informed by reciprocity and legal certainty, where revenue authorities from different countries – each facing a different, peculiar environment – are required to adopt specific provisions tied to the characteristics of their current national taxation system.

OECD's effort started in the 1990s, when the Committee of Fiscal Affairs Working Party Number 8 published a document called "*Taxpayers' right and obligations – a survey of the legal situation in OECD countries*" (OECD, 1990) with a dual purpose: first, to examine the status quo of taxpayers' rights in national laws and practice, and second, to list the essential principles which should be included in a global reach ideal model of *taxpayers' charter*. Results from 1990's survey was then summarized by OECD's Forum on Tax Administration (FTA) and published later in 2003 in a paper entitled "*Taxpayers' rights and obligations – practice note*" (OECD, 2003), which defined the taxpayers' charter as: "*an attempt to summarize and explain in plain language a taxpayers' rights and obligations in relation to their tax affairs, making such information much more widely accessible and understandable*" (p. 6). As noted in the document, taxpayers' charters – which, at that time, were not explicitly present in most countries – are not legally binding documents, although in some cases they may constitute some sort of "ruling", but rather constitute a guide to interpret laws and norms contained in relevant legislation. The following figure recapitulates taxpayers' basic rights and obligations – more or less formally present in all tax systems – and constitutes a practical example of the essential elements a modern taxpayers' charter cannot ignore:

TAXPAYERS' BASIC RIGHTS AND OBLIGATIONS	
The basic rights	***The basic obligations***
- The right to be informed, assisted and heard	- The obligation to be honest
- The right of appeal	- The obligation to be co-operative
- The right to pay no more than the correct amount of tax	- The obligation to provide accurate information and documents on time
- The right to certainty	- The obligation to keep records
- The right to privacy	- The obligation to pay taxes on time
- The right to confidentiality and secrecy	

Figure 3. Taxpayers' basic rights and obligations. (OECD, 2003)

As mentioned earlier, members State adopted OECD's guidance in different ways: while in some countries these principles were simply included in a general statement governing the relationship between taxpayers and revenue authorities, in others they provided a "*more detailed guide to the rights of taxpayers at each stage in the assessment process*" (p. 4). Yet, over the years, many countries started to consolidate these protection measures into an actual taxpayers' charter: Italy, for instance, was one of the earlier adopters of a formal legislative declaration containing the principles to which taxpayers and the tax authority must conform with a view to enhance confidence and legal certainty of the whole tributary relationship[5].

This first, important effort translated, in the subsequent years, in the will to implement those suggestions into a practical and effective set of regulations. Many elements were added to this process in 2008, when the OECD published the "*Study into the role of tax intermediaries*" (OECD, 2008), a document addressed to the specific topic of *aggressive tax planning*, which expanded the former basic relationship – viewing revenue bodies and taxpayers as the sole participants – to a tripartite relationship including tax intermediaries (tax advisers, banks and other financial institutions) as key actors in the whole tax administration process. Following the OECD perspective, actually, tax advisers and taxpayers are viewed, respectively, as the supply side and the demand side in the market for aggressive tax planning; while the majority of tax advisers – who play a vital role in all tax systems, supporting their clients to comply with their

[5]See law July 27, 2000, no. 128, "*Disposizioni in materia di statuto dei diritti del contribuente.*" (July 31, 2000) (Italy). *Gazzetta Ufficiale*, (177).

tax obligations and to manage the overall tax risk – tend to deter taxpayers from engaging in unlawful or risky activities, some others, as emerged from the study, design and promote aggressive tax planning strategies harmful to the entire tax system. Taxpayers, on their side, who determine their own attitude towards tax risk, and develop their own tax-risk management schemes, involve tax advisers in order to implement their (aggressive) tax planning strategies. The tripartite relationship is fundamental in order to understand the different phases of the tributary process, to identify the related issues, and to design the appropriate responses and solutions to contrast the adoption of detrimental approaches. The changing tax environment has undoubtedly provided greater opportunities for aggressive tax planning and tax avoidance in general, and at the same time, established new complicated challenges for revenue bodies all over the world. In this context, the study places high importance on the risk management process as an essential tool for revenue bodies, with the aim of identifying and prioritizing the risks presented by taxpayers (*risk assessment*) and to consequently design the best response strategies in view of an optimal and efficient allocation of resources (*risk-led resource allocation*). As a consequence of the highlighted issues, the main contribution from the 2008 study comes from the development of the conceptual framework for the *enhanced relationship* (ER), created to explain "*how a more collaborative, trust-based relationship can develop between revenue bodies and large corporate taxpayers who abide by the law and go beyond statutory obligations to work together co-operatively*" (p. 39). The ER is the result of extensive consultation among the Study Team – composed of UK's HM Revenue & Custom and the OECD Secretariat, which overseen and prepared the report – countries participating in the FTA and external relevant stakeholders, and also, relies on the experiences of a restricted group of countries (Ireland, the Netherland and the USA) who have established early co-operative relationships. The ER framework specifies a set of principles which should govern the relationship between revenue bodies and taxpayers, and through which the enhanced relationship can be achieved: their dealings have to be based on reciprocal understanding, inspired by *commercial awareness*, *impartiality*, *proportionality*, *openness through disclosure and transparency*, and *responsiveness*. The better revenue bodies are informed about significant, probable risks – which depends on the degree of transparency of taxpayers and their advisers – the better these risks could be managed, facilitating a more appropriate resource allocation, as well as more timely responses, leading to a quicker resolution of potential issues and the avoidance of potential tax disputes, which ultimately reduces time spent on unnecessary audit processes and the general cost of compliance.

A significant characteristic of the ER is that of being based on broader statements and principles rather than detailed rules: this way, the parties are left to freely establish and adopt the more

adequate level of disclosure, which goes furtherly beyond the minimum level of information required by statute and includes any position which could entail a certain degree of uncertainty or unpredictability. Finally, freedom is left to countries in choosing the appropriate mechanisms to implement in order to build a suitable ER framework, depending on their intents, the availability of resources and expertise, and the endorsement level of the involved parties.
Drawing on the notably experiences of 24 countries which – since the publication of the 2008 Study – have developed and adopted approaches based on mutual trust and confidence in the relationship between large corporate taxpayers and tax administrations, OECD published, in 2013, a report called "*Co-operative compliance: a framework – from enhanced relationship to co-operative compliance*" (OECD, 2013) with the aim to take stock of the developments in the implementation of co-operative compliance programs, and to evaluate the effectiveness of this approach in light of past and current experiences. A first important consideration, concerns the switch in the terminology adopted by the FTA to describe the framework of reference: indeed, the term *enhanced relationship* raised some doubts and misunderstandings about the nature of the approach and its compatibility with the essential principal of equality before the law. As a consequence, in order to avoid misinterpretation, FTA coined the term "*co-operative compliance*", which describes the concept more accurately emphasizing its means (co-operation between the involved parties) and ends (tax compliance). Moreover, the term denotes a further improvement of the approach: while the pillars identified in the 2008 Study still remains valid today, the diffusion and development of co-operative relationships has given rise to new major issues, such as the implementation of compliance risk management strategies by revenue bodies, or the development of a corporate *tax control framework* (TCF) as a primary tool to embolden disclosure and transparency; these important challenges are now part and parcel of the constantly-evolving co-operative compliance framework.
The 2013 report, actually, extensively discusses four major key issues related to co-operative compliance, which have emerged since the 2008 Study was published, and highlights the critical aspects which have to be taken under consideration in order to successfully implement co-operative compliance schemes in the context of a modern, wider compliance strategy:

- *Compliance risk management:* the importance of modern risk management practices in managing tax compliance has always been of primary interest for the FTA, which stressed out the importance for revenue bodies to develop a deeper understanding of the drivers of taxpayers' compliance behavior, with the aim of being able to manage compliance risks and to give adequate responses. Responding to these needs, revenue bodies have implemented operational strategies that allow traditional enforcement activities to operate together with innovative practices, offering different ways to

achieve higher levels of compliance, in the view of a consolidated approach which can be summarized as "*co-operation if possible and enforcement if necessary*" (p. 42).

- *Understanding taxpayers' behavior*: the reasons which determine taxpayers' behavior are fundamental for revenue bodies, in order to develop suitable policies addressed to the effective reduction of non-compliant activities. Recent developments in academic literature – analyzed at the beginning of this chapter – emphasized the importance of individual and social factors as determinants of compliance behavior, and have shown how a co-operation-based approach is preferrable to reach substantial levels of voluntary compliance.
- *The principle of equality before the law:* this important principle is today a common feature of the constitutions of most countries, requiring any differences of treatment of the same positions to be rationally justified by the underlying circumstances of the situations in question; some concerns have been raised about the compatibility of co-operative compliance programs with this general rule, in particular whether businesses entering this particular relationship are favored in comparison with those who choose not to participate. Co-operative compliance, however, is not intended to achieve an outcome for the taxpayer which is more favorable than that of a traditional audit-based approach, but rather to reach more effective means to improve tax compliance. Moreover, although co-operative compliance regimes undoubtedly provide benefits to its adopters, it requires also particular conditions to be met, depicting a give-and-take relationship which leaves no room for discrimination.
- *Compliance and the spirit of the law*: the concept of the "spirit of the law" was first addressed in 2011 OECD's Guidelines for Multinational Enterprises (OECD, 2011), stating that "*an enterprise complies with the spirit of the tax laws and regulations if it takes reasonable steps to determine the intention of the legislature and interprets those tax rules consistent with that intention in light of the statutory language and relevant, contemporaneous legislative history.*" (p. 60). This reference has raised some concerns in the business community about its usefulness in resolving uncertain tax positions, and the complexity of modern tax law undoubtedly leaves space for legitimate differences of opinion between taxpayers and the tax authorities about the consistency of a particular tax outcome. Mechanisms that allow taxpayers to achieve early certainty about the proper tax treatment of a specific transaction (e.g., rulings) could be helpful to avoid disputes; however, it must be noted that the revenue body should never be advantaged in interpreting the tax law, or "soft law" may be created to supplant applicable legislation. Rather, within a co-operative compliance framework, full

disclosure of tax positions – even in conflict with the view of the revenue body – and transparency are key elements to achieve certainty through confrontation and to limit the likelihood of conflicts to extraordinary, borderline cases.

3.2.1 The Tax Control Framework

The recurring principle of "transparency in exchange for certainty" requires tax risks to be fully identifiable and assessable, in order to be promptly managed and disclosed; the early recognition of arising issues and risks cannot exist without an appropriate Internal Control Framework (ICF) able to detect and protect enterprises from incoming threats, and this applies also for tax governance and tax compliance mechanisms which are fundamental elements of the overall risk management system. The FTA has emphasized the need for corporations – who commit to behave in a co-operative, transparent and compliant way – to design, implement and maintain an effective Tax Control Framework (TCF) able to control for all the possible processes and transactions that could give rise to tax consequences, and to readily document and report any relevant tax risk to the revenue body. The importance the FTA attributes to internal control systems is furtherly reconfirmed in 2016 OECD's report "*Co-operative tax compliance: building better tax control frameworks*" (OECD, 2016), a guide aimed to help businesses in order to design and efficiently operate their TCFs, defined as: "*part of the system of internal control that assures the accuracy and completeness of the tax returns and disclosures made by an enterprise, playing a central part in bringing rigor to the co-operative compliance concept.*" (p. 7). While it is not possible to design a system of control suitable for all cases, since it relies on the peculiar characteristics of the business and industry in question, the document identifies six relevant directives on which to build a TCF. Accordingly, a TCF should: clearly document and depict – at Board level – the *tax strategy established*; *apply comprehensively* to the full range of corporate activities – since they are all capable of influencing the tax position – and be embedded in the daily-operations management; *assign responsibilities* to the corporate tax department for its implementation and maintenance; be *documented* under *governance* processes to constantly ensure that transactions and activities are carried out in accordance with the expected norms; be *tested* and monitored regularly, particularly after changings in the tax environment; be able to *provide assurance* to internal and external stakeholders – above all, the tax administration – that tax-related risks are under appropriate control and that the outcomes of the tax governance process – information contained in the tax return – are authentic and reliable.

When the TCF is perceived as effective, which means that the tax authority considers the returns submitted as reliable, and is confident over the fact that relevant issues or doubts will be punctually brought to its attention, the extent and the recurrence of audits and review activities could be reduced in a significant way, providing indisputable benefits to the taxpayers and fostering the successful operation of the co-operative compliance relationship.

3.3 International experiences: the Dutch Horizontal Monitoring model

Following OECD's guidance and the increasing international trend to reconfigure the traditional relationship between taxpayers and the revenue authorities, many countries started to implement co-operative and trust-based programs into their national taxation systems during the last decades. In doing so, as mentioned earlier, countries had the freedom to choose the more appropriate means in order to develop a suitable framework of reference for co-operative relationships, in light of political, cultural and social diversities which prevented the creation of a one-size-fits-all system. Analyzing some of the different approaches employed by countries to adopt and put into practice these mechanisms is the more efficient way to evaluate the feasibility and sustainability of co-operative compliance regimes.
Among the early adopters of OECD's directives are the Netherlands, which introduced in 2005 the possibility for companies to establish Horizontal Monitoring (HM) relationships with the Netherland Tax and Customs Administration (NTCA). A recent study from Huiskers-Stoop and Gribnau (2019) investigates and evaluate the key aspects of the Dutch Horizontal Monitoring model in the light of OECD's standards of co-operative compliance. The Netherlands' pilot project constitutes a first-order example of the application of those principles, since, as the authors argue: "*it is […] difficult to draw a clear line between the OECD approach and the Dutch approach, since the Netherlands was a driver of the OECD approach.*" (p. 67). The Dutch HM model – defined as an administrative supervision process inspired to trust, transparency and mutual understanding – is, actually, an enforcement strategy developed by the NTCA in the context of a broader, general discretion – adequately supervised – which the Dutch law attributes to the revenue body in organizing and designing policies to support the whole enforcement process. HM brought an important shift of focus in the traditional NTCA's review process: conventional procedures rely on the information contained in the taxpayer' submitted tax return, which depicts tax-relevant actions that have already been undertaken and thus implies that the revenue body is frequently one step behind the taxpayer; instead, the interactive process promoted by HM shifts the attention to the beginning of the process, in order to discover earlier potentially ambiguous tax positions – where difference of opinion with the NTCA may

arise – providing certainty to tax-relevant actions that will be undertaken. The control of tax risks is of main interest for both parties: as these are discussed in advance, and the taxpayer is clear and transparent with regard to his tax strategy, the NTCA may consider information contained in the tax return to be complete and reliable, resulting in a reduced frequency of audits and reviews conducted – which, nevertheless, remain available tools for the tax authority, in the broader context of the enforcement process addressed to non-compliant taxpayers.

