Problems of Knowledge Transfer in the Field of Taxation

MONIKA ŠESTÁKOVÁ
Vysoká škola manažmentu, Bratislava, Slovakia

Abstract: The purpose of the paper is to reduce the gap in the literature on taxation, where problems of knowledge management, knowledge transfer and knowledge sharing are scarcely analyzed. In the author's opinion, the basic reason behind this situation is the fact that interrelations between the main players in the field (tax authorities, tax payers, national governments, etc.) are based more on rivalry than on cooperation. It's believed that benefits of some players can be achieved just to

the detriment of others. Moreover, there is no institution that could be responsible for knowledge management and transfer in this field. Three levels of knowledge transfer in the taxation will be analyzed: inter-governmental knowledge sharing - learning from other countries' experience in fiscal policy; vertical communication channels within individual countries´ fiscal policy; horizontal knowledge transfer between business units (and inside business units), including the role of consulting companies.

Keywords: up Tax system; role of knowledge in taxation; knowledge transfer and knowledge sharing in the field of taxation; inter-governmental knowledge sharing; vertical and horizontal communication channels. semicolon.

1 Introduction

Tax systems design, administration and tax compliance at all levels are certainly knowledge demanding activities. However, knowledge management issues and knowledge transfer in the mentioned area (especially tacit knowledge sharing) are scarcely analyzed in the literature and are not sufficiently supported by official tax policies. Taxation – which is very important for governments, sub-central fiscal authorities, businesses and all citizens – is a complex reality in search of a supporting knowledge management theory.

In the author's opinion, the basic reason behind this situation is the fact that the interrelations between the main players in the field of taxation (national tax authorities, subnational fiscal bodies, tax payers, etc.) are based more on rivalry than on cooperation. It's widely believed that increasing benefits to one group of players can be achieved just at the detriment of others. Trust, which is a precondition of effective knowledge sharing, (especially tacit knowledge sharing) is often missing. Moreover, there is no institution that will be motivated and empowered to take the role of a knowledge manager in the global taxation framework. Supranational authorities (e.g. OECD or EU) try to achieve some coordination and support knowledge transfer between countries on taxation issues. However, without national governments' motivation and support, their vision of fiscal harmonization seems unrealistic.

In the following parts (subchapters) of the paper, three levels of knowledge transfer in the field of taxation will be analyzed and commented on:

a) Inter-governmental exchange of information (between tax authorities of different countries), with a special role of the EU authorities in the field;

b) Vertical communication channels within individual countries (between tax authorities and tax payers), including communication channels under the fiscal decentralization scheme. Also, the importance of bottom-up knowledge flow will be emphasized;

c) Horizontal communication channels between organizations (businesses, consulting companies providing services in the field of taxation) and intra-organizational flow of knowledge (e.g. between tax specialists in the company and other departments).

2 Inter-governmental knowledge transfer in the area of tax policy

Basic "units" in the world of taxation are individual countries' (national) tax systems. Governments regard independent fiscal policy as the key element of their economic sovereignty and are not willing to accept limitations of this right. However, in the world of increasing interdependence of individual countries and economic agents (tax payers) and intensifying digitalization, which rapidly increases the speed and technical possibilities of knowledge transfer, absolutely independent fiscal policy (and tax policy as its part) is an illusion. This is especially true for the European Union.

The current EU taxation framework leaves Member States free to decide on their tax systems provided they comply with European Union (EU) rules. Those rules are adopted unanimously by the Council. The development of EU tax provisions is linked with completion and proper functioning of the single market, with indirect taxes addressed earlier and more in-depth than direct taxes.

National tax systems face stronger competition as a result of the globalization of the economy. Tax competition favors certain taxpayers to the detriment of others, and the same holds true for Member States when they compete in taxation to attract investors. This is a barrier not only to proper functioning of the single market in the EU but often also to effectiveness of countries' own fiscal policies (harmful tax competition, corporate profit shifting to countries with more liberate tax systems, unregulated transfer pricing policy by TNCs, etc.). Globalization and digitalization both trigger a need to update and adapt tax systems. They offer the opportunity to modernize tax systems generally considered as complex and consequently having a side effect of creating undesirable potential for tax avoidance and evasion (European Parliament, 2015).

