

# Final Report

Implementation of a Horizontal Monitoring Model by the Bulgarian Revenue Agency

**Technical Support Instrument**

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# 1 Summary

In the period June 14, 2021 – August 14, 2023, the National Revenue Agency (NRA) in cooperation with a KPMG team of local and international experts implemented a project "Implementation of a Horizontal Monitoring Model by the Bulgarian Revenue Agency". The project was funded by the Directorate-General for Structural Reform Support (DG REFORM) of the European Commission.

This resume summarizes the activities carried out, the results achieved, the good practices developed, and the lessons learned within the framework of the project.

## 1.1 Project context

In 2008, the Organization for Economic Co-operation and Development (OECD) began to promote the idea of stimulating the voluntary fulfilment of tax obligations by large taxpayers and the need to restore trust between business and the tax administration. At the global level, it is increasingly recognized that traditional restrictive control measures are not sufficient to deal with new trends and that the relationship between tax authorities and taxpayers must be based on trust and cooperation to improve voluntary tax compliance.

Following these new trends to build cooperative relationships with large taxpayers and in order to manage the new globalization challenges, the National Revenue Agency has also taken initiatives related to the promotion of voluntary compliance. One of these initiatives is related to the development and implementation of an innovative approach for working with large taxpayers in Bulgaria, based on the so-called "horizontal monitoring model" (HMM), in addition to traditional control activities. This model of voluntary cooperation is expected to promote efficiency in the tax administration and bring benefits to both the administration and large taxpayers.

The tailor-made HMM for the Bulgarian Revenue Administration was developed under the Technical Support Instrument (TSI) of the European Commission. The project aims to help the National Revenue Agency (NRA) develop a new approach to work with large taxpayers to achieve a higher level of voluntary tax compliance and increase the level of trust and cooperation. The project also contributes to achieving the general goal of institutional and administrative structural reforms in Bulgaria, as well as structural reforms to achieve sustainable growth of the country.

The Bulgarian National Revenue Agency was project beneficiary. NRA's "Risk Management" Directorate was the main driver of the project and bore the responsibility for its management and implementation on behalf of NRA. The Horizontal Monitoring Model teams (HMM Teams) in the NRA Territorial Directorate "Large Taxpayers and Insurers" (TD "Large Taxpayers and Insurers") lead the actual implementation of the HMM.

## 1.2 Brief presentation of the horizontal monitoring model tailor-made for Bulgarian Revenue Agency

The Horizontal Monitoring Model is based on mutual trust between taxpayers and the NRA and provides opportunities for systematic legal enforcement and compliance. As a result, the relationship and communication between taxpayers and the National Revenue Agency become equal (horizontal) and shift the focus of the control process from subsequent to preventive, from mostly subsequent control measures to preliminary monitoring, conversations and consultations.

The HMM is based on the key principles of voluntary participation, commercial awareness, legality, equality, impartiality, proportionality, mutual trust, openness and responsiveness, voluntary and timely disclosure of information. An integral part of the model is the Tax Control Framework (TCF), covering company's tax strategy, documented tax policies and procedures, documented work processes, code of conduct, defined responsibilities and roles, tax risk management and monitoring.