One of the main characteristics of the Dutch Horizontal Monitoring is that it has no legal basis at all: nonetheless, the Dutch Ministry of Finance and the NTCA are given – inside the boundaries of tax and general law and under the general principle of proper administrative behavior – the possibility to organize, on the basis of discretion, the enforcement process – even in the form of customized supervision – and may also issue public guidance to rule the whole HM framework. These guidelines contain the general rules governing HM, while the individual cooperation between the parties is based on a binding private mutual agreement – a *covenant* – which incorporate provisions beyond the traditional statutory rights and obligations.

In order to enter in a Horizontal Monitoring relationship with the NTCA, taxpayers must follow the following steps:

- The NTCA gathers relevant information on the taxpayer – tax attitude, degree of internal tax control – in order to define the *client profile*, which, if positive, is took as a basis to develop a *strategic supervision plan*;
- Subsequently, a *meeting* between the participant taxpayer and the NTCA is organized in order to assess the feasibility of HM. This consist of an exchange of information, expectations and responsibilities, and mutual adherence to the key principles of HM;
- Then, the NTCA performs a *compliance scan* by discussing relevant issues with the company's key officers, including the tax behavior of the company, its internal control environment and the presence of external monitoring;
- Pending tax issues, if any, are resolved upon entering the Horizontal Monitoring relationship, leaving space for real-time working;
- Finally, principles governing the individual HM agreement are wrote down in covenant. The mutual agreements signed by both parties cover the realization of customized tax supervision, information on the actual tax collection, insights into the taxpayer's tax position and the willing to keep the NTCA up-to-date on the whole taxation process;
- After the covenant is concluded, the NTCA constantly supports the company in the process of *analysis and improvement of the internal tax control system*, which is customized on the particular characteristics of the company and is considered a key

element inside the HM program. The NTCA will then *adjust* its supervision process with regard to the company's available information and its peculiarities.

The above-mentioned steps are designed with the aim to assess the trustworthiness of both the parties entering the relationship, and to convert the willingness to regulatory compliance into an actual, compliant behavior. The Dutch Horizontal Monitoring model fits well into the principles formulated by the OECD for a profitable tax cooperation, even developing – through the conclusion of the covenant – a more reciprocal set of obligations between the taxpayer and the revenue body.

3.3.1 The Chinese "thousand companies' group"

As highlighted in the previous paragraph, the Dutch HM model shares several characteristics with the OECD's co-operative compliance framework, since the Netherlands played a pivotal role inside the FTA in developing the main principles and mechanisms of the approach in question. However, the same cannot be said for a large number of countries which, over the last decades, affirmed to have a co-operative compliance approach in place, or started its implementation: differences in the political and social environment have undoubtedly given rise to different ways to interpret and manage the relationship between the country's largest taxpayers and the revenue authorities.
A study from Martini (2022), investigating the approach of China to co-operative tax compliance in light of the international experience, and its adherence with the OECD's framework, presents a clear picture of the international situation regarding the main features characterizing several countries' co-operative tax compliance models: the following table, reproduced without modification, gathers information collected in the 2019 OECD's questionnaire (OECD, 2019):

Year	N° of countries		N° of Countries where Cooperative Tax Compliance Programmes entail:			
	that responded to the questionnaires	with Cooperative Tax Compliance: planning, implementing or in place	the need to have a TCF as a requirement to join	disclosure of relevant tax issues on a real-time basis	real-time solving of relevant tax issues	pending tax issues to be resolved
2014	55	33	14	24	22	12
2015	55	33	14	25	21	12
2016	58	35	18	26	25	16
2017	58	37	18	26	25	16

Figure 4. *Features of Co-operative Tax Compliance as per the 2019 OECD questionnaire* . Reproduced without modification from: Martini, M. H. (2022).

It is important to note that the need to implement an adequate TCF – to which OECD's guidelines have addressed much of emphasis – is not a requirement in order to enter in a co-operative relationship in around half of the countries investigated. The same can be said for the resolution of pending tax issues, and, surprisingly, in approximately one third of the countries is neither possible to engage in real-time working or to promptly discuss relevant tax issues with the revenue body. It is clear now how the different approaches countries adopted in order to shift toward a co-operative tax compliance relationship resulted in differing frameworks to be implemented; the term Co-operative Compliance as coined by the OECD, nevertheless, can be utilized to refer to any and all the means promoting mutual interaction and understanding between the taxpayers and the tax authorities, regardless of any existing difference, but taking due care in order not to incur in terminology misconceptions.
Given these assumptions, the author takes into consideration the relevant features listed in the table reported above – the TCF, the general regulatory framework, the possibility to engage in real-time working with the revenue body, and the need to "clear the past" before joining the program – with the aim to determine whether the Chinese approach can be considered pertinent to the Co-operative Compliance view.
The development of the Chinese tax system is relatively recent: actually, in 1978, China started to shift from its historical model of "planned economy" – where all the companies were owned by the Chinese Government – to the more open, internationally-oriented model of the so-called "socialist market economy", now allowing companies to be privately-owned, and, at the same time, forcing Government's financing to replace losses in profits originating from the state owned enterprises (SOE) with revenues generated by the collection of taxes. This important shift, however, occurred gradually in time and often in a partial way: in fact, as the author reports, in 2019 around 60% of the 300 largest Chinese companies – in terms of stocks being

traded on the Shanghai Stock Exchange – were SOE. This ratio furtherly increases if the 2020 Fortune Global 500 index is considered: among 124 of Chinese companies listed, 91 (73%) of them were state-owned, depicting a situation where the Chinese Government still exerts notable influence over a relevant portion of the largest companies of the country. As argued by researchers, the intense participation of the Chinese Government in the country's enterprises has relevant implications on their tax compliance behavior: empirical findings showed that, for instance, large SOE pay less taxes on average than their private counterparts, as a result of their embedded political power. Again, SOE were found to be engaged in less tax planning practices in situations where the Chinese Government had direct advantages from higher tax collection. This, somewhat forced, mutual relationship has shaped the general tax compliance environment in China, which has been progressively inspired by principles of trust and co-operation: non-deterrent practices, such as the possibility for taxpayers to amend their tax returns, the fact that no penalties are issued in relation to "first offence" acts, or communication and negotiation as the preferred alternative to tax litigation, are now common characteristic of the tax administration process. Along with the developments of the Chinese accounting framework, which led, in 2006, to the harmonization of the Chinese Accounting Standards (CAS) with the IFRS, and the introduction, in 2008, of the Basic Standards for Enterprise Internal Control (BSEIC) which required additional disclosure over relevant matters such as the effectiveness of internal control system, China created a competent regulatory framework which fostered the emergence of a co-operative compliance approach.

Meanwhile, in 2008, the Large Enterprise Tax Department (LETD) was created as a special department of the State Administration Taxation (SAT), with the main aim of supporting large, selected businesses and assessing the related tax risks. Over time its functions were broadened, even to the possibility to engage in the conclusion of voluntary Tax Compliance Agreements (TCA) signed between large businesses and the SAT, an agreement which – at least in a formal way – incorporated many features of the OECD's Co-operative Compliance framework. The outstanding step towards this direction, however, is represented by the creation, in 2015 – inside a general plan of reform of the national and local taxation systems – of the "*thousand companies' group*" plan, with the intention to supervise the group of largest companies, with different industry segment representativity, in a more accurate manner. Testifying to the fact that the Chinese tax administration overlaps the "thousand companies' group" to Co-operative Compliance, is that the number of companies that constitutes the group (1,062) is the same number which the Chinese tax administration communicated the OECD to be taking part in the Co-operative Compliance approach in 2016 and 2017. However, despite the considerations of the Chinese tax administration, the "thousand companies' group" exhibits some relevant

differences with respect to the co-operative tax compliance approach, as shaped by OECD's publications and other international experiences: the first significant divergence is the mandatory nature of the Chinese approach: participation is not voluntary nor upon invitation; rather, it is mandatory for those companies exceeding the criteria – of which the main one is the total annual tax payment – established by the tax administration. Moreover, taxpayers' risk assessment is not conducted before entering the relationship, but at a later time in order to assign companies a rating which will determine their probability of being audited. Finally, the main incentive to co-operate derives from the fact that non-compliant behavior may result in the company to be associated with high degree of risk ratings, leading to undesirable consequences; this latter aspect, in fact, fits better within the basic, vertical relationship where taxpayers' behavior is mainly influenced by the fear of negative outcomes deriving from the non-fulfillment of tax authority's requests.

Nevertheless, some peculiarities of the "thousand companies' group" fall under the scope of co-operative compliance: for instance, the tax authority promptly informs companies about the results of the tax risks analyses conducted, and give taxpayers the opportunity to amend errors and clarify doubtful positions before starting the inspection process and without applying any penalty – this approach conforms with *responsive regulations* principles and the *enforcement pyramid*, which promotes a progressive escalation of deterrence practices based on the taxpayer's behavior and responses. Yet, the tax authority acts in respect of the discussed principle of "equality before the law", granting different treatment to different taxpayers, on the basis of the tax auditing function which relies on the individual taxpayer risk profile. This way, proportionality of measures is realized too, by channeling requested resources to higher risks taxpayers. Finally, taxpayers are encouraged – not forced – to develop and maintain an efficient TCF in order to enhance the degree of trust and co-operation from the tax authority side, by assuring the reliability of information disclosed and guaranteeing that potential tax risks are kept under adequate supervision.

While the Chinese "thousand companies' group" plan definitely shares many important characteristics with the Co-operative Compliance framework, in the author's opinion, the highlighted differences lead to the conclusion that the Chinese approach does not perfectly conform with the elements of co-operative tax compliance; moreover, the high degree of Government participation, and its prevailing presence in the Chinese economy, are thought to be the most relevant incentive to co-operation – especially for larger entities. The most important insight in the Chinese experience – and what makes it noteworthy – is, anyways, the significant process of transformation pursed by the Chinese tax administration, aimed to reform and re-think the administrative and legislative tax framework, acknowledging the importance

of developing a trust-oriented, co-operative relationship between taxpayers and the tax administration itself – even overcoming the difficulties that can arise when trying to implement innovative schemes in a traditionally closed, politically-oriented economic environment.

3.4 The Italian approach

As briefly anticipated before, Italy has been among the first promoters – with the formal adoption, in 2000, of a taxpayers' charter – of a renovated, dialectical relationship between the Italian tax authority – the Italian Revenue Agency – and the country taxpayers' community.
Following a period of intense legislative production, which contributed to add confusion and ambiguity to a yet difficult to understand fiscal legislation, the Italian taxpayers' charter (hereinafter referred to as "the Statute") was issued with the intention to explicitly regulate the tax administration's behavior, by reducing its degree of discretion in the supervisory process and disciplining tax and fiscal law legislative production, with the aim to give to the whole tributary system renewed trust and certainty, and to provide taxpayers adequate tools to correctly interpret tax law provisions and protect their rights in the tax assessment process (Turchi (2007)).
The Statute, actually, can be divided into two different groups of norms (Fondazione Luca Pacioli (2002)); the first (articles 1-4) is dedicated to the regulation of the tax law legislative production and lays down its many limits and principles: article 1, in fact, elevates provisions contained in the Statute to general principles of the tax system, establishing that any exception or amendment must be made explicitly and only through ordinary law. Moreover, the following articles assure the clarity and transparency of tax law provisions, and, concerning their efficacy, determine their nonretroactive nature. The second body of norms (articles 5-12) is instead dedicated to safeguard the taxpayer's position towards the tax administration: indeed, it is introduced the duty for the tax administration to promptly provide taxpayers adequate information about the content and directions of tax law provisions, along with the responsibility to guarantee the knowability and secrecy of the tax administration's documents addressed to taxpayers, which must always be sufficiently motivated. From the taxpayers' perspective, the Statute formally introduces a set of tutelary rights, such as, for instance, the right for the taxpayer to request and obtain a reinstation of the time limit, whenever he has been unable to fulfill fiscal and tax obligations due to *force majeure*, or, under exceptional and unpredictable situations, to ask for suspension or deferral of the deadlines set for their fulfillment. In addition, article 10 explicitly states that the relationship between the taxpayer and the tax administration must be inspired to principles of co-operation and good faith, and sets forth the inapplicability

of penalties in those cases where the taxpayer's behavior depended on the tax administration's indications or negligence, and in any case where the applicability and reach of tax law provisions are characterized by objective uncertainty. Yet, article 11 introduced – although in a primitive form, which will be revised and expanded in 2015[6] – the possibility for the taxpayers to ask the tax administration clarifications over specific and concrete individual cases of tax-relevant matters, in situations of uncertainty on the correct interpretation of tax law provisions, which are issued in the form of rulings; a particular characteristic of this institution, is that – as long as the transaction follows the path described in the ruling – the interpretation of relevant legislation is legally binding for the tax authority, while the taxpayer can choose whether to conform or not; this mechanism allows taxpayers and the revenue body to seek early certainty on the tax consequences of a particular set of circumstances, benefitting both parts of the tributary process, and nowadays the Italian tax system provides the possibility to apply for different and alternative forms of tax rulings. Finally, article 12 imposes strict premises and conditions to the auditing process of the tax administration: checks and inspections must be motivated, must cause the least harm to the course of taxpayers' economic activity and time limitations are established too. In addition, taxpayers have the right be informed over the reason and the object of the audit, and both parties must observe the principle of co-operation.

This brief explanation shed light on the relevance and importance of the main concepts and principles contained in the Statute, in line with the OECD's earlier recommendations and conforming to the need of organizing and formalizing taxpayer's basic right and obligations into a charter having the same applicability and enforceability of ordinary law.

