Study into the Role of Tax Intermediaries

Foreword by the Chairperson of the Cape Town Forum meeting

This report has been prepared by a Study Team comprised of HM Revenue and Customs (HMRC) in the United Kingdom and the OECD Secretariat. During the course of the study, the team included a number of people on short-term attachments from several major law and accounting firms.

The Study Team worked closely with a core group of countries that acted as a steering group for this work (Australia, Canada, Chile, France, India, Ireland, Japan, Mexico, the Netherlands, South Africa, Spain and the USA). There were three workshops at which the progress and direction of the study were reviewed. Additional oversight was provided by a mid-term review conducted by commissioners from France, Ireland, Japan, Netherlands, South Africa, UK and the USA.

There was extensive consultation with the private sector. Meetings were held with the 'Big Six' and other accounting firms and with major law firms, and also with business groups including the Business and Industry Advisory Committee (BIAC). Staff of HMRC and the OECD made numerous presentations on the project at conferences organised by the private sector. Drafts of the key chapters of the report were issued on the OECD's website for public comment. The Study Team was able to deal with many, although not all, of the extensive and helpful comments, and the Forum on Tax Administration (FTA) intends to continue this dialogue with the private sector.

Throughout the process, all of the OECD and non-OECD countries that participate in the FTA have had an opportunity to contribute to the study. The terms of reference for the study were circulated in draft to participating countries. Drafts of the final report were circulated during November. The Study Team also had bilateral contacts with many countries. The objective of this extensive consultation was to ensure that the report would reflect the rich diversity of country experiences found in the FTA.

The Study Team recognises that this diversity of experiences means that certain of the recommendations in the report may be less relevant to some countries than others and that each country will have to find its own path to achieving the enhanced relationship that is central to this report. Consequently, the report should be seen as a report of the Study Team.

I would like to thank all of those who over the last fifteen months have given their time, counsel and resources to help the Study Team to complete this report. The report was considered at the FTA meeting on 10-11 January 2008. I look forward to the next steps in the study and continuing to exchange views with fellow commissioners on their experiences in enhancing the relationship between themselves, tax intermediaries and taxpayers.

Pravin Gordhan
Chairperson of Cape Town Forum meeting

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Executive summary

All the countries participating in the OECD's Forum on Tax Administration (FTA) recognise the impact aggressive tax planning has on tax administration, although in some countries this has been far more prevalent than in others. Aggressive tax planning is one of the risks revenue bodies have to manage in order to collect the tax due under their tax systems. Aggressive tax planning typically requires the involvement of tax professionals – in accounting firms, law firms or other tax advisory firms, in financial institutions or in large corporate taxpayers' tax departments.

That is why the FTA commissioned a study of the role these tax intermediaries play in tax compliance and the promotion of tax minimisation arrangements.

As advisers, tax intermediaries play a vital role in all tax systems, helping taxpayers understand and comply with their tax obligations in an increasingly complex world. But some of them are also designers and promoters of aggressive tax planning, a role that has a negative impact on tax systems.

The Study Team considered the different approaches FTA countries are using to respond to tax intermediaries' involvement in aggressive tax planning. All revenue bodies need robust strategies in this area.

However, the Study Team has come to the firm conclusion that to understand and, more importantly, to influence the behaviour of tax intermediaries, a broader view is needed. Tax intermediaries represent the supply side of aggressive tax planning, but large corporate taxpayers, tax intermediaries' clients, set their own strategies for tax-risk management and determine their own appetites for tax risk. They are the ones who decide whether to adopt particular planning opportunities. Taxpayers represent the demand side of aggressive tax planning.

The report therefore considers the tripartite relationship between revenue bodies, taxpayers and tax intermediaries. The Study Team's conclusion is that there is significant scope to influence the demand side – at least in relation to large corporate taxpayers, the taxpayer segment that is the principal focus of the study.

In addressing the demand side, risk management is an essential tool for revenue bodies, assisting with the identification and treatment of risks. It allows revenue bodies to assess the risk presented by taxpayers or groups of taxpayers and then allocate resources to respond to those risks.

Risk management relies on information, which makes it important to encourage disclosure from taxpayers. This means revenue bodies need to operate using the following five attributes when dealing with all taxpayers: understanding based on commercial awareness; impartiality; proportionality; openness (disclosure and transparency); and responsiveness.

If revenue bodies demonstrate these five attributes and have effective risk-management processes in place, this should encourage large corporate taxpayers to engage in a relationship with revenue bodies based on co-operation and trust, with both parties going beyond their statutory obligations. This is the enhanced relationship which is central to this report.

As well as benefiting revenue bodies, the enhanced relationship will also benefit many taxpayers. For example, taxpayers who behave transparently and who represent lower risks can reasonably expect a co-operative relationship with revenue bodies and therefore lower compliance costs, with increased certainty at an earlier stage.

The Study Team recognises that the demand for aggressive tax planning will not disappear completely, and some large corporate taxpayers may choose not to adopt the enhanced relationship. Revenue bodies will need to have effective risk-management processes in place to identify these taxpayers and allocate the necessary level of resources to deal with them.