Taking-up this challenge requires more intensive and broader knowledge sharing between countries, especially between EU member states. A lot of data on individual countries' tax systems, tax revenues and tax structure in the EU as a whole are officially published. Tax databases are formed also at the OECD level (OECD 2017). This explicit knowledge is available to all players in the world of taxation and can be used by governments to optimize their tax policies. It is difficult to estimate how much of this information is actually used and how much countries actually learn from other countries' experience.

Tax policy is at a crossroads: it remains a national matter but requires increasing cooperation and coordination at EU and international level to address specific issues and challenges. It seems that although, for a long time, national governments have been against more strict tax harmonization proposals, recently they are more willing to cooperate to combat tax evasion and tax fraud.

OECD has done a lot of work not only in defining and analyzing aggressive tax planning practices. It has detected a lot of aggressive tax planning techniques applied by internationally active companies and published a directory of over 400 aggressive tax planning schemes submitted by member countries. This is just one of the important materials available to governments, a source of knowledge that has become explicit on the basis of processing tacit knowledge collected from individual countries that were willing to cooperate. OECD has published a lot of reports and materials explaining why reforms in taxing multinational enterprises are important for all countries; it suggests measures to close gaps in international tax rules that allow multinational enterprises to legally but artificially shift profits to low or no-tax jurisdictions (e.g. BEPS - base erosion and the profit shifting initiative). OECD also initiates and supports multilateral conventions and forums for knowledge transfer between governments - e.g. a document *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*, which was signed on June 7, 2017 by over 70 Ministers and other high-level representatives (OECD 2017). A lot of interesting data and suggested measures have been published also on transfer pricing policy, which is an important form of profit shifting and tax base manipulations (PKF 2017).

From the knowledge management point of view, these materials represent a huge complex of data that can be analyzed by appropriate KM techniques, and individual countries can determine what correlations and trends are of key importance and topical for their tax policy plans. Intensive knowledge transfer between countries and in-depth research performed by experts from the OECD Centre for Tax Policy and Administration have been the background of these publications.

Experience from the recent years shows that intergovernmental knowledge transfer (and knowledge sharing between official statistical institutions of different countries) can work effectively *if the governments are interested in the cooperation*, and it works in the sphere where they trust each other (or at least regard the exchange of information as mutually beneficial). All governments, in principle, are motivated to reduce tax avoidance and fraud, to improve the mechanism of collecting taxes.

However, the need of knowledge transfer between countries (connected with taxing issues) is important also in other areas where it is difficult to achieve a consensus. Knowledge flow is very important for the whole complex of the so-called *tax spillovers issues*, meant as the impact of one country´s international tax policy on other countries. Potential economic implications of international tax spillovers thus go well beyond tax revenue, with wider implications for the broader level and distribution of welfare across nations (IMF, 2014).

Published data on taxation are explicit knowledge, available to anybody who is interested. However, a lot of tacit knowledge is still behind the published figures. This is especially important for corporate income taxes. Tax rates are known, but the details of forming the tax base, treating intra-corporate debt, forms of transfer pricing policy especially in intangibles and intellectual assets (that are difficult to objectively measure), amounts of provided and planned tax allowances as the form of government aid to investors, etc. are not known. These forms of tax rules (direct and indirect) can play an important role in the tax competition between countries. However, in principle, governments are not willing to share the knowledge in this field.

In the practice of fiscal policy, it is usually assumed that sharing additional knowledge about taxation issues would be at least a zero-sum game, where the knowledge receiver (seeker) will gain at the detriment of the knowledge provider (source), and the additional information can be misused. However, unwillingness to share information may lead to losses at both sides, and, on the other hand, knowledge sharing can be mutually beneficial. Knowledge sharing (including tacit knowledge sharing) can help to improve the mechanism of collecting taxes, better monitor the transfer pricing policy of companies, adjust rules of forming the tax base in a way that will be advantageous also for local companies (improving business environment), forecast impact of planned changes in the tax rules, etc.

Governments will probably never accept the full harmonization of tax systems. Even if the formal rules are the same, there will still be differences in practical approaches. However, a lot can be done in deepening and widening the mutual communication and knowledge transfer. International institutions and researchers can significantly contribute not only to conversion of so far tacit knowledge into explicit knowledge (by publishing additional data based on individual countries´ experience) but also to creating new tacit knowledge, e.g. by improving methodology of research, etc.