If, on the one hand, Italy was a first mover in the early season of policy and legislative changes towards a trust-based, co-operative model of tax compliance, the same cannot be said for the second, most relevant stage of the development of the theme, when concepts like the Enhanced Relationship or the Co-operative Compliance approach started to be object of debate within the OECD. Indeed, while many countries started to implement, in relatively different forms, co-operative compliance schemes into their national taxation systems (e.g., Australia (2001), South Africa (2004), Ireland and the Netherlands (2005)), Italy made his first step towards this direction later in 2009, when, in conjunction with the reorganization of Italian Revenue Agency which set up a new "Large business division" – specifically addressed to the supervision and risk management of large business taxpayers – the "Large Taxpayers Fiscal Tutoring" program was launched[7], with the main objective of, as stated by the Italian Revenue Agency on its

[6] Following the enactment of the Legislative Decree September 24, 2015, no. 156, "Misure per la revisione della disciplina degli interpelli e del contenzioso tributario." (October 10, 2015) (Italy). Gazzetta Ufficiale, (233).
[7] The program is regulated by article 27, paragrarphs 9-14, Decree-law November 29, 2008, no. 185, "Misure urgenti per il sostegno a famiglie, lavoro, occupazione e impresa e per ridisegnare in funzione anti-crisi il quadro

national website, "*establishing with Large Business taxpayers, which represent a strategic segment of the national economy, a mutual collaboration relationship based on an open and transparent dialogue to support voluntary compliance. The supervision process serves as a tool to counter elusive/evasive behavior, balanced on the characteristic of the individual taxpayer and on its major or minor attitude to engage in fiscally irregular conducts.*"[8]. The main focus of this operation, actually, was to improve the Revenue Agency intervention methodologies by shifting to a more risk-oriented approach, based on the specific characteristics of the industry sector and any relevant, available information about the individual taxpayer, included its level of compliance, ensuring this way that the supervision process is concentrated on high risk taxpayers, and that worthless investigations on low risk taxpayers are minimized, if not avoided at all. From a practical perspective[9], the "Large Taxpayers Fiscal Tutoring" regime in not a form of voluntary agreement between the Italian Revenue Agency and large taxpayers, but is rather an intervention program which applies indiscriminately to all the businesses exceeding the determined turnover or revenues threshold of EUR 300 million (progressively reduced to EUR 100 million starting from December 31, 2011). Moreover, the activity relies on a "risk assessment profile", arranged for every large taxpayer, recapitulating all the relevant information (e.g., general fiscal position, compliance level towards tributary obligations) able to determine a specific degree of risk of the individual business; consequently, on the base of the assigned ratio, the most adequate method of supervision is selected, with the result that high risk taxpayers will be subject to harsher, deeper supervision and audit processes, while low risks taxpayers – demonstrating a more transparent and co-operative attitude with the revenue body – will expect the inspection activity conducted towards them to be significantly reduced. The development of the "Large Taxpayers Fiscal Tutoring" program certainly lies within the general process of reformation and improvement of the relationship between taxpayers and the Revenue Agency, but the peculiar characteristics of the regime – which recall, regarding for instance its mandatory nature, the Chinese "thousand companies' group" plan discussed earlier – are still far from allowing it to be framed under the Co-operative Compliance approach. Nevertheless, at a later time, following the increasingly important process of reorganization of tax and fiscal legislation, promoted by the Italian Government and relevant tax and

strategico nazionale." (November 29, 2008) (Italy). Gazzetta Ufficiale, (280), converted, with amendments, into Law January 28, 2009, no. 2, (January 28, 2009) (Italy). Gazzetta Ufficiale, (22).

[8] Unofficial translation. Original text available at: "https://www.agenziaentrate.gov.it/portale/web/guest/schede/accertamenti/controllo-grandi-contribuenti-tutoraggio/missione-agenzia-delle-entrate-in-relazione-ai-grandi-contribuenti" (consulted September 14, 2023)

[9] All the mentioned characteristics of the regime were deduced from: Italian Revenue Agency (2009). Circular no. 13/E, April 9, 2009. Rome, Italy: Italian Revenue Agency. Available at: "https://www.agenziaentrate.gov.it/portale/documents/20143/300662/Circolare+13+del+09+04+2009_circ+13e+del+9+aprile+2009.pdf/3117d815-6dfd-fc9f-adc4-6a55b6282ae1".

administrative institutions and aimed to redefine the traditional relationship with taxpayers, and building on important and successful international practice – which stressed, also, the convenience of gradually introducing co-operative compliance-inspired approaches in order to test their feasibility, and the approval of the subjects to which the regime is addressed to – the Italian Revenue Agency, by means of a press release published on June 25, 2013, on their national website, invited taxpayers which were already under the "Large Taxpayers Fiscal Tutoring" program to join a pilot project denominated "*Regime di adempimento collaborativo*". In the document, when stating the objectives of the project, the Revenue Agency explicitly refers to "*the aim of verifying concrete practices of implementation in Italy of forms of dialogue founded on co-operation, transparency and mutual trust, already widespread in other countries and referred to as "Co-operative Compliance Programmes".*"[10]; the pilot project, in fact, served as a "testing ground", for both taxpayers and the Revenue Agency, in order to identify and determine the peculiar characteristics to which the new concept of a co-operative compliance regime should be inspired to, in the view of a progressive evolution of the former Tutoring program. Participation in the pilot project were set on a voluntary basis, with the only requirement – besides the already mentioned one of being part of the Tutoring program, thus being qualified as a "large taxpayer" – of having implemented adequate strategies of assessment and management of relevant tax risks (TCF). On a practical perspective, the project materialized as an actual "discussion table" between the Revenue Agency and participating businesses, with the aim to analyze particular, relevant aspects such as: the characteristics of individual Tax Control Frameworks, the elements and peculiarities of the renewed approach, the incentives to taxpayers' compliance and Revenue Agency obligations; with the reciprocal commitment to, from the taxpayers side, increase voluntary compliance and promptly provide relevant information to the Revenue Agency about tax-relevant transactions, and, from the Revenue Agency side, to respond to taxpayers' necessities and to allow a quicker resolution of tax issues and disputes. In a subsequent article, published on the official Italian Revenue Agency's online magazine[11], the authors identify a total of 84 (representing 55 groups of companies) candidates to the pilot project, of which only 53% represented by Italian companies – suggesting that foreign firms had probably already experienced some forms of co-operation with their national

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[10] Unofficial translation. From Italian Revenue Agency (2013). Press Release June 25, 2013. "*Le Entrate sperimentano il "Regime di adempimento collaborativo". Dialogo avanzato con i Grandi contribuenti.*" Rome, Italy: Italian Revenue Agency. Original text available at: "https://www.agenziaentrate.gov.it/portale/documents/20143/314704/CS+25062013+adempimento+collaborativo_093_+Com.st.+Adempimento+collaborativo+25.06.13.pdf/7dd85b9b-7356-1928-0e43-8d2ad3594667/-/cs-25062013-adempimento-collaborativo"

[11] See Pollice, V., & Quagliana, G. (2013, August 6). *Regime adempimento collaborativo: ok i primi passi del progetto pilota*. FiscoOggi. Retrieved from: "https://www.fiscooggi.it/rubrica/attualita/articolo/regime-adempimento-collaborativo-ok-primi-passi-del-progetto-pilota"

tax authority. Unfortunately, the Revenue Agency never published a report concerning the concrete results achieved within the 2013 Pilot Project, but, as the article closing statement argued: "*it is only a first step in the view of possible Tutoring developments towards more advanced forms of communication, in accordance with what is under discussion in legislation.*". In fact, while the Italian Revenue Agency – and, in particular, the large business division – was dealing with the implementation of the 2013 Pilot Project, the improvement of the tributary relationship was among the main subjects of discussion in the Italian Parliament. The attention of the Italian legislator towards co-operative tax compliance, incentivized, also, by other successful international experiences, actually, culminated with the promulgation of the 2014 parliamentary bill no. 23[12], which delegated the Government to reform the national tax system. Regarding its contents, the Law represents a turning point in the traditional relationship between the Revenue Agency and taxpayers, with specific provisions related to the introduction of forms of closer, enhanced co-operation, to be adopted, also, in advance with respect to conventional tax deadlines, in order to anticipate the occurrence of tax-related risks and manage the more challenging cases. In addition, particular attention in dedicated to the simplification of the whole tax system, starting from the revision of tax regimes and bureaucratic fulfillments – with the aim of eliminating unnecessary, redundant activities and reducing the costs of compliance for taxpayers – to the reformation of tax disputes, introducing particular institutions devoted to the resolution of litigations "outside of the courts", granting additional legal and judicial protection to the taxpayers category, and providing benefits and incentives to enterprises demonstrating a more compliant and transparent behavior in dealing with the tax authority. These reforming principles found their implementation in Legislative Decree no. 128, 2015[13], of which articles 3 to 7 are explicitly dedicated to the regulation of the Italian Co-operative Compliance approach to tax compliance, the "*Regime di adempimento collaborativo*"; in particular, article 3 clearly addresses the rules contained in the following provisions to the relationship between the Italian Revenue Agency and those taxpayers adopting a system able to survey, measure, manage and control potential tax risk, defined as the risk to operate in violation of tax law provisions, as well as against its principles and objectives ("*the spirit of the law"*): the attention the Italian legislator gives to the implementation and maintenance of adequate Tax Control Frameworks is reflected in these words, and is completely in line with OECD's recommendations which, as seen above, has dedicated a whole publication to this

[12] Law March 11, 2014, no. 23, "Delega al governo recante disposizioni per un sistema fiscale più equo, trasparente e orientato alla crescita." (March 12, 2014) (Italy). Gazzetta Ufficiale, (59).
[13] Legislative Decree August 5, 2015, no. 128, "Disposizioni sulla certezza del diritto nei rapporti tra fisco e contribuente, in attuazione degli articoli 5, 6, e 8, comma 2, della legge 11 marzo 2014, n. 23" (August 18, 2015) (Italy). Gazzetta Ufficiale, (190).

pivotal theme. Indeed, article 4 settles the characteristics that the participating taxpayer's TCF must ensure:

- A clear attribution of roles and responsibilities related to tax risks across all the business' divisions;
- Efficient procedures of survey, measurement, management and control of relevant tax risks, observed at all the organizational levels;
- Efficient procedures devoted to the resolution of arising issues regarding the TCF, and the provision of adequate mechanisms of correction.

Moreover, a report addressed to the management body, concerning the functioning of the TCF, its practical implementation and its overall effectiveness towards tax risk management, is scheduled at least once a year, providing a mean of direct, internal communication between the business' divisions – all, more or less, involved in tax-relevant activities in their daily operations management – and the corporate top management team.

Article 5 is then dedicated to the obligations concerning the involved parties: the Revenue Agency, in fact, must:

- Adopt a transparent, objective, and respectful evaluation of the principles of rationality and proportionality of the internal control systems adopted by large enterprises, eventually suggesting the required modifications in order to be admitted to the regime;
- Periodically publish a list concerning the relevant transactions, activities or schemes deemed as *aggressive tax planning*;
- Promote a relationship with taxpayers inspired to principles of transparency, co-operation and honesty, in order to enhance the legal certainty of the tax system;
- Realize an actual simplification of tax obligations, as a result of the flow of relevant information disclosed by taxpayers in the context of the regime;
- Examine, beforehand, those situations susceptible of generating considerable tax risks and answer to taxpayers' requests *in the shortest possible time*;
- Thoroughly consider the outcomes of the evaluations conducted by the management team – contained in the above-mentioned report – as well as the results of the audit activity carried out by the subjects in charge.

The Regime entails instead, from the taxpayers' perspective, the obligation to maintain a co-operative and transparent behavior with the Revenue Agency, by the means of a prompt and exhaustive disclosure of relevant tax risks, as well as those transactions that could be part of

aggressive tax planning schemes. This way of working, moreover, must be shared at all the organizational levels, and be part of the whole corporate culture: this is a meaningful and important consideration, since an effective Co-operative Compliance regime, in order to provide significant and positive advantages to the tax system, should not reduce itself to be the mere application of tax law provisions – even though inspired to the noblest principles of society – but must rather be embedded in the attitudes, behaviors and practices of the individual subjects – employees, directors, managers – that together give life to corporations. Tax authorities, on their side, must ensure that the tax system is fair, proportional and trustable.
Going back to the characteristics of the Italian Regime, article 6 finally describes the effects of the participation in the program:

- Provision is made for the possibility for taxpayers to engage in common, reciprocal evaluation with the Revenue Agency of all those situations capable of generating important tax risks, by the means of a stable and preventive disclosure and before the submission of the tax return;
- A particular, dedicated discipline for advance tax rulings is reserved to participating taxpayers: the law provides the opportunity to ask the Revenue Agency about actual, concrete transactions subject to relevant degree of risk. The Revenue Agency then, within 15 days, verifies the appropriateness of the question and not later than 45 days – versus the 90-day time limit the law provides for ordinary rulings – after its presentation gives a legally binding, comprehensive answer of the inquiry. An appreciable, additional characteristic of this institute is that taxpayers must inform the Revenue Agency about the conduct effectively implemented, only if different from that projected by the revenue body – a brilliant provision in the view of the early disclosure of risks;
- With regard to those tax-related risks promptly and exhaustively disclosed to the Revenue Agency before the submission of the tax return, above which the revenue body does not share the taxpayer's view, the related administrative sanctions are not only reduced by half, but are also not appliable by more than their lower minimum; moreover, their collection is suspended until the audit process is completed;
- Lastly, the law establishes that taxpayers' participating in the Regime are exempted from providing securities for the refund payment of direct and indirect taxes.

Regarding, instead, the requirements to participate in the Regime, the Law refers to one or more subsequent Decisions of the Director of the Revenue Agency to define the entry conditions;

these are contained, in fact, in Decision April 14, 2016, ref. 54237/2016[14], which establishes the following eligibility criteria in order to access the first implementation stage of the Regime[15]:

- Resident and non-resident companies with a realized turnover or revenues not less than EUR 10 billion;
- Resident and non-resident companies with a realized turnover or revenues not less than EUR 1 billion, which had submitted a request to participate in the 2013 Pilot Project;
- Enterprises wishing to implement the Revenue Agency's response following a request for advance tax rulings on new investments[16], independently from their turnover or revenues level.

Eligible enterprises can submit the application to access the Regime using the template provided, in electronic format, on the Italian Revenue Agency's institutional website; the application must contain relevant information on the enterprise, its fiscal strategy and an accurate description of the characteristics and functioning of the Tax Control Framework adopted. The Agency verifies the requisites subsistence and carries out a preliminary investigation about the operational characteristics of the TCF, and proposes any improvement needed, if appropriate, in order to be admitted to the Regime. The verification process lasts a maximum of 120 days from the submission of the application (or from the reception of the additional documentation on the enterprise, if demanded), at the end of which the Agency communicate the results to the taxpayer; in case of admission, the taxpayer is inserted in the list of participating enterprises published on the Revenue Agency's website.

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[14] Decision of the Director of the Revenue Agency, April 14, 2016, ref. 54237/2016, "Disposizioni concernenti i requisiti di accesso al regime di adempimento collaborativo disciplinato dagli articoli 3 e seguenti del decreto legislativo del 5 agosto 2015, n. 128" available at:
"https://www.agenziaentrate.gov.it/portale/documents/20143/343946/Provvedimento+14+aprile+2016+Cooperative+compliance_Provvedimento+ammissibilit%C3%A0+cooperative+compliance+DEF.pdf/49004fbb-eeeb-bdfd-7685-368394572f0e"

[15] The initial dimensional threshold set for resident and non-resident companies at EUR 10 billion has been progressively diminished, in the first instance, to EUR 5 billion, for the years 2020 and 2021, pursuant to the Ministry of Economics and Finance Decree of March 30, 2020, and then to EUR 1 billion, for the years 2022, 2023 and 2024, pursuant to the Ministry of Economics and Finance Decree January 31, 2022.