The recommendations in this report have the potential, if fully implemented, to reduce the demand from large corporate taxpayers for aggressive tax planning and to give revenue bodies much better information about aggressive tax planning and therefore the opportunity to devise more effective responses. If the demand can be reduced, the supply of aggressive tax planning would also fall. In this way, the Study Team believes revenue bodies can best respond to the promotion of aggressive tax planning by tax intermediaries. More generally, the implementation of the Study Team's recommendations should lead to a more constructive relationship between revenue bodies, taxpayers and tax intermediaries.

One particular category of tax intermediaries, investment banks, pose particular issues because some of them are involved in aggressive tax planning in the inter-bank finance market and in trading for their own account ('proprietary trading'). This report does not fully explore these issues and the Study Team will therefore undertake a follow-up study on banks.

High-net-worth individuals ('HNWIs') are the second principal market for aggressive tax planning. Due to time and resource constraints, the Study Team did not have the opportunity to consider this market and recommends that further work should be undertaken to consider whether the enhanced relationship or other strategies are needed for addressing the risks posed by aggressive tax planning by these taxpayers.

Chapter 1 - Introduction

Overview of report

This report sets out the conclusions of the OECD Tax Intermediaries Study that commenced in September 2006, shortly after the third meeting of the Forum on Tax Administration (FTA)[1] in Seoul, Korea.

This study is one of the outputs of the 'Seoul Declaration'.[2] FTA countries developed the Seoul Declaration to address the Forum's concerns about non-compliance with tax laws in an international context. In particular, it sets out countries' concerns in relation to the spread of aggressive tax planning[3] marketed by some tax intermediaries[4] (e.g. law and accounting firms, other tax advisers and financial institutions).[5]

The mandate to the Study Team was to improve understanding of the role tax intermediaries play in the operation of tax systems and specifically to understand their role in 'unacceptable tax minimisation arrangements'.[6] In addition, the Study Team was to identify strategies for strengthening the relationship between tax intermediaries and revenue bodies.

However, recognising that tax intermediaries do not work independently from their clients but supply the services that clients demand, the Study Team concluded that to strengthen relationships with tax intermediaries, revenue bodies also need to consider the taxpayer's role, referred to in this report as the 'demand side' of the market. The study therefore examined the tripartite relationship between taxpayers (in particular large corporate taxpayers), revenue bodies and tax intermediaries as well as looking at strategies to address tax intermediary risk more directly.

Each revenue body faces a different environment within which they administer their taxation system. FTA countries differ in respect of their policy and legislative environments and their administrative practices and cultures. As such, different countries will approach the issues raised in this report in different ways Care should always be taken when considering a particular country's practices to fully appreciate the complex factors that have shaped its approach.

A glossary sets out the meaning of key words and phrases used in this report.

Contents of chapters

Background on the Seoul Declaration and the process the Study Team went through in developing this report is set out in Chapter 2.

Chapter 3 sets out the key drivers that influence the behaviour of large corporate taxpayers and tax intermediaries in tax systems.

Chapter 4 identifies strategies currently used by various FTA countries to directly address the risks presented by tax intermediaries, with particular reference to aggressive tax planning.

Chapter 5 considers how effective risk management can play a significant part in allowing revenue bodies to assess the risks presented by a taxpayer or groups of taxpayers so that resources can be allocated appropriately.

Current, relevant and reliable information is essential for effective risk management. Chapter 6 considers the methods and processes revenue bodies can use to obtain that information.

Chapter 7 describes five attributes that revenue bodies need to demonstrate and that may encourage large corporate taxpayers to offer higher levels of disclosure and transparency.

Chapter 8 brings together the themes of previous chapters and looks at how these can lead to co-operative, trust-based relationships between revenue bodies and large corporate taxpayers. This is the 'enhanced relationship'.

Banks pose particular challenges in the context of this study as they are different from other tax intermediaries and further study is needed. Chapter 9 considers this in more detail.

Finally, Chapter 10 sets out conclusions, recommendations and next steps.

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[1] The FTA provides a forum to improve taxpayer service and compliance. It is a part of the OECD's Committee on Fiscal Affairs (CFA) and its members are the heads of tax administrations from 35 OECD and non-OECD countries.

[2] For the full Seoul Declaration and a list of countries that attended Seoul see: www.oecd.org/ctp/ta/seouldeclaration.

[3] See glossary.

[4] The precise scope of this term for the purposes of this study is set out in Chapter 3.

[5] The precise scope of this term for the purposes of this study is set out in Chapter 3.

[6] See glossary.

Chapter 2 - The 2006 Seoul Declaration: A history, context and framework for this report

The Seoul Declaration context

All governments are faced with the challenge of how to manage global taxpayers through their national tax systems. The integration of national economies, modern communication technology, electronic finance and the dominance of multinational firms (including law and accounting firms, as well as global banks) all pose challenges to today's revenue bodies. As well as challenges, this global environment also provides the opportunity to develop new ways of co-operation between revenue bodies and to find new ways in which revenue bodies can exchange experiences and information.

It is against this background that the FTA developed the Seoul Declaration in September 2006.[1] The Declaration sets out countries' concerns about the rapid spread of aggressively marketed tax planning and the link between 'unacceptable tax minimisation arrangements' and tax intermediaries.