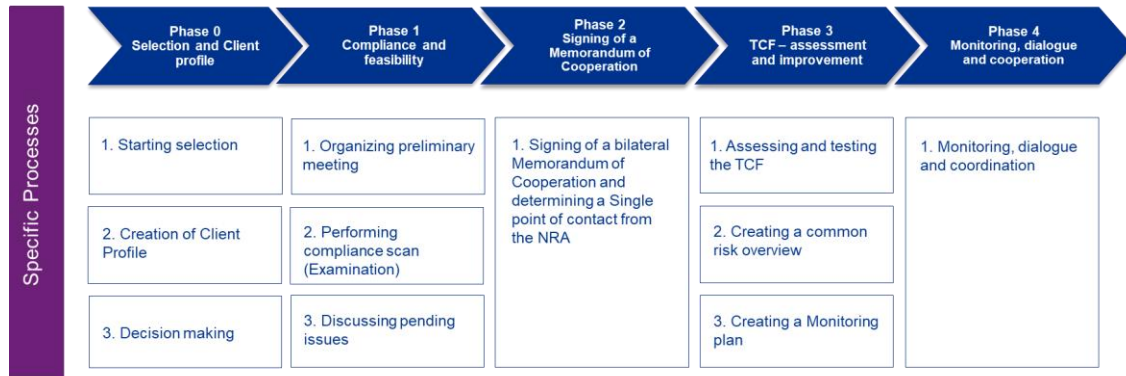
The main members of the team and leaders of the entire HMM process are experts from the Territorial Directorate "Large Taxpayers and Insurers", and if there is a justified need for the implementation of certain phases of the HMM process, supporting experts from the directorates "Risk Management", "Control", "Double Taxation Agreements", "Tax Insurance Methodology", "Appeal and Tax Insurance Practice" and "Communications" are also involved. Tax experts (so-called "Client Coordinators") have also been nominated; they will be a single point of contact between the National Revenue Agency and large taxpayers participating in the model.

The HMM covers the following types of taxes and insurances that fall under the competence of the National Revenue Agency: value added tax (VAT), corporate tax, withholding tax, tax on expenses, personal income tax, as well as issues related to transfer pricing and mandatory insurance legislation.

Initially, the HMM will be accessible to companies that meet the following conditions: a non-financial enterprise which falls into the category of large enterprises as specified in Section I, Chapter Two of the Accountancy Act and is a large taxpayer registered with NRA's Territorial Directorate "Large Taxpayers and Insurers".

Interested applicants should be target group companies that meet all of the following conditions: companies that fulfil their tax and social security obligations in good faith; companies that have set up or are in the process of developing their Tax Control Framework; and companies that wish to work openly and in cooperation with the NRA and are willing to be transparent about their internal control environment.

The Horizontal Monitoring Model consists of five main phases:



**Selection and client profile:** Upon receiving an application from a company, the NRA will set up a client profile including the necessary data and documents to check if the company meets the entry conditions.

**Compliance and feasibility:** Together with representatives of the company, the NRA monitoring team will carry out a feasibility assessment of the HMM for the applicant company.

**Signing a bilateral Memorandum of Understanding:** A memorandum expressing the aligned will of the parties to cooperatively work together under the model with a clear definition of responsibilities will be signed.

**Tax Control Framework:** Together with representatives of the company, the horizontal monitoring team will assess and test the effectiveness and reliability of the company’s internal control environment and tax controls.

**Monitoring, dialogue and cooperation:** This is the operational phase of the model, in which the company and the HM team will actively interact and cooperate with each other to reach decisions on tax and social security issues arising in the course of the current taxation term, before the actual filing of the tax return. This phase will also include monitoring of the tax risks identified in the assessment of the TCF.

The Horizontal Monitoring Model is a voluntary process. HMM applicants or participating companies may withdraw their applications for entry or, respectively, resign from participation in the model at any time. Similarly, the NRA may at any time decide to terminate the HMM process/implementation with a company if that company does not act in accordance with the grounding principles and objectives of the HMM.

### Expected benefits and impacts

This innovative model of cooperation between tax authorities and large taxpayers is expected to bring significant benefits to both parties in the HMM, such as: improving the voluntary fulfilment of tax-insurance obligations of taxpayers, reduced costs of ensuring compliance with tax and insurance obligations, less litigation, a higher degree of certainty for both parties in the horizontal monitoring model.