[16] Advance tax rulings on new investments are a particular type of ruling introduced by Legislative Decree September 24, 2015, no. 156 (see above note, 6). While it is beyond the scope of this paper to analyze its characteristics, for the sake of completeness, its definition – as described on the Italian Revenue Agency institutional website – is reported here: "*The advance tax ruling on new investments enables resident and non-resident investors, going to realize long-lasting and relevant investments within the Italian territory, to obtain the preventive opinion from the Italian Revenue Agency about the tax treatment applicable to business plans and related extraordinary operations. The main aim is to give more certainty to the economic operators in the determination of fiscal burdens connected to relevant investments in Italy*." Available at:
"https://www.agenziaentrate.gov.it/portale/web/english/nse/invest-in-italy/advance-tax-ruling-on-new-investments#:~:text=The%20advance%20tax%20ruling%20on,business%20plans%20and%20related%20extraordinary"

A particular provision introduces a ground for exclusion from the Regime: indeed if, subsequently to the admission, relevant tax-related risks not identified by the TCF nor promptly disclosed to Revenue Agency should arise, the Agency can establish, by a substantiated decision, the exclusion of the enterprise from the Regime.
The above-listed features of the Italian "*Regime di adempimento collaborativo*" are without any doubt in line with OECD's guidance and recommendations; this is visible, at first sight, if confronted with the primary peculiarities of international Co-operative Compliance approaches as defined by the OECD and depicted in Figure 4 above: the need to have implemented an adequate TCF in order to join the program, for instance, is not a second-order requirement but rather the pillar on which the Italian Regime is based upon, testified by the importance the Italian Parliament, as well as the Revenue Agency, has reserved to this theme in all the different legislative sources issued in order to regulate the Regime. Again, the disclosure of relevant tax issues on a real-time basis is also a key element of the program, a possibility not only the law provides for, but also, as mentioned earlier, a ground for exclusion for non-conforming taxpayers. Yet, the real-time solving of relevant tax issues is achieved through direct confrontation with the Revenue Agency, or through the institute of advance tax rulings in the most complicated cases. Finally, and surprisingly, no reference is made in any legal document with regard to pending tax issues to be resolved; these continue, in fact, to be regulated by ordinary law, and although these do not represent an explicit ground of exclusion from the Regime, their presence may hinder the participation in the program.
To this day, 109 enterprises – of which many belonging to different groups of companies - are participating in the Italian Co-operative Compliance Regime, thanks also to the progressive decrease of the eligibility criteria which allowed smaller companies to apply to. The following, conclusive chapter selects one specific company among the group, and elevates it as a representative case in order to try to shed some light on the practical effectiveness and feasibility of the Italian "*Regime di adempimento collaborativo*".

Chapter 4

A CO-OPERATIVE COMPLIANCE CASE STUDY

4.1 Case selection – 4.2 Hypothesis development – 4.3 Financial Statements analysis – 4.3.1 BTDs decomposition: dividends – 4.3.2. Allowance for Corporate Equity (ACE) – 4.3.3 Impairment adjustment to investments – 4.3.4 Non-disclosed factors – 4.4 Final results

The previous chapters have analyzed the tax avoidance dilemma under different perspectives – starting from the empirical, mathematical outlook of AFIT, to the more theoretical, sociological approach of behavioral economics – emphasizing the advantages and disadvantages of engaging in such behavior, and attempted to clarify the reasons which encourage taxpayers to act in a more or less compliant way with respect to their national tax authorities.

What can be said to be, at this point, the main concern of tax research? Maydew (2001) addressed this question with a clever metaphor provided by the common riddle joke of "Why did the chicken cross the road?"; as the author explains, he has been, at that time, the first victim of this jest, told to him by a non-tax, maybe pleasant colleague which immediately after asking him this old but still enigmatic question, merely responded: "*because taxes were lower on the other side.*". Nobody knows the exact reaction of the author to this disconcerting joke which, however, surely provided him an amusing frame to think about the directions and the objectives of tax research. In fact, expanding the chicken-crossing-the-road scenario, he continued: "*imagine now that instead of one chicken there are many chickens, representing firms, some of whom have crossed the road and some of whom have not. The real question is not why did the chicken cross the road, but why did not all the chickens cross the road?*" (p.393). The answer, here too, is straightforward: "*if we assume, [...] that the chickens/firms are rational economic decision-makers, then one way some chickens would choose to not cross to the low tax rate side of the road is if there are costs associated with crossing the road.*".

Maydew was surely right: as seen throughout this paper, firms engaging in tax avoidance practices must confront themselves with a broad set of shortcomings, ranging from the tax burden itself, directly tax-associated costs and the key role played by non-tax determinants – until reaching the pivotal theme of tax compliance costs, stemming straight from the relationship between the firm and the tax authority. Tax authorities, on their side, are well conscious about the damages and losses perpetrated by tax avoidance and elusion mechanisms, and have always struggled with all their might in order to make them a more onerous task for

non-compliant taxpayers. However, this effort – which initially focused on an adversarial, accusatory approach – demonstrated to be insufficient: a different method of intervention was needed in order to hinder the elusive process, not by the means of increasing the associated costs (*deterrence approach*) in the hope of dissuading its further adoption, but rather providing an overwhelming set of benefits such as to make (voluntary) compliance an almost mandatory choice. It is right in this context that the outstanding work of OECD is inserted, in the ways and times thoroughly investigated in the previous chapter; the strong reception and adoption of its recommendations and newly established principles from an increasing number of countries all over the world – albeit with some differences – testifies to its significance and importance.
The aim of this conclusive chapter is not only to evaluate – through the presentation of a practical case – the relevance and the magnitude of the effects of participating in Co-operative Compliance programs – among which, for the purpose of this analysis, the Italian Co-operative Compliance Regime is opted for – but also to assess whether an increased effort towards trust, openness, transparency and co-operation in tax compliance actually paves the way to the long-sought reconciliation between taxpayers and national governments.

4.1 Case selection

As anticipated earlier, 109 Italian enterprises – the majority of which are part of diverse groups of companies – are currently participating in the Italian Co-operative Compliance regime. The list of participating companies is of public domain, published on the Italian Revenue Agency's institutional website and is periodically updated following the entry of new participants[17]. With the press release of January 5, 2017[18], the Revenue Agency announced the effective start of the program, consequent to the admission of Ferrero S.p.A. – together with other companies of the group – the first Italian enterprise to be admitted in the Regime. Since then, many other large companies followed the path to enter, together creating an heterogeneous group of participating firms with respect to their ownership structure and sector representativity: in fact, both public and private firms (e.g., Trenitalia S.p.A. and Pirelli & C. S.p.A.) and family and nonfamily firms (e.g., Barilla G. e R. Fratelli S.p.A. and Intesa Sanpaolo S.p.A.), all belonging to different

[17] The list is available at: "https://www.agenziaentrate.gov.it/portale/web/guest/schede/agevolazioni/regime-di-adempimento-collaborativo/elenco-societa-ammesse-al-regime" (consulted September 25, 2023).
[18] From Italian Revenue Agency (2017). Press Release January 5, 2017. "Cooperative Compliance: siglati i primi accordi. Con l'adempimento collaborativo più certezza fiscale per i grandi investimenti. Emessi i primi provvedimenti di ammissione." Rome, Italy: Italian Revenue Agency. Original text available at: "https://www.agenziaentrate.gov.it/portale/documents/20143/313306/cs+05012017+Cooperative+compliance+siglati+i+primi+accordi_003_Com.+st.+Cooperative+Compliance+05.01.17.pdf/30b02437-edf0-1737-e187-8e4e5a9dc3cd/-/cs-05012017-cooperative-compliance-siglati-i-primi-accordi".

industry sectors (banking, transport, food, fashion) and based in different countries, exhibited the willingness to apply for the Italian Co-operative Compliance regime, highlighting, from the very beginning, a fair degree of first reception from the interested parties.
I selected, among all these different, thus equally interesting entities, the company *Prada S.p.A.* to be a representative case study in order to shed light on the (positive) consequences and outcomes of taking part in the Italian *Regime di adempimento collaborativo*. Anyway, before listing the main reasons behind my choice, a brief introduction about the company's history and recent development is needed. First of all, the actual organizational form of Prada S.p.A. is relatively recent: indeed, it was first established in Italy on July 11, 1990, as a limited liability company; consequently, on November 25, 2003, it was transformed into a joint-stock company after a merger by incorporation with other companies of the Group. The company's origins, nevertheless, dates back to 1913 when a store selling leather bags, trunks, and other luxury accessories was opened in Galleria Vittorio Emanuele II, in the center of Milan, by Mr. Mario Prada – the grandfather of Ms. Miuccia Prada, the actual executive director and controlling shareholder of the company. The expansion of the Group began later in the 1970s, when Ms. Miuccia Prada entered the company's top management team, and started a collaboration with the owner of a business operating in the high-end leather goods industry: Mr. Patrizio Bertelli, who is today Prada S.p.A. chairman and controlling shareholder, as well as Ms. Prada's husband. Their partnership began to be more and more reserved, until it became exclusive in 1984. From 1986 onwards, the company opened new stores all over the world (New York, London, Paris), and at the same time expanded its product range to include also shoes and ready-to-wear fashion. In 1993, Ms. Miuccia Prada established the new fashion brand "Miu Miu", which was acquired by the Group later in 2003, and is nowadays the Group's second brand in order of number of stores opened and net revenue generated from retail sales (e.g., in the six-month period ended June 30, 2023, Miu Miu brand net revenue sales accounted for nearly 15% of the Group's total net revenues[19]). More recently, between 2003 and 2008, in the view of consolidating its distribution network, Prada S.p.A. started a corporate reorganization program which led to the concentration of all the operations of the Group in the Company and through directly controlled subsidiaries. On June 24, 2011, Prada S.p.A. successfully concluded an IPO – the largest in the world during the year 2011, considering consumer goods companies – which led to 19% of the total share capital of the Company to be listed on the Hong Kong Stock Exchange (HKSE).

[19] Prada Group. (2023). 2023 Interim Financial Report. Milan, Italy. Available at: "https://www.pradagroup.com/it/investors/investor-relations/results-presentations.html".

Nowadays, working in accordance with principles of creativity, transformation and sustainable growth, and building on the strength of a business model capable of combining skilled craftsmanship with industrial manufacturing processes in order to offer an ever-evolving variety of innovative, successful creations, the Prada Group is one of the world's leading luxury groups, embedding the renowned attention towards product quality and exclusivity, typical of the Italian manufacturing and industrial culture. Due to the particular, enduring bond existing between Prada S.p.A. and the Italian cultural, political and sociological background, I expect the effects and outcomes of the thoroughly examined legislative changes, which led to the birth of the Italian Co-operative Compliance Regime, to be more visible and appreciable than in the case of a foreign, multinational company operating in Italy for strictly economical or strategical reasons.

The main interesting characteristic of Prada S.p.A. is, anyways, the fact of being – despite its relevant size – a true family business. Indeed, while approximately 20% of the total issued capital of the Company is actually floating – consequent to the 2011 HKSE listing – the remaining 80% is owned by Prada Holding S.p.A., the holding company of Prada S.p.A., which, in turn, is controlled – indirectly – by Mr. Patrizio Bertelli and his wife, Ms. Miuccia Prada. The deemed interests of the couple in the shares of the Company, are represented in the following picture:

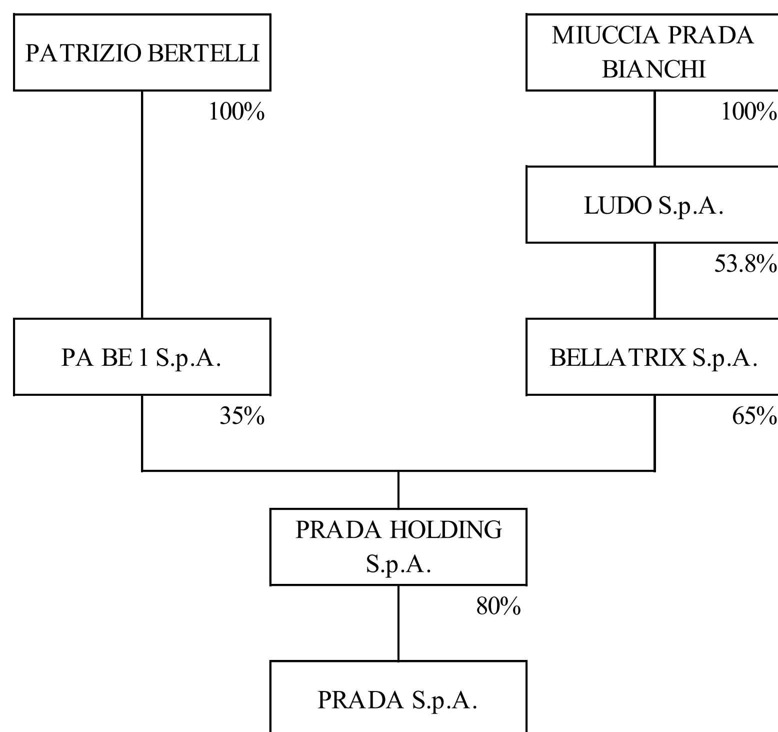

Figure 5. Prada S.p.A. ownership structure.