Tax minimisation has a long history, but the more recent experiences of various countries justify the attention and direct language of the Seoul Declaration. For example, in the USA in the mid-1990s, a confluence of events and circumstances altered the traditional business models of many accountants and law firms and led to an increased supply (by tax intermediaries) of and demand (from taxpayers) for 'mass-marketed' or 'off-the-shelf' aggressive schemes.

Many factors produced this shift. Broader factors included rapidly increasing complexity in business models, financial markets and global operations, rapidly changing tax and legal systems and development of information technology tools that allowed for more complex and sophisticated analysis and financial products. These combined with conditions in the market for tax advice – including fierce competition among tax intermediaries, in some countries a loosely self-regulated tax profession, and fees linked to tax benefits – to create an environment in which tax intermediaries were willing and able to promote higher risk schemes.

In some countries during this period, an aggressive tax scheme would develop through a number of distinct phases. While not the same in all FTA countries, an example is summarised below:

- A tax intermediary saw a combination of features – fact patterns plus legal (and often accounting) analysis – that could lead to an unexpectedly favourable tax result.
- This idea was developed and offered to taxpayers with the requisite fact pattern.
- The scheme was then marketed as a 'tax product'. A recent decision in the UK provides an account of this process as it existed in 2002.[2]
- Some competitors of the tax intermediary became aware of the 'tax product' and developed and sold their own cloned tax products.
- Momentum developed with these cloned tax products being marketed on a broader scale, including through national newspapers, until they were seen as 'mass-marketed', reaching well beyond the initial market.

- Even some taxpayers who were initially reluctant to participate felt compelled to do so because of competitive pressures.
- The scheme is by now seen by tax intermediaries and taxpayers as accepted practice and no longer innovative and therefore perceived as not aggressive.

These phases did not usually play out in full – legislation or litigation usually intervened – shortening the life of the scheme. But the revenue body was always behind the tax intermediary; often tax returns were not submitted until a year or two after the transactions had been implemented and only then did revenue bodies have the opportunity to become aware of the scheme. Once the revenue body identified a scheme and an operational or legislative response was framed, the scheme evolved into a further iteration, starting the cycle again. Sometimes, the next iteration of the scheme was being sold even before the response to the previous iteration had been framed. This evolution of aggressive tax planning meant that revenue bodies were constantly at least one step behind the tax planners.

While the tax environment in all countries has changed significantly over the past fifteen years, the newly created OECD Directory of Aggressive Tax Schemes demonstrates that the majority of OECD member countries continue to face challenges in this area.

It was in the context of these evidence-based concerns and challenging global environment that FTA commissioners met in Seoul in September 2006, establishing this study to examine the role of tax intermediaries. Subsequently, the commissioners agreed the Terms of Reference which were released on the OECD website in January 2007.3

As set out in the terms of reference, the mandate was: to improve understanding of the role tax professionals play in tax administration generally and in ‘unacceptable tax minimisation arrangements’ in particular; and to identify strategies for strengthening their relationship with revenue bodies.

From Seoul to Cape Town - the report’s framework.

The Study Team undertook an extensive consultation process with FTA countries, taxpayers and tax intermediary stakeholders. This process included posting six working papers on the OECD website for public information and comment.4 These consultations extended across many countries and with stakeholders including: representatives from leading legal and accountancy firms; corporate tax directors and finance executives of global corporates; tax executives from major banks; the Business and Industry Advisory Committee (BIAC)5; and representatives from business, accounting and tax professional bodies. In addition, many countries conducted their own national consultations.

These extensive consultations led to the scope of the study evolving over time. Three points are worth highlighting.

First, there was early consensus that, variations between the legal frameworks of FTA countries mean it would not be appropriate or feasible to attempt to reach a definition of ‘unacceptable tax minimisation arrangements’ as used in the Seoul Declaration. Nevertheless, the Study Team recognised that it was important to provide as much clarity as possible about the arrangements that underlay commissioners’ concerns – and clarity about the types of arrangement to which revenue bodies frequently allocate significant resources. The following two areas of concern were identified:

- **Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences**. Revenue bodies’ concerns relate to the risk that tax legislation can be misused to achieve results which were not foreseen by the legislators.

This is exacerbated by the often lengthy period between the time schemes are created and sold and the time revenue bodies discover them and remedial legislation is enacted.

- **Taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law**. Revenue bodies' concerns relate to the risk that taxpayers will not disclose their view on the uncertainty or risk taken in relation to grey areas of law (sometimes, revenue bodies would not even agree that the law is in doubt).

In this report, these two areas of concern are referred to as 'aggressive tax planning'.

Second, while it can exist in other segments of the taxpayer population, consultations identified two groups of taxpayer that are generally agreed to represent the greatest risk in relation to aggressive tax planning. These are large corporate taxpayers and high-net-worth individuals (HNWIs)6. Both groups have the ability to enter into complex, very often cross-border, tax-planning arrangements that are within the ambit of the first area of concern. Both groups also have access to sophisticated advice and legal resources to facilitate identification and realisation of tax planning opportunities. However, because of resource and time constraints and following consultation within the FTA, the Study Team concentrated mainly on large corporate taxpayers. It is in the context of this group that recommendations are made in this report.