## 1.3 Overview of project implementation

During the project implementation, the following seven main deliverables were successfully elaborated:

### **Deliverable 1: Inception Report**

During the Inception Phase, the project kick-off meeting and a number of meetings and discussions were held with representatives of the NRA senior management and NRA directorates in order to better understand the stakeholders' expectations of the project, as well as to initially introduce the consultant to the internal context in which NRA operates. In this phase, the project methodology was confirmed, the approach and schedule for the implementation of the activities included in the project next stages were updated, the responsibilities of the interested parties and the results to be presented were defined.

A project kick-off meeting took place as a virtual meeting on 7 July 2021. In addition, seven individual meetings with NRA directorates were carried out to better understand the stakeholders' expectations of the project.

The Inception Report summarized the project implementation approach and activities, the roles and responsibilities of stakeholders, and an updated description of possible project risks and approaches to their management.

### **Deliverable 2: Technical report describing the HMM**

#### **Sub deliverable/Chapter 1 Analysis of the environment in which the NRA operates**

The environment analysis covered three main analyses: the economic, social, demographic and cultural characteristics of the country impacting the HMM introduction in Bulgaria; analysis of the large taxpayers' business characteristics and their preparedness and willingness for accepting this new working approach and internal analysis covering NRA's internal context regarding policy towards the large taxpayers in Bulgaria, including structure, organization of work, practice of the control activities, staff competencies and culture attitude.

The main findings and conclusions from the above-mentioned analyses were summarized in a SWOT analysis for the HMM implementation. The Gap Analysis was used to identify the gaps between the current environment specifics and the target that the NRA would like to achieve when introducing the cooperative compliance methodologies.

The data for preparing the analyses were collected through online surveys among NRA experts and large taxpayers in Bulgaria, and interviews carried out with large taxpayers, financial intermediaries, and representatives of NRA Directorates.

#### **Sub deliverable/ Chapter 2 Benchmarking study in the field of cooperative compliance programmes**

During the project inception phase, countries to be considered for the benchmarking analysis were selected in consultation with the NRA project team. They were Austria, Belgium, Denmark, Netherlands, and Sweden.

During the project implementation phase, the Consultant's team prepared a benchmarking analysis structure, detailed specifics on the selected voluntary compliance programmes, letters to the selected tax authorities, a set of interview questions and online survey for the satisfaction and perceptions of the foreign large taxpayer participants in the compliance programmes in the selected countries. Then meetings with the 5 tax administrations in the selected countries were carried out.

The Consultant explored different approaches to identify and contact large taxpayers from each of the selected countries in order to collect feedback regarding the HMM implementation. After several discussions, it was decided to approach companies participating in cooperative compliance programmes in Austria, Belgium, Denmark, Netherlands, and Sweden by an anonymous on-line questionnaire. The questionnaire providing feedback and opinions on the cooperative compliance programmes was filled out by 2 Swedish companies, 7 Belgian companies, 8 Austrian companies, and 10 Dutch companies.

On the basis of the benchmarking analysis, conclusions were drawn which to the greatest extent are relevant to the NRA and can be applied in Bulgaria.

#### **Sub deliverable/ Chapter 3 Framework for a tailor-made HMM**

The third sub deliverable, Framework for a tailor-made HMM, was based on the results of the analysis of the current environment and the examined good practices and lessons learned from the implementation of cooperative compliance programs by other EU tax administrations as part of the benchmarking analysis.

The document serves as a framework for the implementation of horizontal monitoring and provides general guidance and instructions for HMM introduction and implementation, its objectives, principles of cooperation and benefits. The framework also describes the HMM governance model including HMM teams, their roles, and responsibilities, HMM elements (target group, types of tax covered), HMM phases and processes and the HMM impact evaluation.

#### **Sub deliverable/ Chapter 4 Implementation plan for the HMM**

The HMM implementation plan should help to make the model recognized and operational both for the NRA and large taxpayers. It encompasses the specific activities necessary for building cooperation relations with large taxpayers and for developing and strengthening NRA capacities to work with the model. The HMM Implementation Plan describes the necessary steps required for the introduction and initial HMM implementation and includes information on the specific tasks, responsibilities, and action owners, as well as the potential sources of funding.