Moreover, the spouses are not only controlling shareholders of the Company, but are also key figures within Prada S.p.A. Board of Directors, both serving as executive directors and Mr. Bertelli holding the position of Chairman of the Board. The interests of the Prada family are undoubtedly embedded in the company, and this peculiarity give rise to the many, interesting implications investigated in section 2.4 of this paper (e.g., non-economic goals, reputational concerns) dedicated to the behavior of family firms. A particular, relatively recent episode involving Mr. Bertelli and Ms. Prada is worth being reported, as it supports the aforementioned view: in fact, as revealed on January 10, 2014 by many national and international news agencies[20], the couple were under investigation by the Italian Judicial Authority regarding the exactness of past individual tax filings with respect to foreign owned companies. At that time, indeed, Prada S.p.A. ownership structure was different from the actual illustrated above: the Company's immediate holding company was Prada Holding B.V., controlled, in turn, by Gipafin S.à.r.l.; the two entities were based, respectively, in the Netherlands and in Luxembourg, countries accused of being *tax havens*, in relation to their loose corporate taxation legislation and favorable corporate tax rates. The interesting fact, here, is that the Authority's investigation did not start *ex officio*, but as reported by Prada S.p.A. in a subsequent announcement on September 28, 2014[21], it followed "*the voluntary disclosure made by Ms. Miuccia Prada Bianchi and Mr. Patrizio Bertelli which resulted, in December 2013, in an agreement between them and the Italian Tax Authority. This agreement completely satisfied the claims of the Italian Tax Authority, as declared and confirmed by the Authority itself.*". The announcement states, also, that neither the Company nor its subsidiaries were involved in the investigation. Although the agreement led to the repatriation of the foreign owned assets – with the newborn holding company Prada Holding S.p.A. – and to all taxes owed, including interest and penalties, to be paid by the couple, this did not prevent the investigation to be carried out anyway by the Italian magistrates: later on December 5, 2016, however, news reported[22] that prosecutors in Milan, responsible for the case, asked for the procedure of alleged tax avoidance to be closed, consequently to the full payment of the tax debt. This episode clearly demonstrates a compliant, transparent attitude by Mr. Bertelli and his wife, and their willingness to reach an agreement with the Italian tax authority over relevant tax matters – rather than entering in a contentious relationship – testify to the importance given to non-economic factors, such as the

[20] D'Alessandro, M., & Binnie, I. (2014, January 10). *Prada owners under investigation for tax avoidance: sources.* Reuters. Retrieved from: "https://www.reuters.com/article/us-prada-tax-idUSBREA0912Z20140110". (Consulted October 10, 2023).
[21] Prada S.p.A. e-Announcement September 28, 2014. *Procedure by Italian Authority*. Milan, Italy. Retrieved from: "https://www1.hkexnews.hk/listedco/listconews/sehk/2014/0929/ltn20140929005.pdf".
[22] Segreti, G. (2016, December 5). *Prosecutors seek to close Prada CEO tax case: sources*. Reuters. Retrieved from: "https://www.reuters.com/article/us-prada-tax-court-idUSKBN13U24L". (Consulted October 10, 2023).

family's and the Company's reputation and image, the reach of a high degree of citizenship commitment – a matter over which Prada has always concentrated lots of resources – and the damage that would result from public condemnation. Following these assumptions, I expect to recognize a clear trend of transparency and openness in Prada S.p.A. behavior towards tax compliance, especially after their joining in the Italian Co-operative Compliance program.
Finally, furtherly supporting the argument is the fact that Prada S.p.A. has been among the first the companies to be selected in order to participate in the Regime: as reported by the Company in a press release[23] on November 9, 2017: "*Prada S.p.A. has been admitted in the Co-operative Compliance regime [...] an important objective in the project of cooperation and mutual trust that Prada has already launched with the Tax Authorities, in the growing awareness that a tax risk management process based on transparency will be beneficial to all the stakeholders of the Group.*". Actually, Prada S.p.A. is the fourth enterprise – or group of enterprises – to be admitted, chronologically, in the Italian Regime: this not only demonstrates a clear attachment and commitment of the Company to good compliance principles, but also the early application of these rules and working standards – with respect to more recent entrants – provides a larger set of information over which the aforementioned assumption could be tested.

4.2 Hypothesis development

As the reasons behind the selection of Prada S.p.A. as a case study to test the effects of the renewed framework of the tributary relationship are now clear, and considering the expected positive outcomes of the implementation of the Italian Co-operative Compliance Regime rules, I lay down my hypothesis as follows:

> *H: I expect to detect a progressive reduction in Prada S.p.A. tax gap, in the years following its admission in the Italian Regime di Adempimento Collaborativo.*

In order to test my hypothesis, I will thoroughly analyze Prada S.p.A. separate Financial Statements for the years 2016 – 2019, drafted in accordance with the international accounting principles (IAS/IFRS). Since, among the Prada Group, only Prada S.p.A. – and not its subsidiaries – is participating in the Regime, I will not take into consideration the consolidated Financial Statements of the Group, if not for reasons related to the disclosure of relevant events. Prada S.p.A. separate Financial Statements (hereafter, FS) are available in electronic format on the Group's official website, covering the years 2009 – 2022; I chose year 2016 as the starting

[23] Prada S.p.A. Press release November 9, 2017. *Prada S.p.A. ammessa al regime fiscale di cooperative compliance con l'Agenzia delle Entrate*. Milan, Italy. Unofficial translation. Original text available at: "https://www.pradagroup.com/content/dam/pradagroup/documents/Comunicati_stampa/Comunicato%20stampa_Prada%20SpA_Cooperative%20Compliance.pdf".

period of my examination because it is the first year of implementation of the Regime, and I decided to cover a four-year interval excluding years from 2020 onwards due to well-known COVID-19 implications, which would have probably led me to uncorrected and biased results. I define the above-mentioned *tax gap*, for the purposes of my study, as the *difference between the Theoretical Tax Rate (TTR) and the Current Tax Rate (CTR)*: the TTR is simply represented by the corporate tax rate prescribed by law; actually, Italian corporations are subject to two different types of income taxes: IRES (*Imposta sul Reddito delle Società)* and IRAP (*Imposta Regionale sulle Attività Produttive*)[24], which differ from each other not only for the tax rates applied to taxable income, reported in the following table, but also for the rules applied for the effective calculation of taxable income (e.g., Italian tax law may provide different rules for the deductibility/taxability of the same transactions under the two tax regimes). Relevant differences between accounting and tax rules in determining taxable income will be adequately illustrated when needed.

	2016	2017	2018	2019
IRES tax rate	27.50%	24.00%	24.00%	24.00%
IRAP tax rate	3.93%	3.93%	3.93%	3.94%
Total	**31.43%**	**27.93%**	**27.93%**	**27.94%**

Figure 6. Evolution of IRES and IRAP tax rates over the years 2016 – 2019.

The CTR, instead, is calculated as the TTR net of the positive/negative effects established by differences in accounting and tax law provisions which determine an increase/decrease of taxable income. The CTR is, in fact, the effective tax rate calculated on Prada S.p.A. taxable income determined following tax law provisions, as it results from the tax return of the Company. If no differences between accounting and tax rules were to exist (perfect book-tax conformity), the two indexes would correspond. This is not obviously the case, and, moreover,

[24]Under Italian tax legislation, corporations are subject to IRES, the main tax levied on corporate income, regulated by the Italian Income Tax Consolidation Act, known as TUIR (Testo Unico delle Imposte sui Redditi) and issued by Decree of the President of the Republic December 22, 1986, no. 917, "*Approvazione del Testo Unico delle imposte sui redditi.*" (December 31, 1986) (Italy). Gazzetta Ufficiale, (302). Moreover, any company, independently from the adopted corporate form, is subject to IRAP, a tax levied on regional basis and regulated by Legislative Decree December 15, 1997, no. 446, "*Istituzione dell'imposta regionale sulle attività produttive, revisione degli scaglioni, delle aliquote e delle detrazioni dell'Irpef e istituzione di una addizionale regionale a tale imposta, nonché' riordino della disciplina dei tributi locali.*" (December 23, 1997) (Italy). Gazzetta Ufficiale, (298). Although they share some similarities, methods of calculation of the relative taxable income for IRES and IRAP purposes are different and difficult to be compared. In addition, while IRES tax rate is the same for every corporation, IRAP tax rate is established by law at 3.9%, but Regions have the right to vary it in a range of 0.92 percentage points. The reported IRAP tax rate is that appliable to companies based in Lombardy, as Prada S.p.A. Registered Office is located in Milan.

transactions which originates these differences are subject to different degrees of disclosure: as will be shown, I will be able to determine and confirm the actual effect of the different tax treatment of certain income-related elements based only on the information contained in the FS, in particular in the Notes section, while, for other aspects, I will not be able to trace the calculations since the required information is not publicly available. I will certainly take into consideration this last aspect in assessing Prada S.p.A. general level of disclosure and transparency.

Finally, to furtherly support my analysis, I will also include the computation of the following four, popular measures of tax avoidance, reported in the figure below, which are among the most employed indexes in tax avoidance literature (Hanlon et al. (2010)) and will help me to deliver important considerations:

GAAP ETR $$\frac{\text{Total income tax expense}}{\text{Total pre-tax accounting income}}$$

Current ETR $$\frac{\text{Current income tax expense}}{\text{Total pre-tax accounting income}}$$

Cash ETR $$\frac{\text{Cash taxes paid}}{\text{Total pre-tax accounting income}}$$

Long-run cash ETR $$\frac{\Sigma\ (\text{Cash taxes paid})}{\Sigma\ (\text{Total pre-tax accounting income})}$$

Figure 7. Employed measures of tax avoidance, computation.

In summary, my analysis will be structured as follows: based on the data contained in Prada S.p.A. separate Financial Statements for the years 2016 – 2019, I will be able to depict, thanks to the implementation of the above reported measures, a general frame of reference with regard to the Company's tax position. Consequently, through the utilization of the information reported in the Notes to the Financial Statements, comprising relevant tax-related disclosure data of which I will discuss in a moment, I will be allowed to break up the positive/negative effects of different income factors on taxable income, and thus to give a comprehensive representation of all the elements capable of explaining the difference between the Theoretical Tax Rate, established by law, and the Current Tax Rate, calculated as the ratio of total income taxes for the period on the taxable income determined following tax law provisions. As will be seen, adequate information related to the composition of accounting values reported in the FS

is available for the principal factors affecting taxable income: in these cases, I will try to reconstruct the implicit steps which lead to a different fiscal evaluation of the elements reported in the books. In other cases, instead, whenever no relevant information is provided in the Notes, I will reproduce the same effects as are reported, highlighting, anyways, the need for additional explanations and making the permitted considerations. Thus, through this study, I will be able to determine whether the actual difference, over the years, between the theoretical and effective taxation of Prada S.p.A. is mainly attributable to tax advantages which are permitted by the law, and whose related elements are clear, verifiable and sufficiently disclosed, and thus are not ascribable to tax avoidance practices, or, on the contrary, are the result of tax benefits resulting from ambiguous or unexplained elements which could suggest a more or less aggressive level of tax planning. Finally, I will be able to test my hypothesis against the results of the study; however, an important consideration must be made: I adopted for my study a strict accounting perspective, and chose the *tax gap* as an indicator for tax avoidance, expecting that its evolution over the years could lead to some important conclusions over the general effectiveness of the Italian Co-operative Compliance Regime in fostering voluntary compliance and adherence to tax law provisions. Anyway, I recognize that this method of inquiry is far from being an accurate method to carefully and thoroughly evaluate the implementation of Co-operative Compliance programs, even because a similar task would necessarily go further beyond the mere values reported in the financial statements: Co-operative Compliance is a framework of relationship between the taxpayer and the tax authority; the contents of consultations, agreements and opinions over relevant tax matters are not available to the public, and is thus difficult to make any consideration on the topic from an external perspective. I have already dedicated a section of this paper to the limitations of AFIT: I admit these limitations, and I am aware of the fact that whichever would be the result of my study, it would not allow me to draw indisputable conclusions. What is certain, is that it will let the reader to take an early glimpse on the magnitude and scope of Co-operative Compliance regimes, the effects of which will be surely become more visible and appreciable in the future, thanks also to the never faded academic research interest on the topic.

One of the last, but most important things to consider before I get to the hearth of the speech is, in fact, that the feasibility of this analysis is mainly due to more than satisfactory level of tax-related disclosure that is represented in Prada S.p.A. FS, and which allows my calculations and considerations to be carried out and to be tested for against: to be clear, I report here as an example the table contained in the Company's FS for the year 2016, which shows the reconciliation between the TTR and the CTR:

(amounts in thousands of Euro)	IRES	Eff. IRES rate	IRAP	Eff. IRAP rate	Total taxation	Eff. Total rate
Theoretical tax on income before taxation	68,128	27.50%	9,736	3.93%	77,864	31.43%
Dividends exempted	(21,643)	-8.74%	-		(21,643)	-8.74%
ACE	(8,216)	-3.32%	-		(8,216)	-3.32%
Impairment adjustment to investments	6,690	2.70%	-		6,690	2.70%
Taxation of revenue allocated to OCI	(108)	-0.04%	-		(108)	-0.04%
Other permanent differences	533	0.22%	285	-0.22%	817	-0.01%
Adjustments in annual tax return "UNICO"	8,172	3.30%	583	0.24%	8,755	3.54%
Difference between income before taxation and net value of production	-		224	0.10%	224	0.10%
Taxes for period	53,556	21.62%	10,828	4.05%	64,384	25.67%
Temporary differences	(12,762)	-4.76%	(1,062)	-0.43%	(13,824)	-5.19%
Current taxation	40,794	16.86%	9,765	3.61%	50,559	20.48%

Figure 8. Table reproduced without modification from Prada S.p.A. 2016 FS.[25]

The same table – along with many other, useful tax-related disclosure elements – which is, in fact, provided for by IAS 12 *Income Taxes*, paragraph 81, (c), (i), is then presented again in the following years, and constitutes the starting point of the following analysis: the first row of the table reports the total tax for the period, calculated on the accounting income reported in the Statement of Profit or Loss. Then, the subsequent rows highlight the elements which determine a difference between accounting income and taxable income, and can be split into permanent differences and temporary differences, of which I have already discussed in Chapter 1. Finally, the algebraic sum of the positive/negative effect on taxation of each factor determines the current taxation for the period.

4.3 Financial Statements analysis

In order to give a preliminary view on Prada S.p.A. tax position, I start my analysis by computing the four tax avoidance indexes, reported in Figure 7 above, based on the values reported in the FS for the years 2016 – 2019. The results are presented in Table 1: Income before taxation and Total income taxes are those reported, for each year, in the Company's Statement of Profit or Loss. Moreover, Notes on taxation provides the distinction between Current taxes, Prior year taxes and Deferred taxes. Net income taxes paid, instead, are those

[25] Prada S.p.A. (2017) *Separate Financial Statements 2016*. Milan, Italy. Available at: "https://www.pradagroup.com/content/dam/pradagroup/documents/Financial-Report---presentation/2_FULL-YEAR-2016-results----12-Apr-2017/e-Separate%20Financial%20Statements%202016.pdf"

reported in the Statement of Cash Flows. The subsequent measures are computed for every period on the corresponding values; Long-run cash ETR is calculated as the sum of cash taxes paid on the sum of total pre-tax accounting income on a five-year period, and values from prior years included in the calculation are reported in the consecutive table.

	2016	2017	2018	2019
Income before taxation	247,738,976	207,615,956	766,822,290	200,462,038
Total income taxes	64,383,515	46,061,991	58,274,094	(48,565,350)
of which:				
Current taxes	43,456,000	49,331,000	58,829,000	32,772,000
Prior year taxes	7,103,000	(5,780,000)	(1,627,000)	(79,678,000)
Deferred taxes	13,824,000	2,511,000	1,072,000	(1,656,000)
Income taxes paid, net	54,769,000	0	21,870,000	0
GAAP ETR	25.99%	22.19%	7.60%	-24.23%
Current ETR	17.54%	23.76%	7.67%	16.35%
Cash ETR	22.11%	0.00%	2.85%	0.00%
Long-run cash ETR	36.67%	30.70%	20.24%	12.62%

Table 1. Measures of tax avoidance calculated for each reporting period.