Third, the study's scope was broadened to include the taxpayers who are the consumers of tax intermediary services and directly influence their behaviour. In this 'tripartite' environment, the primary relationship – from both a statutory perspective and a practical one – is that between the taxpayer and the revenue body. The Study Team therefore found it useful to distinguish between the supply of aggressive tax planning by tax intermediaries and the demand by large corporate taxpayers for such advice. While the Seoul Declaration focuses on the supply side, the Study Team concluded that FTA countries should also consider strategies directed towards the demand side. Successfully reducing taxpayer demand for aggressive tax products should, under conventional market economic principles, lead to a reduction in the supply. This report accordingly covers potential response strategies to both the supply and demand sides of aggressive tax planning.

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[1] For the full Seoul Declaration see: www.oecd.org/ctp/ta/seouldeclaration

[2] Prudential plc v Commissioners for HM Revenue and Customs sets out that ".… a presentation given by [tax intermediaries] to members of [large corporate]'s tax "team". The presentation included details of a tax-efficient method of hedging exchange rate risks. … slides explained "the transaction". The first slide stated "The Transaction provides significant savings relative to traditional currency transactions" and began with these words:
"The Transaction provides a tax enhanced method for a UK company to hedge a foreign currency exposure.
The Transaction provides a UK company with a tax deduction for, in economic terms, the prepayment of part of the final principal exchange under a swap
…
The transaction … relies on an asymmetry between [different pieces of tax legislation] …
A letter … from [tax intermediaries] … contains these words:
… engagement to advise [large corporate] … in respect of the tax planning opportunity (the 'Opportunity') using the hedging method …
We will provide the following advice and assistance in respect of the Opportunity:
provide a copy of the instructions to Counsel … to analyse the tax effects of the Opportunity;
provide a copy of the note of our consultation with Counsel as settled by Counsel;
review of the tax effect of the swap confirmations used to implement the Opportunity;
discussion with those at the Company responsible for pricing the swap premium paid; responsibility for setting the price and the commercial effects of the swap will remain with the Company.
[Initial fee] of £200,000 (plus VAT)

[Second fee] in the event that the Company receives a reduction in the profits chargeable to corporation tax following implementation of the Opportunity … £300,000 (plus VAT).

Fees for assistance with tax computations, accounting presentation and subsequently correspondence with the [revenue body] "

3 http://www.oecd.org/document/50/0,3343,en_2649_201185_37930802_1_1_1_1,00.html

4 The six working papers can be found at: http://www.oecd.org/document/27/0,3343,en_2649_33749_39006683_1_1_1_1,00.html. These papers were written for the purposes of the study and were not endorsed in advance by FTA countries.

5 See glossary.

6 See glossary.

Chapter 3 - The tax environment

Key points:

- Tax advisers play a vital role in all tax systems, helping their clients understand and comply with tax obligations.
- The behaviour of tax advisers is driven by a range of factors – most importantly, their responsibilities to their clients.
- The behaviour of large corporate taxpayers has been driven by managing tax costs.
- Managing tax risks is becoming equally important – this means achieving early certainty of tax matters.

Introduction

As set out in Chapter 2, the Study Team looked at the role of tax intermediaries as one of the participants in a tripartite tax environment. The other two parties are taxpayers and revenue bodies. This chapter identifies some of the key drivers in the tax environment with particular reference to aggressive tax planning.

There is a further significant party in the tax environment – wider government, including tax policy- and law-makers. Tax systems are shaped by policy-makers and by the legal frameworks within which they operate. The Study Team was told during consultation that policy decisions and the rule and application of the law – particularly where they are, or become, uncertain – affect the market for aggressive tax planning.[1] Furthermore, many of those consulted advised that taxpayers are more likely to undertake aggressive tax planning where and when they perceive unfairness in the tax system.[2]

However, the study focused on the administration of tax systems, not on the policy choices or legal frameworks which shape them. The Study Team has, therefore, taken this broader context into consideration but not attempted to make direct recommendations to address it.

The tax environment varies considerably between FTA countries. While recognising this diversity, this chapter identifies some of the drivers in the tax environment that are common to all, with particular reference to aggressive tax planning.

Tax intermediaries

There are two principal groups of tax intermediary that are relevant to the study: tax advisers; and banks and other financial institutions.

In the context of this study, **tax advisers** are law, accounting and other professional firms that provide sophisticated tax advice and other services.[3] In a world where tax codes have become increasingly complex, tax advisers help taxpayers to comply with the requirements of existing tax codes and to understand the complexity of legislation, particularly in the context of global businesses. In addition, managing tax risk has become an integral part of taxpayers' corporate governance and hence the tax adviser's role. Tax advisers help taxpayers design and comply with internal risk-management processes as part of newly developed corporate governance policies[4]. Tax advisers also have roles in respect of aggressive tax planning and Chapter 4 examines these further.

In some FTA countries, tax boutiques[5] are also engaged by large corporate taxpayers to provide highly specialised services on particular issues or for dispute resolution matters.