3 Vertical knowledge transfer between tax authorities and tax payers

In individual countries´ tax systems, the basic form of knowledge transfer is top-down communication between the tax authority (central through lower levels bodies) to tax payers. Sometimes, this is the only way of communication with a significantly authoritarian approach. The central authority publishes legal norms and interprets them, which is also important because of frequent changes in the legislation. Feedback from lower levels (bottom-up flow of information) is scarcely used. Lower level players in the tax system are just supposed to comply. In some cases, tax payers´ requirements and comments can be interpreted by particular bodies (e.g. employers´ associations) and negotiated with the government. Sometimes, the formal representation is missing (small businesses, citizens), or some official communication exists, but cannot be regarded as knowledge flow between equal partners (e.g. knowledge transfer in the framework of the fiscal decentralization – IMF, 2017).

Top-down knowledge transfer within individual tax systems cannot be regarded just as explaining taxation rules and requirements. It should perform also an educational function. Central tax authorities should explain to lower level and decentralized authorities the rationale for tax changes, details of compliance requirements, which can include some tacit knowledge. The lack of this communication can lead to problems in the working of tax systems – as the case of Slovakia shows (Jakubek et al., 2016). On the other hand, some bottom-up knowledge transfer, as feedback helping to improve the tax legislation, is also very important. In some countries, a *lack of IT skills* of particular groups of tax payers can also be a barrier.

Tax authorities sometimes require a digital form of reporting and communication, which presents a serious problem for some small businesses. Improving IT skills of the population (especially those that are not included in the formal education) is an important educational role of the government, relevant not only in the field of tax policy but also in other forms of policy. e-government projects can´t properly function without this education.

There are many unsolved problems in vertical communication flow within tax systems, and further research could significantly contribute to mapping these problems and suggesting potential solutions. Organizations that possess a lot of important explicit and tacit knowledge in the field are *consulting companies* providing services in the area of accounting and taxation. Although their primary function is cooperation with business organizations (mainly large companies), they publish and disseminate a lot of knowledge that is important also for the national economy as a whole (Erst & Young 2011; PKF, 2017, etc.). Unfortunately, this knowledge is hardly used in the government´s economic policy.

4 Horizontal (intra-organizational and inter-organizational) knowledge transfer in the field of taxation

The bulk of the literature on knowledge flows and knowledge management regarding taxation deals with these issues at the level of corporations. This is quite natural. Taxes that companies should pay can influence a firm’s operating and financial decisions not only by direct imposition of the tax itself but also indirectly through associated compliance costs. Firms can attempt to reduce the impact of taxation, both through tax planning and by ensuring that compliance-related tasks are carried out efficiently (Haseldine et al. 2009, p.7).

An interesting theoretical approach to the mentioned issues is the concept of the so-called *market for tax knowledge*. Basic participants in the tax system are regarded as market players. Processes by which taxpayers become aware of tax legislation and other tax-related information are called *tax knowledge* (Haseldine et. al., p.7-11). A tax authority is the producer and seller of this knowledge. Tax payers, basically companies, are the buyers of tax knowledge. Consulting companies providing services in the field of accounting and taxation are brokers that intermediate the transactions. At various stages, the parties’ roles may change; for example, in some settings, corporate taxpayers may act as knowledge suppliers to accountancy firms acting as knowledge buyers. The central tax authority can also be a “buyer” of tax knowledge (in its role of determining whether taxpayers have complied with legislation and when it is looking for feedback from the tax system participants in the assessment of the existing and proposed legislation and administrative processes).

This model is very interesting and inspiring. Although the market in this model does not correspond, in many aspects, to the traditional working of competitive markets (just the relations between consulting companies and corporations are actual market relations), it makes it possible to include and analyze motivation, tactics and strategy of basic participants in a tax system. Primarily, the model is oriented towards inter-organizational relations and knowledge transfer, but it is possible to apply it also at the intra-organizational level (e.g. knowledge sharing between tax experts and nonfinancial operational decision makers in a company). An advantage of this model is also the fact that it makes it possible to include all types of tax knowledge buyers, not just transnational companies and their tax planning policies (as mentioned in the first part of our paper).

The application of the market for tax knowledge model in research performed in the U.K. has led to conclusions that are in principle relevant also to tax systems in other countries, including Slovakia (compare Jakubek et. al., 2016).