	2012	2013	2014	2015	2016	2017	2018	2019
IBT	456,148,000	591,935,000	547,562,372	348,852,533	247,738,976	207,615,956	766,822,290	203,372,362
Net taxes paid	207,215,000	189,909,000	204,745,000	147,325,000	54,769,000	-	21,870,000	-
L-R cash ETR					36.67%	30.70%	20.24%	12.62%

Table 2. Accounting values used in the calculation of Long-run cash ETR (five-year period).

The initial situation depicted in Table 1 exhibit a clear, diminishing trend for nearly all the calculated indexes: above all, GAAP ETR shows a strong reduction, in particular in the years 2018 and 2019. The negative ratio reported in year 2019 is the consequence of a significant tax benefit recognized in the last period and relative to the years from 2015 to 2019, as can also be deduced from the negative value of Prior year taxes, and will be furtherly analyzed later. For the same reason, Current ETR index exhibits a more stable trend, since it is not influenced by taxes relative to prior years but only by current taxes. The numerator of Cash ETR, instead, is represented by the amount of the disbursement during the period relative to income taxes, net of potential prepayments or refunds from prior years: the presence of tax credits or advance tax payments, indeed, influences the actual payments made during the year, with the result that if no cash disbursement is registered in the period, the corresponding value of the measure is zero. Long-run cash ETR, on the other hand, is partially capable of counter-balancing this effect by taking into consideration income taxes paid over a longer period, thus partially eliminating the volatility of its single-period counterpart. The same decreasing trend is however apparent also

in this last measure. Results of this first analysis, which employs the values reported in the books, are far from being comforting: if no other information about the accounting numbers were available, a hasty conclusion may be that of Prada S.p.A. exhibiting a clear aggressive tax planning attitude. Nevertheless, as argued in Hanlon & Heitzman (2010), most of the measures employed in the tax avoidance literature are able to capture only so-called *non-conforming* tax avoidance, which refers to those transactions, which may be related to tax avoidance, that are accounted for book and tax purposes in a different manner: thus, values of indexes reported in Table 1 are surely influenced by relevant book-tax differences, which, thanks to the appropriate disclosure related to taxation, I am able to break up and control for.

4.3.1 BTDs decomposition: dividends

The following sections are dedicated to the decomposition of the main factors which originates relevant book-tax differences, and thus influence the determination of taxable income for the relative reporting period. The first income-related element analyzed, due also to the magnitude of its effects on Prada S.p.A. total corporate taxation, are dividends received from controlled entities: in fact, Prada S.p.A. operates through a structure which comprises more than forty, directly controlled subsidiaries, whose periodical earnings distribution constitutes a distinctive contribution to the Company's total revenues: still, under Italian tax law, dividends, and more in general every form of earnings distributed by corporations, do not constitute taxable income for the receiving corporation in relation to 95% of their total amount; in other words, only 5% of collected dividends are subject to corporate tax, according to paragraph 2 of article 89, TUIR. An important difference to pay attention to, is that dividends reported in the Company's FS are those actually *deliberated* by subsidiaries during the reporting year; the tax norm, instead, refers to dividends actually *collected* during the tax period, irrespective, on the contrary, of the date of earnings distribution approval. Some exceptions are made to this general provision: paragraph 2-bis of article 89, indeed, provides for the full taxability of distributes earnings whenever relative to stocks, shares or similar financial instruments held for trading, applying only to entities which prepare their financial statements according to IFRS. Again, article 47, TUIR, governs the tax treatment of earnings distributed by Controlled Foreign Companies (CFC): it establishes that dividends received from foreign controlled entities located in countries with privileged tax regimes – whose criteria of definition are contained in articles 47 bis and 167, TUIR – participates entirely to the determination of taxable income. The following table illustrates the effects of the different treatment of dividends for book and tax purposes: the starting point of the calculation is the value of the Effect of dividends on taxable income

(IRES), as reported by Prada S.p.A., for each period, in the taxation section of the Notes to the financial statements, in the table of reconciliation between the TTR and the CTR of which Figure 8 above constitutes an example. This crucial value represents the *actual tax saving* deriving from the non-taxability of dividends received from subsidiaries, following the above-mentioned provisions: thus, by dividing the numerical outcome by the corresponding corporate tax rate, I am able to trace the value of the deduction from accounting income; moreover, by comparing the resulting deduction with the reported total amount of dividends received, I can determine the actual portion of dividends subject to corporate taxation[26]. For each period, the total amount of dividends received from subsidiaries is reported; the Theoretical taxable amount is computed by multiplying the non-deductibility rate (.05) for the total amount of dividends: it represents the taxable amount that would result if all dividends were subject only to the general provision of paragraph 2, article 96, TUIR. The Taxable amount represents, instead, the actual taxable portion of total dividends, computed by subtracting the actual deduction from the Total dividends. Redetermined income is then calculated on Income before taxation, as reported in Table 1, minus the corresponding actual deduction for tax purposes.

	2016	**2017**	**2018**	**2019**
Income before taxation	247,738,976	207,615,956	766,822,290	200,462,038
Total dividends	80,739,514	24,779,000	603,102,126	48,741,382
Theoretical taxable amount	4,036,976	1,238,950	30,155,106	2,437,069
Taxable amount	2,036,976	1,238,950	31,496,772	2,437,069
Redetermined income	169,036,438	184,075,906	195,216,936	154,157,725
GAAP ETR	38.09%	25.02%	29.85%	-31.50%
Current ETR	25.71%	26.80%	30.14%	21.26%
Theoretical tax rate (IRES)	27.50%	24.00%	24.00%	24.00%
Effect of dividends on taxable income (IRES)	(21,643,000)	(5,650,000)	(137,185,000)	(11,113,000)
% effect of dividends on TTR	-8.74%	-2.72%	-17.89%	-5.46%
Current Tax Rate (IRES)	18.76%	21.28%	6.11%	18.54%

Table 3. Effects of dividends exemption on taxable income.

[26] A numerical example should clarify any doubt (amounts are reported in Euro): I start from the absolute value of the tax saving generated from dividends exemption, reported for each period in the Notes to the FS. As can be seen in Figure 8, column “IRES”, row “Dividends exempted”, the numerical value for year 2016 is 21,643,000. By dividing it by the 2016 IRES tax rate, .275, I obtain the (rounded) value of 78,701,818, which represents the corresponding deduction from accounting income before taxes. By subtracting it to the total amount of dividends received – 80,739,514 – I am able to obtain the actual portion of total dividends subject to taxation, 2,036,976. Calculated values are, however, slightly approximated due to rounding, since the value of tax savings are reported in thousands of Euros.

I choose to include also the recalculation of GAAP ETR and Current ETR indexes, by substituting, in the denominator, Income before taxation with the Redetermined Income measure, which takes into account the effect of dividends exemption: although, obviously, the indexes lose their significance, since they are conceived to be calculated on book values, it is interesting to note – by simply comparing the recalculated measures with the correct ones reported in Table 1 – how much these measures are influenced by book-tax differences: indeed, only by controlling for the effect of earnings distribution, the situation depicted in the first instance changes profoundly. By analyzing in detail the single periods, I am able to highlight some differences between the Theorical taxable amount of dividends – where all dividends are assumed to benefit from a 95% exemption – and the actual Taxable amount – calculated on accounting values. While for the years 2017 and 2019 the two measures match perfectly – meaning that all dividends are actually treated pursuant to the provision contained in paragraph 2, article 89, TUIR – the same cannot be said for the other periods, which suggest instead the presence of some exceptions to the general provision. Although it is not possible to obtain absolute certainty about the reason which determine the highlighted differences, since the necessary information – the tax return – is not available for consultation, I can anyway try to find a plausible explanation. Considering year 2016, I can easily determine the difference between the Theoretical taxable amount and the actual one: 2,000,000. By subsequently dividing the calculated difference by the non-deductibility rate (.05), I obtain the gross value of the dividend(s) determining the difference: 40,000,000. Now, I am able to compare this value with the table of allocation of dividends received from subsidiaries, contained in Prada S.p.A. FS for the year 2017 and reported in Figure 9 below:

(amounts in thousands of Euro)	December 31 2017	January 31 2017
Artisans Shoes S.r.l.	(903)	(739)
PRADA Far East II S.r.l.	-	(40,000)
PRADA Japan Co Ltd	(2,571)	-
PRADA Sa	(20,000)	(40,000)
Sitoy Group Holdings Ltd	(670)	-
TRS New Zealand Pty Ltd	(634)	-
Total	(24,779)	(80,739)

Figure 9. Allocation of dividends by counterparty, comparison of years 2016 – 2017.[27]

[27] Prada S.p.A. (2018) *Separate Financial Statements 2017*. Milan, Italy. Available at: "https://www.pradagroup.com/content/dam/pradagroup/documents/Shareholderinformation/2018/inglese/e-Separate%20Financial%20Statements%202017.pdf"

As can be seen from the prospectus, for the year 2016 (period ended January 31, 2017) two subsidiaries – Prada Far East II S.r.l. and Prada SA – deliberated a distribution of dividends equivalent to Euro 40,000,000 – the same value calculated above. Following this line of reasoning, I can argue that – almost certainly – one of the two reported dividends were not subject to corporate taxation. Furtherly supporting this assumption is the fact that, as reported in Prada S.p.A. Notes to the FS for the year 2017, the subsidiary Prada Far East II S.r.l. "*was absorbed into PRADA spa, with a retroactive effective date of February 1, 2017 for accounting and tax purpose*": this could suggest that the subsidiary's deliberated 2016 dividend was not effectively paid to the Company, due to the subsequent incorporation, and thus, Prada S.p.A. did not subject the corresponding value to taxation. However, as far as this argument could seem appropriate, I am not able to actually check for its effective correctness, due to the lack of required information. The difference between the Theoretical taxable amount and the actual amount for the year 2018 highlights, instead, the opposite difference, equal to Euro (1,341,666): here, the actual taxable amount is higher than the theoretical one; this means that one or more deliberated dividends did not benefit from the 95% exemption, but were on the contrary subject to full taxation or to a lesser degree of deductibility. In order to verify this conjecture, I investigate the corresponding table of dividends allocation included in Prada S.p.A. Notes to the FS for the year 2018[28], and the related disclosure. Results are presented in Table 4:

Subsidiary	Country	Dividends	Recalculated TTA
Artisans Shoes S.r.l.	Italy	1,635,000	81,750
Prada Asia Pacific Ltd.	Hong Kong	575,335,000	28,766,750
Prada Japan Co., Ltd.	Japan	4,689,000	234,450
Prada Retail Malaysia Sdn	Malaysia	1,049,000	52,450
Prada SA	Luxembourg	15,000,000	750,000
Prada Sweden AB	Sweden	968,000	48,400
Sitoy Group Holdings Ltd	Hong Kong	632,000	632,000
TRS Hong Kong Ltd	Hong Kong	2,986,000	149,300
TRS New Zealand Pty. Ltd	New Zealand	109,000	5,450
TRS Singapore Pte Limited	Singapore	700,000	35,000
Total		603,103,000	30,755,550

Table 4. Allocation of dividends for the year 2018.

[28] Prada S.p.A. (2019) *Separate Financial Statements 2018*. Milan, Italy. Available at: "https://www.pradagroup.com/content/dam/pradagroup/documents/Shareholderinformation/2019/inglese/e-Separate%20Financial%20Statements%202018.pdf"

For each subsidiary, the country where the registered office is located is reported, as well the corresponding amount of dividends deliberated. The last column shows the recalculation of the Theoretical taxable amount, reported in Table 3, following some personal intuitions: in fact, as evidenced in Prada S.p.A. Notes to the FS for the year 2017 at the paragraph "Investments in associates", the participation of the Company in Sitoy Group Holdings Ltd share capital is represented by "*a 4.88% stake [...] whose shares were acquired when PRADA Far East II srl was absorbed into the Company*", and the relative investment value is reported under the entry "Investments available for sale"; recalling the provisions of paragraph 2-bis, article 89, TUIR, I can argue that the corresponding dividend of Euro 632,000 deliberated by the subsidiary whose shares were held for trading, was subject to full taxation. Again, the reason why I included subsidiaries' country of residence is related to the other afore-mentioned exception provided for by article 47, TUIR: indeed, since the majority of the above-listed entities are located in foreign countries, provisions on privileged tax regimes must be applied; in particular, article 47-bis, TUIR establishes that a country's tax regime is considered favorable, and, as consequence, dividends from subsidiaries located thereto are fully taxable, if the two following conditions, contained in paragraph 4, article 167, TUIR are met:

- Foreign controlled entities are subject to a less than half level of effective taxation than the one that would otherwise be incurred if they were located in Italy;
- More than one third of realized revenues are attributable to specified non-operating activities (e.g., interest income, dividends, leasing income).[29]

Moreover, even if these conditions should be met, subsequent paragraph 5 provides for the possibility for the taxpayer to consult the Italian Revenue Agency, by the means of the ruling institute, in order to demonstrate that an actual economic activity, through the use of staff, equipment and properties, is carried out by the foreign controlled entity. In addition to this, taxpayers participating in the Italian Co-operative Compliance Regime are allowed to ask the Revenue Agency for the disapplication of the discipline in any case, independently from the existence of the conditions set forth in paragraph 4. Effectively verifying the criteria for the application of the provision contained in article 47, TUIR, is a nearly impossible task to achieve in the view of the scarce additional information available; the only reference to the afore-mentioned discipline is contained in Prada S.p.A. Notes to the FS for the year 2017, where it is stated that: "*PRADA Spa provided exhaustive disclosure of the accounting and tax effects of the Italian tax authorities' dismissal of PRADA spa's petition to not apply the Controlled Foreign Company ("CFC") rules to its Dutch sub-holding company, PRADA Far East bv (spun*

[29] See letter b), paragraph 4, article 167, TUIR for the complete list.

into Prada Far East II srl and then absorbed into PRADA spa), and of the inadmissibility of the petitions filed with the same authorities regarding other subsidiaries of the Group operating in countries with privileged tax systems". This last sentence suggests a possible litigation between Prada S.p.A. and the Revenue Agency over the correct interpretation of the CFC discipline, and is indeed confirmed by the following statement, reported from the Company's Notes to the FS for the subsequent year: "*On April 23, 2018, pursuant to its adherence to the Cooperative Tax Compliance program [...] PRADA spa signed a formal agreement with the Italian Revenue Agency to reciprocally waive continuation of the disputes initiated in the past by PRADA spa regarding the dismissal or inadmissibility of petitions filed to not apply Controlled Foreign Company ("CFC") rules*". Contents and subject of such petitions are obviously unknown to the general public, and is thus not possible to trace the precise and actual calculation of taxable dividends for the year 2018.
Finally, the percentage effect of dividends is reported in the lower section of Table 3, representing the abatement in the TTR due to the near-total exemption of dividends income. By subtracting the relative effect of dividends on taxation from the TTR, I am able to determine the CTR, which measures the effective tax burden borne by the Company. All the considerations made this far are relative only to IRES corporate tax: dividends, in particular, are not considered in the calculation of Value of production for IRAP purposes; in any case, the impact of factors which are accounted for by both IRES and IRAP discipline will be treated separately, in order to avoid possible confusion due to the different rules which govern the regimes.