Banks and some other financial institutions design, promote and facilitate tax-driven financial instruments and other arrangements, including those that revenue bodies see as aggressive tax planning. This makes them tax intermediaries for the purposes of this study. In many ways, their behavioural drivers overlap with tax advisers (and large corporate taxpayers) but a more detailed discussion of their role within the tax environment is set out in Chapter 9.

Behavioural drivers of tax advisers

The importance of the role tax advisers play in a tax system can be tested by answering a simple question: would compliance with tax laws improve if tax advisers did not exist? The Study Team found no country where the answer to that question is yes. Across the whole range of taxpayers, taxes and circumstances, the vast majority of tax advisers help their clients to avoid errors and deter them from engaging in unlawful or overly-aggressive activities.

The following factors are key in influencing the behaviour of tax advisers, the advice they give their clients and their interactions with revenue bodies:

- **Client and legal responsibilities.** Professional and ethical responsibilities to the client and to the law are uppermost in the mind and actions of any tax adviser. This is expressed in different ways but the overarching principle is constant: the tax adviser's loyalty is to the client; and the duty of loyalty to the client is to represent their interests and give best advice. In most FTA countries, legally, professionally and ethically, tax advisers have no direct responsibility to revenue bodies other than to comply with the law.

- **Personal responsibilities: regulation of the tax profession.** In some FTA countries, tax advisers are entirely self-regulated; generally within the framework provided by professional (or qualifying) bodies. In others, the revenue body plays a more active role providing regulatory oversight for at least some purposes (such as their ability to represent taxpayers in correspondence or dispute resolution cases, or certifying certain types of tax intermediary and/or activity).[6] In most cases, the ethical standards set by professional bodies are supplemented and exceeded by the major international accounting and legal firms' own standards. Registration and regulation of tax intermediaries is explored further in Chapter 4.

- **Financial and reputation risks.** Historically, potential liability exposures of tax advisers were dealt with quietly through private malpractice insurance settlements. However, with an increased public focus on professional integrity and attendant media publicity, the larger professional firms with tax practices are more attuned to reputation risks and many have established strong internal risk-management and quality-review processes to limit and manage exposures. This may be a less important factor with the smaller, non-institutional tax advisers and boutique firms.

- **Professional fee structures.** Traditionally, tax advisers are compensated on a straight hourly or fixed-fee basis for their professional services. In some countries, this changed in the 1990s when 'value-based' fee structures (e.g. contingent fees) emerged. These fee structures were usually directly linked to the eventual success of the tax scheme or to the amount of the claimed tax benefit (the role of fee structures in the development of aggressive tax planning is also mentioned in Chapter 2). In some countries, use of 'value-based' fee structures by tax advisers remains. In others, such as the UK and USA, tax advisers' ability to adopt 'value-based' fee structures is restricted.

- **Legal professional privilege.** Most common and civil law jurisdictions recognise a doctrine of 'legal professional' or 'attorney-client' privilege (LPP) which prevents forced disclosure of confidential advice provided to taxpayers by lawyers and certain information contained in communications between them. In most countries, this is limited to advice provided by a lawyer although in some countries[7] there is also an accountant-client privilege or a judicially created 'work product' doctrine that prevents disclosure of confidential information created in anticipation of tax litigation.

- **Auditing standards.** Tax advice delivered to large corporate taxpayers is almost always audited. This can drive the behaviour of tax advisers working for accountancy firms involved in auditing tax advice. They will usually consider how tax planning will be reflected in the financial statements of the taxpayer and the level of likely disclosure.

Behavioural drivers of large corporate taxpayers

The Study Team's consultations suggest that in many FTA countries the relationship between large corporate taxpayers and revenue bodies tended historically to be more confrontational than collaborative. However, in recent years certain taxpayers and some revenue bodies have seen benefits from a more co-operative approach.

Taxpayers place a high value on the ability to finalise their tax positions quickly, particularly if this can be done in real time. This helps them minimise unpredictability of earnings projections and achieve predictability of future cash flows, allowing more accurate assessment and public reporting of the value of the business.

This does not mean that large corporate taxpayers no longer view tax as a cost to be managed. In most large companies, taxes are viewed no differently than payroll and other operating costs. For some large corporate taxpayers, this means there is an emphasis on delivering a low or relatively low effective tax rate (ETR), particularly by comparison to other companies in the same industry. ETR and other metrics used to enhance shareholder value are now important beyond the corporate tax department and are carefully watched, not only by senior management but also by analysts, rating agencies and institutional investors. Some tax executives are under enormous and continuing pressures to effectively manage the ETR and other measures of shareholder value.

Against this backdrop, the following summarises some other key factors that drive large corporate taxpayers' financial decision-making processes as well as their interactions with revenue bodies:

- **Corporate governance.** With the unearthing of widespread and widely publicised financial scandals in the global securities markets, and driven by broader market expectations as well as legislative developments in some countries, the need for sound corporate governance now drives financial decision-making processes. For example, in some countries, audit committees are now required to take responsibility for oversight of the corporate tax function. This typically includes (i) which professional tax advisers to retain, (ii) what professional tax activities to outsource, and importantly (iii) developing and monitoring an appropriate overall tax-risk strategy. As a corollary, many revenue bodies are now assessing corporate governance processes as a part of risk management.