### **Deliverable 3: Operational processes and procedures for the HMM**

Project Deliverable 3 represents the operational processes and procedures for the HMM introduction and implementation presented in the HMM Implementation Manual. It is structured in three main parts and six chapters including Chapter 1: HMM subject, objectives, principles and benefits; Chapter 2: HMM organizational framework; Chapter 3: HMM main elements, Chapter 4: HMM main phases. Processes and implementation procedures. Chapter 5 describes the tax control framework, while Chapter 6 describes the indicators for HMM progress monitoring and methodology for HMM impact evaluation.

The manual is a tool that aims to support the horizontal monitoring model teams in the implementation of the model and to ensure a uniform approach and consistency of actions in the implementation of the model pilot testing, within the framework of the current legislation and in accordance with the established public administration rules and procedures.

#### **Deliverable 4: Report from the pilot testing of the HMM**

The HMM Pilot Testing phase was the most interesting part of the project implementation as it was the phase where the developed tailor made HMM for NRA was implemented in a real environment with selected large taxpayers. The pilot testing of the HMM was initially planned to last 6 months but was extended to 10 months. The Consultant's team developed specific guidelines for the HMM pilot testing, intended to assist the NRA's horizontal monitoring model teams in the process of its implementation.

The process of selecting companies for the HMM pilot testing began in early 2022. As a result of an automated risk assessment, a profiling of the companies from the target group, at which the model is aimed, was carried out, based on their behavior regarding compliance with tax and insurance legislation in the period 2016-2020. From these, 25 companies with different risk profiles (predominantly low and medium) were selected. NRA developed client profiles of the 25 selected companies. As a result of an analysis of the information collected in the client profiles, letters were sent, and meetings were held with 5 of the selected companies. 4 companies agreed to participate in the HMM pilot testing.

Throughout the 10 months of pilot testing, the Consultant's team provided methodological support and consulting on the implementation of the HMM. 11 meetings were organized between the Consultant's team and the HMM teams to discuss the following topics: level of detail of client profiles, usefulness and updating, procedural issues related to the HMM Implementation Manual, potential legislative obstacles to the HMM implementation, and progress achieved in relations with large taxpayers.

At the end of the pilot testing, two companies were actively working on the HMM and had completed phase 1 "Compliance and Applicability" of the model. They are about to enter phase 2 and sign a Memorandum of Understanding with the NRA. The third company was in phase 0 "Selection and Client Profile". After meetings with the HMM team, the fourth company considered that it does not have the necessary resources to participate in the HMM.



## Evaluation of the HMM Pilot Testing

The Consultant's team prepared a methodology for the HMM pilot testing evaluation and elaborated detailed questions for an online survey among HMM teams, structured questionnaires for interviews with large taxpayers participating in the in the HMM pilot testing, and questions for discussions with focus groups of NRA experts. The international experts from the Consultant's team participated actively in the focus groups and interviews. According to the conclusions of the HMM Pilot Testing Evaluation, the HMM implementation has made good progress, and the teams are building experience and capacity in implementing this innovative approach of working with taxpayers based on trust, transparency, and partnership.

The large taxpayers involved in the pilot testing of the HMM are extremely positive towards the model and the HMM teams. They welcome the new way of working based on trust, transparency, and cooperation, and are enthusiastic about building a cooperative relationship with the HMM teams.

### **Deliverable 5: Training materials and training sessions on the HMM**

#### **Prepare and deliver a training on the HMM for the experts that will be working on the HMM**

KPMG's team designed and delivered a training course to two groups of a total 40 NRA experts, lasting 3 days. The training was implemented in two sessions according to the main topics, namely: 2 days on the elements, processes and procedures of the HMM and 1 day on the Tax Control Framework (TCF) concept.

All participants were very active and participated fully in all sessions and exercises. The training course finished with a knowledge check test and a training evaluation form. All participants provided very positive feedback showing their high satisfaction with the training approach and materials, training organization, and the lecturers.