4.3.2 Allowance for Corporate Equity (ACE)

Dividends, analyzed so far, and more in general every form of earnings distribution, are a common income element which could be found in most corporations' financial statements. This section, instead, is dedicated to a discipline which leave no trace on the firm books: in fact, the ACE (*Aiuto alla Crescita Economica – Allowance for Corporate Equity*) – introduced with article 1, Decree-Law December 6, 2011, no. 201[30] – is a facilitative measure instituted with the aim to incentivize enterprises capitalization by reducing the differences between debt and equity financing. The incentive takes the form of a deduction from taxable income corresponding to a notional component representing the return on corporate equity. In practice,

[30]Decree-Law December 6, 2011, no. 201, "Disposizioni urgenti per la crescita, l'equità e il consolidamento dei conti pubblici." (December 6, 2011) (Italy). Gazzetta Ufficiale, (284).

increases in corporate equity with respect to its reported value at the closing of the period in progress at December 31, 2010, constitutes, for each entity subject to the discipline, the ACE calculation basis. Then, for each subsequent reporting period, the ACE incremental basis is determined by adding/subtracting to the ACE calculation basis the value of positive/negative changes on equity occurred during the year. For the purposes of the discipline, positive changes are represented by *cash* increases in equity – contributions in kind are excluded – and profits allocated to reserves; negative changes, instead, are constituted by every decrease in equity with the simultaneous distribution of profits to shareholders, even in the case of distributions in kind[31]. Finally, the ACE incremental basis calculated at the end of each period is multiplied for the ACE rate, which is determined every year by the means of a Ministry of Economics and Finance Decree; the result represents the notional return on corporate equity that the enterprise is allowed to deduct from taxable income; moreover, if the value of ACE deduction should exceed taxable income of the reporting period, the law allows the surplus to be carried forward over the following tax years. The illustrated steps are exemplified in the next table:

Equity value at December 31, 2010	1,000,000
Increases in Equity	500,000
Decreases in Equity	(300,000)
Equity value at December 31, 2011	1,200,000
ACE calculation basis	200,000
2011 ACE rate	3%
2011 ACE deduction	6,000

Table 5. ACE deduction calculation example.

The ACE deduction is the result of an extra-accounting calculation, and thus it does not affect values reported in the books; anyway, if adequate information is provided about the changes occurred in corporate equity during the period, the calculation of the ACE incremental basis can be traced for each year. This is the case of Prada S.p.A., which thanks to the disclosure

[31]Rules of application are reported in accordance with article 5, Ministry of Economics and Finance Decree of March 14, 2012, "*Disposizioni di attuazione dell'articolo 1 del decreto-legge 6 dicembre 2011, n. 201 concernente l'Aiuto alla crescita economica (Ace)*" (March 19, 2012) (Italy). Gazzetta Ufficiale, (66).

provided in Notes to the FS, allowed me to verify the correctness of the reported effects of ACE deductions on corporate taxation. Results are presented in the following tables:

	2016	2017	2018	2019
Income before taxation	247,738,976	207,615,956	766,822,290	200,462,038
ACE theoretical incremental basis	628,968,000	604,438,000	568,067,000	1,102,231,000
ACE rate	4.75%	1.6%	1.5%	1.3%
ACE deduction	29,876,000	9,671,000	8,521,000	14,329,000
Redetermined Income	217,862,976	197,944,956	758,301,290	186,133,038
Theoretical tax rate (IRES)	27.50%	24.00%	24.00%	24.00%
Effect of ACE on taxable income (IRES)	(8,216,000)	(2,321,000)	(2,045,000)	(3,439,000)
% effect of ACE on TTR	-3.32%	-1.12%	-0.27%	-1.69%
Current Tax Rate (IRES), cumulative	15.45%	20.16%	5.84%	16.84%

Table 6. Effects of ACE deduction on taxable income.

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Net result allocation	98,220,000	227,049,000	283,510,000	395,574,000	385,429,000	248,421,000	183,355,000	161,554,000	708,548,000
Other movements	206,631,000			(3,514,000)		(15,089,000)	80,290,000		4,533,000
Dividends paid	(35,000)	(127,941,000)	(230,294,000)	(281,471,000)	(281,471,000)	(281,471,000)	(307,059,000)	(191,912,000)	(153,529,000)
Net effect	304,816,000	99,108,000	53,216,000	110,589,000	103,958,000	(48,139,000)	(43,414,000)	(30,358,000)	559,552,000
ACE calculation basis	304,816,000								
ACE incremental basis		403,924,000	457,140,000	567,729,000	671,687,000	623,548,000	580,134,000	549,776,000	1,109,328,000
% difference on ACE theoretical incremental basis						0.87%	4.19%	3.33%	-0.64%
ACE deduction						29,618,530	9,282,144	8,246,640	14,421,264
Redetermined Income						218,120,446	198,333,812	758,575,650	186,040,774
Effects of ACE on taxable income (IRES)						(8,145,000)	(2,228,000)	(1,979,000)	(3,461,000)
% effect of ACE on TTR						-3.29%	-1.07%	-0.26%	-1.70%

Table 7. Calculation of ACE incremental basis based on values reported in the Statements of Changes in Equity for each reporting period.

Table 6 calculations are similar to those presented in Table 3 above: I start by dividing the reported effect of ACE on taxable income by the TTR, and thus I am able to determine the corresponding ACE deduction. Then, by dividing this last measure by the ACE rate determined for the period, I find the ACE theorical incremental basis, that is, the theorical value of the sum of the yearly changes in the value of Prada S.p.A. corporate equity from 2011 onwards. As shown in Table 7, in order to verify the correctness of this measure, I report the positive and negative variations in equity for each fiscal year; since elements included in the entry Other movements are not furtherly disclosed, I am not able to control for values possibly not accounted for the calculation of the ACE incremental basis. The sum of the reported changes in equity is contained in the Net effect, which constitutes the ACE calculation basis for the year 2011, and is then subsequently added or subtracted in the following years in order to determine the ACE incremental basis for the period. Concerning the years from 2016 to 2019, the percentage differences between the ACE incremental basis, determined in accordance to the calculations reported above, and the one reported in Table 6 is calculated, exhibiting a slightly difference in each period, in particular regarding years 2017 and 2018. Nevertheless, I estimate again the Redetermined income measure by subtracting the recalculated ACE deduction from Income before taxation, in order to determine its absolute and percentage effects on taxable income and on the TTR. Finally, by comparing the results of my calculation with the values reported in Prada S.p.A. Notes to the FS, I am able to verify their correctness: despite the calculated measures do not exactly match the reported ones, this small difference is attributable to rounding of values reported in the books and to elements accounted under the entry Other movements, which I considered in my calculation even though they may represent variations not accounted for the ACE discipline. The CTR reported in Table 6 is a cumulative measure, which takes into consideration also the previous percentage variation due to the effect of dividends exemption.

4.3.3 Impairment adjustment to investments

The last factor I am going to analyze, determining relevant book-tax differences and influencing Prada S.p.A. corporate taxation, is represented by the impairment adjustments to investments. This particular accounting practice is governed by IAS 36 *Impairment of Assets*, aiming to ensure that the value at which an asset is recognized after deducting any accumulated depreciation (*carrying amount*) does not exceed its recoverable amount, that is "*the amount to be recovered through use or sale of the asset*". If an entity carries assets at more than their recoverable amount (and thus are categorized as *impaired*), the Standards provides for the

recognition of an equivalent *impairment loss*. Minimum, although not exhaustive indications that an asset may be impaired and its recoverable amount should be determined are given, ranging from external information (e.g., the asset value has declined more than predicted), internal information (e.g., obsolescence, visible damage) and particular evidence on investments in subsidiaries, JV and associates.

Under Italian law, article 13-bis of Decree-Law December 30, 2016 no. 244 amended paragraph 1, article 83, TUIR and introduced into the Italian legislation the principle of "*reinforced derivation*" (*derivazione rafforzata*), under which it is provided that qualification, time allocation and classification criteria set forth by accounting principles apply also in derogation of the provision contained in the TUIR. Nevertheless, the Italian legislator has provided some exceptions to this general principle: one, in particular, is related to write-downs due to impairment test results – the above-mentioned *impairment losses*, and their eventual reversal – in fact, as the impairment test represents a merely evaluative process, article 101, TUIR continue to apply, according to which assets write-downs are irrelevant for the determination of taxable income, since they constitute unrealized losses. The following tables summarize the effects on Prada S.p.A. taxation of the non-deductibility of impairment losses recognized in each reporting period:

	2016	2017	2018	2019
Income before taxation	247,738,976	207,615,956	766,822,290	200,462,038
Theoretical impairment losses	(24,327,000)	(33,633,000)	(33,004,000)	(32,663,000)
Redetermined Income	272,065,976	241,248,956	799,826,290	233,125,038
Theoretical tax rate (IRES)	27.50%	24.00%	24.00%	24.00%
Effect of non-deductibility of IA on taxable income	6,690,000	8,072,000	7,921,000	7,839,000
% effect of impairment adjustment on TTR	2.70%	3.89%	1.03%	3.85%
Current Total Rate (IRES), cumulative	18.15%	24.05%	6.88%	20.70%

Table 8. Effects of non-deductibility of Impairment Adjustments on taxable income.

	2016	2017	2018	2019
PP&E	(2,485,000)	(2,247,000)	(983,000)	(105,000)
Intangibles			(78,000)	
Investments	(22,017,000)	(31,450,000)	(26,315,000)	(32,622,000)
Total impairment losses	(24,502,000)	(33,697,000)	(27,376,000)	(32,767,000)
Redetermined Income	272,240,976	241,312,956	794,198,290	233,229,038
Effect of non-deductibility of IA on taxable income	6,738,000	8,087,000	6,570,000	7,864,000
% effect of impairment adjustment on TTR	2.72%	3.90%	0.86%	3.87%

Table 9. Calculation of total impairment losses for the period.

Table 8 reflects the methods of calculation employed earlier: Theoretical impairment losses value is calculated by dividing the reported effects of the non-deductibility of assets write-downs by the corresponding tax rate. Write-downs are reported with negative sign since they represent losses, but are then added in the calculation of Redetermined Income for the reasons highlighted above: in fact, reported absolute and percentage effects on taxation are positive, since the unrecognized losses constitute additional taxable items of income. Table 9, instead, calculates the Total impairment losses for the period by summing up all the results of the impairment tests carried out by Prada S.p.A., on the different assets categories which fall under the provisions of IAS 36, as they are reported in the Notes to the FS. The corresponding recalculation of the Redetermined Income measure and the relative effects on taxable income and TTR are reported in the final part of Table 9. By comparing the results of my calculation with those reported in the Company's FS, I am able to recognize a partial correspondence between the two, except for the year 2018; the differences recognized in the other reporting periods are however very limited.

In accordance with the general provisions described above, it is important to note that Italian tax law still allows for the deductibility of assets write-downs recorded in the Statement of Profit and Loss but not deducted for fiscal purposes, through a particular mechanism respecting certain boundaries[32]: In fact, as provided for by paragraph 2, article 102, TUIR, assets depreciation charges are deductible within the limits of the application to their historical cost of the amortization coefficients prescribed by the law, and depreciation deduction is allowed, pursuant to paragraph 4, article 109, TUIR, up to the corresponding value reported in the P&L Statement. The write-down recovery for tax purposes, thus, will be allowed starting from the years subsequent to its recognition in the P&L Statement, within the limits of the difference between the new value of accounting depreciation (calculated on the historical cost of the asset net of the corresponding write-downs) and the value of fiscal depreciation calculated on the historical cost of the asset, gross of any results recognized from impairment tests. In light of these considerations, I am able to partially justify the differences reported above, explainable by the different timing of deductibility of assets write-downs for accounting and tax purposes.

4.3.4 Non-disclosed factors

[32]Rules for the application of the mentioned provisions are contained in Italian Revenue Agency (2013). Resolution no. 98/E/2013, December 19, 2013. Rome, Italy: Italian Revenue Agency. Available at: "https://def.finanze.it/DocTribFrontend/getContent.do?id=%7B26177958-900B-4497-BB6B-B7C51BF8CFA6%7D".

While the previous sections have been dedicated to the decomposition of book-tax differences impacting Prada S.p.A. taxable income, for which the related disclosure provided in the Notes to the Financial Statements of the Company allowed me, as an outside observer, to (partially) verify for the correctness of the data reported in the tax-related disclosure – highlighting also a fair degree of transparency from Prada and the application of compliance-oriented reporting practices – the following table summarizes the effects of those factors for which no adequate information about is available in the Company's FS, and is thus not possible to assess the elements these effects originates from.

	2016	2017	2018	2019
Taxation of revenue allocated to OCI	(392,727)	(308,333)		
Effect of taxation of revenue allocated to OCI	(108,000)	(74,000)		
% effect of taxation of revenue allocated to OCI on TTR	-0.04%	-0.04%		
Other permanent differences	1,938,182	(30,995,833)	(10,641,667)	(74,883,333)
Effect of other permanent differences	533,000	(7,439,000)	(2,554,000)	(17,972,000)
% effect of other permanent differences on TTR	0.22%	-3.58%	-0.33%	-8.83%
Adjustments in annual tax return	29,716,364	(20,658,333)	(5,266,667)	(308,641,667)
Effect of adjustments in annual tax return	8,172,000	(4,958,000)	(1,264,000)	(74,074,000)
% effect of adjustments in annual tax return on TTR	3.30%	-2.39%	-0.16%	-36.36%
Temporary differences	(12,762,000)	(2,531,000)	(877,000)	996,000
% effect of temporary differences on TTR	-4.76%	-1.22%	-0.10%	0.45%
Cumulative effect of non-disclosed values	8,597,000	(12,471,000)	(3,818,000)	(92,046,000)
% cumulative effect of non-disclosed values on TTR	-1.29%	-7.23%	-0.60%	-44.74%

Table 10. Effects of non-disclosed factors on taxable income.