- **Financial and other public disclosures.** Large corporate taxpayers, especially those that are traded on major markets or are otherwise in the public eye, have become very sensitive to adverse publicity on many matters, including tax issues. Tax executives aim to avoid unwanted surprises and minimise uncertainty. This has produced a cultural change in many public companies over their attitude to tax risk and co-operation with revenue bodies. Large corporate taxpayers are increasingly keen to achieve early certainty of their tax liabilities and they place a high value on finalising their tax positions quickly, particularly if they can do so in real time. This helps in minimising 'restatements' relating to tax liabilities in their financial accounts and also helps achieve predictability of future cash flows.

- **Accounting for uncertain tax liabilities.** A related point involves the evolution of financial accounting standards for taxes (such as FIN 48 in the USA)[8] that require public companies to disclose their tax uncertainties. This is causing some companies to review their tax strategies and appetite for tax risk as a result of an increased awareness of the potential disclosures required in their accounts.

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[1] For example: where a government chooses to introduce retrospective legislation (i.e. announce a law change that applies for transactions that took place before the announcement); where tax incentives are introduced to encourage behavioural change but taxpayers respond more actively than anticipated and the cost to government spirals and the incentives are withdrawn or curtailed; or where revenue bodies' behaviour does not accord with a nationally agreed service charter or similar. Very complex, badly drafted legislation or legislation that fails to take into consideration business models or issues can also contribute to aggressive tax planning and uncertainty.

[2] For example, taxpayers who do not use aggressive tax planning to generate tax losses where there is no commercial loss may be prepared to use aggressive tax planning to obtain tax relief for commercial losses which would otherwise not be recognised for tax.

[3] The activities undertaken by tax advisers include: tax compliance; tax accounting and audit support; day-to-day advisory; business and economic tax planning; and dispute resolution. Tax intermediaries will deal with clients at various different levels and represent client's interests in many different ways.

[4.] An example of a global accounting firm's view of their role in risk management is set out in PricewaterhouseCoopers 2004 publication Tax Risk Management.

[5] See glossary.

[6] For example, in Japan, the legal obligation of confidence stipulated in Article 38 of the Certified Public Tax Accountant (CPTA) Law is interpreted in conjunction with the statutory mandate of CPTAs to oblige CPTAs to act as independent and impartial professionals for the purpose of realising the proper fulfilment of the tax obligations by taxpayers. CPTAs or 'Zeirishi' are tax practitioners qualified to act in Japan and bound by explicit statutory obligations prohibiting, for example, engaging in advice on tax evasion and any other disgraceful conduct. In France, since 1974, the French revenue body has certified professional bodies that help their members dealing with tax duties. The objective of this certification is to help self-employed professionals to be compliant and to promote actual basis assessment. 610 certified bodies are registered.

[7] For example New Zealand.

[8] See glossary.

Chapter 4 - Responding to tax intermediaries who engage in aggressive tax planning

Key points:

- Some tax intermediaries continue to be involved in aggressive tax planning.
- Countries have developed various response strategies including registration and regulation, advance disclosure, compliance agreements, and penalties and other sanctions

This chapter considers strategies used by revenue bodies to respond directly to tax intermediary risk and in particular to the concerns identified in the Seoul Declaration. These strategies are necessary to protect the integrity of the tax system, reassuring the majority of taxpayers and tax intermediaries that revenue bodies are capable of responding to risk and that the tax system is administered fairly.

These strategies are often responses to specific domestic risks and it does not follow that because a technique works in one country it will have a similar impact in another. Careful consideration needs to be given to the organisational structure and legal frameworks that underpin the approaches and factors (political, social, economic and cultural) that have shaped them, before considering whether similar approaches should be adopted by other countries.

Not all the strategies identified have been designed exclusively to address high-risk issues and behaviour. Revenue bodies take an integrated approach and a particular tool will often be multi-purpose – contributing to intelligence, enforcement and service objectives. Some of the methods included in Chapter 6 to obtain information using statutory powers also contribute to reducing aggressive tax planning by tax intermediaries.

As set out in Chapter 3, the overall impact of tax intermediaries on the risks presented by their clients, through the tax compliance advice they provide as well as broader business and accounting advice, is very positive.

Despite this generally positive impact, revenue bodies remain concerned about the involvement of some tax intermediaries in aggressive tax planning. This involvement takes a number of forms, including:

- promoting aggressive tax planning marketed to a number of taxpayers;
- designing or jointly designing (for example with taxpayers) aggressive tax planning;

- advising, including the issuing of legal opinions, on aggressive tax planning designed by others – this may be advice to other tax intermediaries including banks or other financial institutions or to taxpayers; and
- advising in relation to taxpayers' legal obligations once aggressive tax planning has been implemented – for example, disclosure requirements.

These activities may involve tax intermediaries with very different responsibilities and obligations and therefore call for very different responses from tax authorities concerned about aggressive tax planning.