Companies included in the survey (together 218 respondents) mention official documents of the central tax authority (websites, newsletters, etc.) as the basic source of tax knowledge. Direct communication with tax authorities is regarded as weak, and if some knowledge sharing with tax authorities occurs, it is motivated basically by attempts to achieve financial or reputational benefits (about 10-11 % of respondents). It can be assumed that this motivation is typical basically for large companies. Maybe the understanding of tax rules is better in developed market economies (in comparison with Slovakia or other new EU member states). Consulting firms are significantly helping in practical application of the tax knowledge.

However, a tax authority can be regarded as a heterogeneous complex, including lower level officials and decentralized decision makers in the framework of fiscal decentralization (Jakubek et a. 2016, IMF 2017), and officials at these levels may negatively evaluate the role of the central tax authority in knowledge sharing. These issues are not addressed in the U.K. survey.

The role of consulting companies as tax advisers has not been sufficiently analyzed in European literature. The U.K. research brings some interesting findings in this area. More than 90 % of respondents agree or strongly agree that tax advisers are an important source of tax knowledge for their organization. It is interesting that the importance of cooperation with external tax advisers varies, in some regard, in the internal tax knowledge management system in the company. If the company has got some internal tax specialists, its dependence on external advisers is lower, and lower is also the willingness to share some internal accounting and tax information with external parties.

In all countries´ tax systems, top-down knowledge transfer from the tax authority to consulting companies (tax advisers) is important. Consulting companies must respect the law and advise in such a way that clients´ decisions comply with the law. However, an interesting finding of the U.K. research is that also a tax authority regards the knowledge transfer from consulting companies (bottom-up) as useful and takes it into account in forming a tax policy. This lesson can be learnt by many countries.

In the *intra-company tax knowledge management systems*, it is important to consider the degree of interaction between taxation and operational decision making within a company. According to majority of respondents, tax awareness of non-financial decision makers is poor. This is probably true for many countries. According to the U.K. survey, it is disappointing that just one third of operating managers seek knowledge from internal taxation experts although they (operating managers) are evaluated on the basis of criteria reflecting taxation (revenue after taxes, etc.). On the other hand, the influence of internal tax experts on operating decision making is not significant either. It seems that internal tax knowledge flows do not work appropriately.

From the knowledge management point of view, capturing internally generated tax knowledge is an important role of the tax function. However, only minority of companies have either formal (30.5 %) or informal (48.8 %) procedures designed to capture this knowledge. One of the basic conclusions of the U.K. research is that "Corporate taxpayers should consider their need for tax knowledge management in the wider context of decision making in general" (Haseldine et al. 2009, p.29).

At the level of multinational corporations and their tax planning, a neglected topic of knowledge management and tax knowledge management literature is *the transfer pricing knowledge management system* (Plesner Rosing – Pearson, 2014). Although the transfer pricing policy has been intensively addressed in materials published by international organizations and discussed in the public policy, a theoretical analysis of the activities that a multinational enterprise (MNE) performs in order to create, organize and transfer knowledge for meeting transfer pricing objectives is missing. Such theory could actually contribute to improving the interrelation between taxation and operating decisions of a company.

The aim of the transfer pricing knowledge management is to ensure that knowledge of the historical and future transfer pricing practices of the MNE is captured, organized and transferred in a transparent and logical manner to those who need it, when they need it. Basically, knowledge captured in these systems is explicit knowledge structured for potential users (including external tax inspectors). MNEs usually give high priority to the ability to demon¬strate that their transfer pricing positions are set and doc¬umented in compliance with the local tax laws and transfer pricing practices are accepted by local tax authori¬ties. Tacit knowledge, which is also important in transfer pricing policy, is more difficult to formulate, and companies are often unwilling to make it accessible to external users.

The transfer pricing database of a company is based on internal accounting information but includes also many types of transfer pricing-related material that go beyond the core accounting data, such as: inputs from operational staff during functional analyses; stra-tegic/operational business documents; intercompany invoices; experience from transfer pricing audits and lit¬igation; learning from external transfer pricing network meetings and conferences; conclusions from meetings with tax authorities and external advisers, etc. Experience of MNE employees at both the central and decentralized organizational levels is also an important source of knowledge. Even MNE employees, besides those directly involved in transfer pricing activities, such as business operational staff, will – over time – generate knowledge that adds to the MNE transfer pricing knowledge base.