Taxation of revenue allocated to Other Comprehensive Income (OCI) refers to revenues and gains that have yet to be realized, and thus are excluded from the computation of taxable income; the related effects are almost negligible and are present only in the first and second period. On the other hand, relevant effects of Other permanent differences (OPD) and Adjustments in the annual tax return are reported, in particular for the year 2019: since, however, Prada S.p.A. tax returns are not available to the public, there is no way to trace the factors that originated the reported effects. With respect to the last observed period, a reference to the huge tax benefit recognized is made in the following statement contained in Company's Notes to the FS for the year 2019[33]: "*The income tax for the period benefitted from the recognition of income of Euro 100 million, which was the tax relief for the four years from 2015*

[33]Prada S.p.A. (2020) *Separate Financial Statements 2019*. Milan, Italy. Available at: "https://www.pradagroup.com/content/dam/pradagroup/documents/Shareholderinformation/2020/inglese/april/e-prada%202019%20SFS.pdf".

to 2019 pursuant to the signature of the [...] Patent Box. In this respect, on July 1, 2019 PRADA spa and the Italian Tax Authority ("Ufficio Accordi Preventivi") stipulated an agreement for the tax benefit regime regarding income deriving from the use of qualifying intangible assets". The Patent Box regime, firstly introduced by paragraphs 37-45, article 1 of Law December 23, 2014 no. 190[34] (2015 Italian Bill), and subsequently amended by article 6, Decree-Law October 21, 2021 no. 146[35], provided for, in its first formulation, a partial income tax exemption for revenues derived from the use of specific intangible assets, such as industrial patents, software, know-how, industrial designs and models. The income tax exemption is recognized in an amount equal to 30% for the year 2015, 40% for the year 2016 and 50% for 2017 onwards, calculated on revenues deriving from the use of subsidized intangible assets multiplied for the *nexus ratio*[36]. The option for the application of the Patent Box regime is exercised in the tax return, it is irrevocable and valid for the fiscal year in which it is communicated and for the subsequent four periods. In particular cases, the law provides for the signing of a ruling agreement between the taxpayer and the Revenue Agency in order to determine and specify the calculations criteria of the economic contribution to the production of business income of subsidized assets. The benefit recognized to Prada S.p.A., as the Company states, amounts to Euro 100 million and relates to years 2015 – 2019, following the stipulation of an agreement with the Preliminary Agreements Office of the Italian Revenue Agency on July 1, 2019. Since no more information about the contents of the Patent Box regime application is given in the Notes to the FS, it is not possible to isolate the benefit directly related to this relevant tax relief which allowed Prada S.p.A. to significantly lower its actual tax burden. Moreover, effects of the Patent Box regime are reported gross of other adjustments in the Company's tax return.

4.4 Final results

Finally, after having dealt with all the factors determining relevant book-differences and influencing Prada S.p.A. average level of corporate taxation, Table 11 below presents the overall results of my analysis for all the investigated periods, showing the reconciliation

[34] Law December 23, 2014 no. 190 "*Disposizioni per la formazione del bilancio annuale e pluriennale dello Stato (legge di stabilità 2015)*". (December 29, 2014) (Italy). Gazzetta Ufficiale, (99).
[35] Decree-Law October 21, 2021 no. 146 "*Misure urgenti in materia economica e fiscale, a tutela del lavoro e per esigenze indifferibili*". (October 21, 2021) (Italy). Gazzetta Ufficiale, (252).
[36] Provisions for the calculation of the *nexus ratio* are contained in paragraphs 2-5, article 9, Decree of the Ministry of Economic Development, in consultation with the Ministry of Economics and Finance, November 28, 2017, "*Revisione del regime di tassazione agevolata dei redditi derivanti dall'utilizzo di software protetto da copyright, di brevetti industriali, disegni e modelli, nonché di processi, formule e informazioni relativi ad esperienze acquisite nel campo industriale, commerciale o scientifico giuridicamente tutelabili*". (February 6, 2018) (Italy). Gazzetta Ufficiale, (30).

between the Theoretical Tax Rate and the Current Tax Rate for IRES purposes. Table 12, instead, presents the same exact calculation with respect to IRAP taxation.

	2016	2017	2018	2019
Theoretical Tax Rate (IRES)	27.50%	24.00%	24.00%	24.00%
% effects on TTR:				
Dividends	-8.74%	-2.72%	-17.89%	-5.46%
Aid to Economic Growth (ACE)	-3.32%	-1.12%	-0.27%	-1.69%
Impairment adjustments to investments	2.70%	3.89%	1.03%	3.85%
Revenue allocated to OCI	-0.04%	-0.04%		
Other permanent differences	0.22%	-3.58%	-0.33%	-8.83%
Adjustment in annual tax return	3.30%	-2.39%	-0.16%	-36.36%
Temporary differences	-4.76%	-1.22%	-0.10%	0.45%
Current Tax Rate (IRES)	**16.86%**	**16.82%**	**6.28%**	**-24.04%**

Table 11. Reconciliation of Prada S.p.A. TTR and CTR for IRES purposes.

	2016	2017	2018	2019
Theoretical Tax Rate (IRAP)	3.93%	3.93%	3.93%	3.94%
% effects on TTR:				
Other permanent differences	-0.22%	-0.07%	-0.07%	1.63%
Adjustment in annual tax return	0.24%	-0.40%	-0.04%	-5.86%
Difference between IBT and net value of production	0.10%	0.68%	-2.63%	0.96%
Temporary differences	-0.43%	0.01%	-0.03%	-0.15%
Current Tax Rate (IRAP)	**3.62%**	**4.15%**	**1.16%**	**0.52%**

Table 12. Reconciliation of Prada S.p.A. TTR and CTR for IRAP purposes.

At first sight, presented results are clearly contesting my hypothesis and the opposite situation is actually represented: although Prada S.p.A. CTR exhibits a slightly increase in the first two periods – considering the drop in the TTR from 27.5% to 24% between 2016 and 2017 – its relevant decrease reported in the following years is anything but in line with what I initially expected. Nevertheless, as it is explicitly noticeable by comparing with each other the percentage effects on the Company's TTR reported in Table 12, the corresponding lowest values of the CTR calculated for the years 2018 and 2019 are the results of the negative incidence of the effect of dividends – for the year 2018 – and of both OPD and adjustments in annual tax return – which comprises the tax benefit related to the Patent Box regime – for the last period. Following these considerations and based also on the fact that the mentioned effects exhibit abnormal values if compared with prior years, and thus can be considered as outliers, I am able to verify again my initial conjecture on a hypothetical scenario. In order to test whether

my first assumption could be validated in the absence of outliers, I recalculate and then substitute the reported percentage effects, for the corresponding years, with their average value. Results are presented in the following tables:

	2014	2015	2016	2017	2018	2019
% effect of dividends on TTR	-4.44%	-3.15%	-8.74%	-2.72%	-17.89%	-5.46%
Average 4-years value for 2018					**-4.76%**	
% effect of OPD on TTR	1.62%	0.37%	0.22%	-3.58%	-0.33%	-8.83%
Average 5-years value for 2019						**-0.34%**
% effect of adjusments in annual tax return	0.09%	-0.59%	3.30%	-2.39%	-0.16%	-36.36%
Average 5-years value for 2019						**0.05%**

Table 13. Calculation of the average value of outliers on prior years.

	2016	2017	2018	2019
Theoretical Tax Rate (IRES)	27.50%	24.00%	24.00%	24.00%
% effects on TTR:				
Dividends	-8.74%	-2.72%	**-4.76%**	-5.46%
Aid to Economic Growth (ACE)	-3.32%	-1.12%	-0.27%	-1.69%
Impairment adjustments to investments	2.70%	3.89%	1.03%	3.85%
Revenue allocated to OCI	-0.04%	-0.04%		
Other permanent differences	0.22%	-3.58%	-0.33%	**-0.34%**
Adjustment in annual tax return	3.30%	-2.39%	-0.16%	**0.05%**
Temporary differences	-4.76%	-1.22%	-0.10%	0.45%
Current Tax Rate (IRES)	**16.86%**	**16.82%**	**19.41%**	**20.86%**
Tax gap	10.64%	7.18%	4.59%	3.14%

Table 14. Recalculation of Prada S.p.A. corporate tax rate reconciliation.

Regarding the average values of outliers reported in Table 13, I tried to include in the calculation as many years as possible; however, although the Company's separate FS are available also for prior periods, the table of reconciliation between the TTR and the CTR – showing the decomposition of each single effect on corporate taxation – is included only in the FS from 2014 onwards. For this reason, the mean of the percentage effect of dividends is calculated on a four-year horizon (from 2014 to 2017), while for the other measures the prior five years are considered. The calculated average of outliers is then substituted to their corresponding values in the years 2018 and 2019, and the resulting CTR is reported. In order to highlight the considerable differences with the prior, actual tax position of the Company, and to give my hypothesis a partial confirmation, the *tax gap* is calculated for each period, showing a stable, although slightly decrease. Finally, as a way to furtherly support the above considerations, I calculate the Long-run GAAP ETR and the Long-run current ETR as shown in Table 15 below:

Year	Income Before Tax	Income taxes	Current taxes
2011	344,369,000	105,370,000	
2012	456,148,000	167,851,000	
2013	591,935,000	196,361,000	
2014	547,562,372	162,133,289	163,070,000
2015	348,852,533	100,431,715	103,093,000
2016	247,738,976	64,383,515	43,456,000
2017	207,615,956	46,061,991	49,331,000
2018	766,822,290	58,274,094	58,829,000
2019	200,462,038	(48,565,350)	32,772,000
L-R GAAP ETR		**22.96%**	
L-R current ETR			**19.43%**

Table 15. Calculation of Long-run GAAP ETR (years 2011 – 2019) and Long-run current ETR (years 2014 – 2019).

The Long-run GAAP ETR is calculated as the sum of total income taxes divided by the sum of Income before tax as reported in Prada S.p.A. separate FS, for the years from 2011 to 2019. The Long-run current ETR, instead, is calculated on a shorter period (2014 – 2019) due to the availability of tax-related disclosure in the Company's FS of which I spoke earlier. To conclude, I compare these calculated measures with the actual CTR reported in Table 11 and the recalculated values reported in Table 14, and thus I am able to confirm that the decrease of the current tax rate exhibited in the last periods of my investigation are mainly attributable to the above-average effect of dividends exemption for the year 2018, and of OPD and adjustments in annual tax return, directly related to the Patent Box tax incentive, for the year 2019. Moreover, the factors considered – dividends income and the Patent Box exemptions – are subject to constant control and evaluation from the Italian Revenue Agency, as can be deduced from the Company's Notes to the FS and furtherly presumed in virtue of the participation of Prada S.p.A. in the Italian Co-operative Compliance regime, and thus no evidence is given about the fact that these factors could be related, even only in small part, to tax avoidance practices.

CONCLUSIONS

Tax avoidance is much like an *asymptomatic disease*: while its harmful consequences – such as the diversion of government financing resources, or the creation of unfair competitive advantages in the market, to mention a few – are of great concern for governmental and supranational institutions all over the world, much less clarity about the determinants of detrimental non-compliant behavior is at disposal, in particular regarding the sources which can constitute irrefutable evidence of such an attitude.

The first part of the paper has highlighted, by analyzing the developments and the directions of recent tax avoidance research, the main factors identified in the literature which may encourage firms to engage in aggressive tax planning practices: however, although the topic has received increasing attention from researchers in the last decades – in particular in the accounting field – many divergences and disagreements still characterize the debate. The AFIT literature alone, as seen, suffers from many limitations, of all the lack of reliable, publicly available information about the actual tax position of the firm. Scholars have long argued the need for a more accurate and exhaustive disclosure from businesses' perspective, and even though, in recent years, international regulations have contributed to increase the quality of tax-related information contained in companies' financial statements, a fully transparent and qualified disclosure level is still far from being achieved.

An important breakthrough in tax avoidance studies, indeed, is represented by the increasing contributions that different disciplines, like economics, finance and law fields gave to the argument, allowing to extend the scope of the research to those determinants which leave no trace on the firm's books, but surely exert significant influence over the managerial decision-making process. In this view, I gave particular attention to the *non-tax trade-offs* body of literature and to the *agency view of tax avoidance*, which represent meaningful contributions to the general understanding of the pitfalls of the tax avoidance dilemma. Moreover, research considerations on the distinctive behavior of family firms furtherly supported the relevance of non-economic utilities and socio-economic factors in shaping firms' attitude and engagement in tax avoidance practices. Following these intuitions, I argue that the *antidote* to tax avoidance should be able to act over those determinants which could encourage a voluntary, deliberated compliance to tax law provisions, and to prevent the adoption of aggressive tax schemes and mechanisms.

For too long, tax authorities have focused their efforts in the deterrence and strict prosecution of non-compliant behavior, concentrating on the enforcement of increasingly complex tax systems and contributing to give an adversarial nature to their historical obligation-based

relationship with taxpayers. This approach, however, has proven over time to be insufficient in order to contrast elusive behavior of firms, and the need to reconsider the basic relationship between taxpayers and revenue bodies started to take shape in the intentions and proposals of policy makers and intergovernmental organizations all over the world: the prominent work of the Organization for Economic Co-operation and Development, started in the early 1990's and still active nowadays, testifies to the willingness of worldwide regulators to develop a new framework of relationship between taxpayers and tax authorities inspired to principles of trust, reciprocal co-operation, openness and voluntary disclosure. In this view, the result of the pivotal role played by the OECD is, in fact, the establishment of the general principles of reciprocity and legal certainty on which the *Co-operative Compliance Framework* is based on, and the clear definition of the characteristics of the essential *Tax Control Framework*. The adoption of OECD's guidance in many countries, including Italy, highlighted a fair degree of first reception from the interested parties: moreover, as seen in the course of the paper, each country implemented the *Framework* guidelines in slightly different ways, based on the peculiar characteristics of their national taxation system.

The analyzed peculiarities of the Italian *Regime di adempimento collaborativo*, finally, demonstrate the concrete possibility to build a tributary relationship – in particular with large taxpayers – inspired to good compliance principles, and the careful analysis of the participating company *Prada S.p.A.* represents my effort to bring some further positive evidence on the matter. However, despite the more than adequate and increasing level of disclosure recognizable in the Company's Financial Statements, which allowed me to decompose and control for many factors influencing its actual tax position, very little references are made with respect to the outcomes of the participation in the *Regime*, making it quite impossible to reach any judgement or consideration over the topic. Extant literature, in addition, has not provided yet careful examinations and evaluations of Co-operative Compliance regimes outcomes, since, as predictable, the more qualitative than quantitative nature of the involved characteristics makes related research a difficult task, which will need, in the future, different methods of analysis in order to provide thoughtful studies of the framework implementation.

The last aspect to consider, to conclude, is that Co-operative Compliance regimes, in nearly all the adhering countries, are at the early stages of their application: the more information about will be available in the future, coming also from the desired extension of the framework to a greater number of parties, the less arduous will be to evaluate if, finally, taxpayers' and governments are on the right path to achieve their long-sought reconciliation.

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