Addressing tax intermediary risk

Revenue bodies have historically responded to aggressive tax planning by developing strategies to address the demand, or taxpayer, side of the market. This focus reflects the fact that it is taxpayers who are ultimately liable for the tax position taken. These strategies have an effect on tax intermediary behaviour in that they reduce the demand for aggressive tax planning and therefore dissuade the development and promotion of such schemes.

More recently, some revenue bodies have started to develop strategies that have a more direct impact on the supply, or tax intermediary, side of the market. In general, these strategies aim to increase the risk to tax intermediaries who are developing or promoting aggressive tax planning, providing appropriate deterrence. The response strategies covered in this chapter are:

- Registration and regulation
- Advance disclosure
- Compliance agreements
- Penalties and other sanctions

The Study Team **recommends** that countries formulate their own methods of dealing with tax intermediary risk. In doing so, they may wish to consider the strategies used by various countries as described in this chapter.

The role of registration and regulation

An ability to identify tax intermediaries is generally seen as being an important step in understanding and effectively managing their role within the tax system. However, the level of revenue body involvement in the registration and regulation of tax intermediaries varies considerably among FTA countries.

In some FTA countries, tax advisers are entirely self-registered and regulated; generally, within the framework provided by professional bodies. This framework can be very strict as some tax intermediary businesses are tightly regulated and operate under a number of professional and ethical codes.

The UK is an example of a country that, to some extent, relies on self-regulation by professional bodies.[1] The five main principles of one such body, the Institute of Chartered Accountants in England and Wales (ICAEW), are integrity, objectivity, professional competence and due care, confidentiality and professional behaviour[2].

In other countries, the revenue body is more active and this may involve some form of regulation by it. This will typically involve a registration process that allocates a unique number to individual tax intermediary businesses or professionals within the business. The number must then be included on any contact with the revenue body and on any submission made by their clients to the revenue body.[3] In order to become 'registered', tax advisers must sign up to a minimum standard of behaviour or meet a minimum standard of qualification as set out in relevant legislation. These standards are then monitored by the revenue body. For example, in Japan, the National Tax Agency (NTA) provides guidance and supervision for certified public tax accountants (CPTAs) or 'Zeirishi'. The NTA is currently making efforts to collect information on cases of professional misconduct and dealing strictly with those in breach of the CPTA Law.[4] Further details on the NTA's approach can be found at Annex 4.1.

There are few examples of revenue bodies utilising regulation (either where undertaken by the state or by professional bodies) as a lever to directly address aggressive tax planning. One revenue body that has done so is the Internal Revenue Service (IRS) in the USA.

The IRS regulates tax professionals through its Office of Professional Responsibility (OPR) whose role has been legislatively enhanced as a result of recent experience of abusive practices in the USA, and by means of regulations known as Circular 230 (C230). When making amendments to the regulations in 2004, the IRS explicitly stated that they were "*part of an ongoing effort to improve ethical standards for tax professionals and to curb abusive tax avoidance transactions*".[5] Key features of the OPR and C230 are set out in Annex 4.2.

Advance disclosure

Canada, South Africa, the UK and the USA have statutory rules that require disclosure of certain schemes or arrangements to the revenue body in advance of the tax-return process – typically when the scheme is promoted. In these four countries, much of the obligation for disclosure falls on the tax intermediary.

The experiences of countries using disclosure regimes are that they have a significant deterrent effect and reduce the attractiveness of aggressive tax planning. They directly affect the economic attractiveness of aggressive tax planning, significantly reducing the time taken by the revenue body to detect a scheme and embark on a response (either legislative or through the courts). For the tax intermediary, the period in which professional fees can be earned is reduced; for taxpayers, a swifter response means a reduced period in which tax advantages accrue. Such regimes need to be carefully designed in order to meet their objectives and Chapter 6 and Annex 6.1 provide further detail.

Future compliance agreements

Where a particular tax intermediary has engaged in conduct potentially subject to civil or criminal sanctions, some revenue bodies require them to sign 'future compliance agreements'. These place restrictions or set additional standards on their future behaviour. Typically, these agreements form part of the sanction applied to the tax intermediary in direct response to a particular issue or arrangement. One country that has used this technique is the USA where typically it is one element of a comprehensive agreement under which penalty and other proceedings are resolved. The IRS currently has agreements with a wide range of tax intermediaries. The broad approach to future compliance agreements is set out in Annex 4.3.

Penalties

Several countries have recently enacted penalty regimes aimed specifically at tax intermediaries in relation to aggressive tax planning.[6] These penalty regimes can be broadly summarised as:

- penalties underpinning statutory obligations that relate to aggressive tax planning – for example non-compliance with disclosure requirements; and
- penalties for involvement in aggressive tax planning – for example, civil penalties where a promoter has sold, issued or promoted a scheme that involves an abusive tax position; or for making false statements in promotion or planning activities.

The following paragraphs focus on the second point above as these are the more significant recent developments in responding to aggressive tax planning.