#### **Prepare and deliver a training on the HMM for the managers of the NRA**

The NRA senior management training session was organized and held on 8 July 2022 in the NRA office. All NRA management including NRA Director General, NRA Deputy Director General, directors of NRA directorates attended the training. The NRA Deputy Director General, responsible for the project, provided positive feedback on the developed Horizontal Monitoring Model for Bulgaria and confirmed the management's full support for its implementation.

### **Deleiverable 6: Communication strategy and materials on the HMM for the large taxpayers and the general public**

The communication strategy preparation started in the first months of the project implementation and was agreed with the NRA project team in the period October - November 2021. The communication strategy includes both traditional and digital channels to effectively reach the audience and to create engagement. The messages

are oriented not so much to the tax collection increase as to improving the tax environment for large taxpayers.

The key products and materials elaborated by the Consultant's team under the HMM Communication Strategy and Action Plan during the project are the following:

- Information material presenting the HMM Framework published in NRA's Internal Newsletter "Posoki";
- information material for large taxpayers presenting the HMM Framework with participation criteria, main requirements, phases, responsible NRA experts and main benefits;
- created HMM promotion section on the NRA intranet website for promoting the HMM among NRA experts.

### **Deliverable 7: Final report**

The Consultant's team together with the NRA project team organised and carried out a closing workshop to present the project results to all stakeholders on 30 June 2023 in the NRA premises.

The Consultant's team presented the main project achievements, the results of the HMM pilot testing evaluation and recommendations for the further development of the HMM implementation by the NRA. The NRA Project Manager shared the NRA experience with this interesting project. A representative of the HMM teams also shared the experience, successes, and challenges of the HMM teams with implementing the model with large taxpayers.

### **Project success factors**

Following the end of the project, the following factors contributing substantially to the effective achievement of all envisaged project results and outcomes and for the smooth and timely project implementation were identified:

- Clear project objective. NRA clearly identified the challenge they wanted to overcome with this project as part of the measures laid down in the "Strategy for countering the risk related to transfers of profits and income abroad".
- NRA experts' commitment to the project. They were engaged in all activities and project outputs preparation and provided timely and valuable feedback and extensive contribution for upgrading the elaborated outputs.
- Strong and effective project management. The project has strong and clear leadership on behalf of the NRA. Very transparent and open communication lines were established between the consultants and NRA experts.
- NRA management's support for the project and the HMM introduction.
- Desire of all NRA experts to change. The experts were embracing a new way of working, willing to learn more and change their attitude, and build new relations with the large taxpayers.

### **Lessons learnt**

The introduction of the HMM is a lengthy process and the progress depends very much on the commitment and availability of the participating large taxpayers. This is very much valid for the pilot testing of the model and was confirmed during the HMM pilot testing under the current project. The HMM teams managed to carry out only the first two phases of the 5-phase model with two companies for the period of 10 months. Best practices from EU member states show that usually the pilot testing requires more than 2 years to be completed.

### **Recommendations for further HMM development**

As a result of the HMM pilot testing interim evaluation, the Consultant's team has the following recommendations for the HMM further implementation and the successful completion of the pilot testing:

- Nomination of a dedicated team of experts which will continue to provide support to the HMM teams and TD “Large Taxpayers and Insurers” with the HMM pilot testing;
- Provision of institutional and budgetary support for the implementation of the HMM and the pilot testing;
- Development of a comprehensive and long-term training program for NRA experts who participate in the HMM implementation;  
Organisation of priority trainings for the HMM teams;
- Support and financial motivation of the NRA experts engaged in the HMM introduction and implementation;
- Appointment of new experts if necessary to build capacity for the TCF evaluation;
- Provision of external technical support for the HMM pilot testing and for building capacities for the HMM teams;
- Provision of support for the implementation of the planned activities in the Communication Strategy for the HMM promotion.



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