The literature on transfer pricing has been growing rapidly during the recent years. This trend is not just a response to increasing globalization and intensive competition. This is also a result of a "race" between two groups of knowledge seekers in the field : regulators (national, but mainly supranational bodies), which try to map and identify the recent techniques of transfer pricing used by MNEs and formulate rules, or at least recommendations, for national governments to monitor this policy and adjust national tax regulation and, on the other hand, MNEs, which have to improve their transfer pricing policy to meet new challenges and simultaneously are confronted with more sophisticated regulators and tax inspectors that are able to discover some deeper and confidential background of a transfer pricing policy. MNEs also have to respond to new demands of regulators and innovate methods of their transfer pricing policy. Of course, tax knowledge of regulators is different in different countries and must be of an interdisciplinary character (to better understand also technological aspects of MNEs' activities and their value chains).

5 Conclusion

Literature on taxation, both at the theoretical level and in practical policy, is very rich. However, problems of transferring knowledge, and especially tacit knowledge sharing, have been addressed scarcely. The process of globalization and digitalization has provoked more interest in the knowledge transfer in this field because of the need to somewhat regulate multinational companies´ policies in the field of profit shifting and tax base manipulation. Inter-governmental knowledge transfer in this area is supported by international institutions (OECD, IMF, EU). However, many governments are not willing to cooperate or do not use sufficiently available databases.

Vertical knowledge transfer from the top (central tax authorities) to the lower levels (tax payers) has traditionally been the basic knowledge flow in individual tax systems. The more digitalization is applied to the tax policy, with increasing complexity of tax rules, the more of the educational function of the tax communication comes to the fore. Central authorities have to explain new tax compliance requirements and help improve IT knowledge of some taxpayers. Bottom-up knowledge transfer (feedback from taxpayers) is also important.

The most developed problem area in the literature on tax knowledge management is the horizontal communication within business organizations (e.g. between tax specialists and other managers), which is supposed to contribute to optimization of tax burden and improving methods of tax compliance. In the horizontal communication between organizations, the role of consulting companies is important..

Literature

1. ERST & YOUNG, 2011. *Managing Global Tax Reporting Challenges*.
2. EU, 2016. *Political Economy of Tax Reforms*. Proceedings of the workshop organised by the Directorate General for Economic and Financial Affairs (DG ECFIN) held in Brussels on 19 October 2015.
3. EU, 2017. *Taxation Trends in the European Union*.
4. European Parliament, 2015. *Tax Policy in the EU. Issues and Challenges.EPRS (European Parlamentary Research Service)*. February 2015.
5. HESELDINE, J. - HOLLAND, K. – VANDER, RIJT, P., 2009. *The Management of Tax Knowledge. ACCA Research Report 112.*
6. IMF, 2014. *Spillovers in International Taxation. IMF Policy Paper*, May 9, 2014.
7. IMF, 2017. *Fiscal Decentralization and Fiscal Policy Performance*. IMF Working Paper.
8. JAKÚBEK, P. – TEJ, J. – LAJČIN, D. – GABRHELOVÁ, G., 2016. Perception of the Reform of the Tax System in the Slovak Republic by Business Entities and Financial Administration In: *Ekonomický časopis (Journal of Economics) 2016*, N.8, pp.751-767.
9. OECD, 2017. Tax Database – published annually.
10. OECD, 2017. OECD Work on Taxation 2016-2017.
11. PLESNER ROSING, CH. and PEARSON, C. T., 2014. *Transfer Pricing Knowledge Management*. In: *INTERNATIONAL TRANSFER PRICING JOURNAL* (July- August 2014).
12. PKF, 2017. Worldwide Transfer Pricing Guide 2017.
13. SAAD, N., 2014. *Tax Knowledge, Tax Complexity and Tax Compliance: Taxpayers' View*. Paper presented at the 2nd World Conference on Business, Economics And Management -WCBEM 2013.
14. TARC (Tax Administration Research Centre), 2014. The Definition, Measurement, and Evaluation of Tax Expenditures and Tax Reliefs. Available at: https://tarc.exeter.ac.uk/publications/reports/.

Contact data:

Assoc.prof. Monika Šestáková, DrSc.
Vysoká škola manažmentu v Trenčíne/City University of Seattle
Panónska cesta 17
851 04 Bratislava, Slovenská republika
msestakova@vsm.sk