In 2006 Australia introduced ‘promoter penalty laws’ aimed at deterring the promotion of schemes by providing civil penalties for, and injunctive relief against, those who engage in the promotion of tax exploitation schemes. The practice statement on the promoter penalty laws can be found on the Australian Taxation Office (ATO) website.[7]

Commenting on the provisions in a 2006 speech, ATO Commissioner Michael D’Ascenzo stated that *“… the vast majority of tax professionals act ethically and professionally and so significantly contribute to maintaining the integrity of the tax system. The promoter penalty legislation is aimed at eliminating unscrupulous operators who peddle unsustainable arrangements to the detriment of both the taxpayer and ethical advisors.”*

As these provisions were only introduced in 2006, there is little empirical evidence of its impact on the profession. However, many professionals and revenue officials in Australia believe that the promoter penalty provisions have significantly decreased the supply of mass-marketed schemes which were predominately devised and promoted by boutique-type tax advisers.

Other countries that have third-party penalties for aggressive tax planning include New Zealand and Canada.

New Zealand’s penalty is applied against the tax intermediary where the taxpayer has incurred a shortfall penalty for an abusive tax position as a result of the arrangement, or where the arrangement is offered, sold, issued or promoted to ten or more persons in an income year. The practice statement is available on the New Zealand Inland Revenue’s website.[8]

Canada’s legislation, applying to both income tax and goods and services tax (GST), was introduced in 2000. The legislation applies primarily to promoters and is aimed at deterring the making of false statements and ensuring compliance. The public policy statement on third party penalties can be found on the Canadian Revenue Agency’s website.[9]

Other methods

There are other non-monetary sanctions in place in some FTA countries that apply to the role of tax intermediaries in aggressive tax planning. These sanctions include injunctions to stop the promotion of a scheme, and censures, suspension or disbarment from practice under professional conduct rules.[10]

Some countries[11] have general anti-avoidance or abuse rules which, although directly applicable to taxpayers, can also deter the design of aggressive tax planning by tax intermediaries.

[1] UK solicitors are regulated. The Solicitors Regulation Authority is the independent regulatory body of the Law Society, and the Solicitors Disciplinary Tribunal is a statutory tribunal which is constitutionally independent.

[2] The ICAEW's five main principles are: Integrity - A professional accountant should be straightforward and honest in all professional and business relationships. Objectivity - A professional accountant should not allow bias, conflict of interest or undue influence of others to override professional or business judgements. Professional Competence and Due Care - A professional accountant has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services. Confidentiality- A professional accountant should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Professional Behaviour- A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

[3] FTA countries that adopt this approach include China, Italy and South Africa.

[4] A further example is legislation proposed for New Zealand in December 2007. The government is proposing to add a requirement to the definition of 'tax agent' to allow the discretion to withhold recognition, or remove a person as a tax agent, when the Commissioner thinks the action is necessary to protect the integrity of the tax system. Potential factors that may be taken into account include: whether a person has been found guilty of an offence or breach by the disciplinary body of a professional organisation of which they are a member – for example, the New Zealand Institute of Chartered Accountants; and the tax agent's compliance history - including both their own tax affairs and their level of compliance as an agent. Further details can be found at http://www.taxpolicy.ird.govt.nz/publications/files/compliancedd.doc.

[5] Internal Revenue Service press release IR-2004-152, Dec 17, 2004.

[6] Any penalty regime needs to be underpinned by adequate safeguards, such as appeal mechanisms.

[7] http://atogovau/corporate/content.asp?doc=/content/00094866.html

[8] www.ird.govt.nz/technical-tax/standard-practice/shortfall/sps-inv-290-promoterpenalties.html

[9] http://www.cra-arc.gc.ca/E/pub/tp/ic01-1/ic01-1-e.html

[10] For example in the USA, courts can and do stop promoters through injunctions. The US courts have broad statutory authority (Internal Revenue Code (IRC) sections 7402(a) and 7408) to enjoin promoters of abusive tax shelters and reportable transactions. The injunctions actions against promoters are filed by the US Department of Justice, Tax Division. In 2007, the IRS secured 51 injunctions against promoters and 9 injunctions against return preparers.

[11] Countries that have a general anti-avoidance or abuse rule include Australia, Austria, Belgium, Canada, Hong Kong, Ireland, New Zealand, South Africa and Switzerland.

Chapter 5 – Risk management

Key points:

- Risk management is an essential tool for revenue bodies, allowing efficient allocation of resources.
- Taxpayers who provide full disclosure and transparency may achieve earlier, increased certainty of their tax affairs and reduced compliance costs.

Why risk management is important

As noted in Chapter 2, the changing tax environment presents particular challenges for revenue bodies as, for instance, it can provide greater opportunities for aggressive tax planning. Detecting and responding to these challenges makes revenue bodies' task more difficult and more costly. It is therefore critical for revenue bodies to allocate available resources in a targeted and effective manner.

Risk management is therefore an essential tool for revenue bodies, assisting with both the identification and treatment of risks[1]. It allows revenue bodies to assess the risks presented by taxpayers or groups of taxpayers ('risk assessment') and then allocate resources accordingly ('risk-led resource allocation').

- **Risk assessment** involves revenue bodies identifying, analysing and prioritising the risks that might otherwise prevent them from carrying out their function.
- **Risk-led resource allocation** involves a revenue body using risk assessment to make informed, evidence-based decisions about: which risks to respond to; the best mix and sequencing of response strategies and treatment (including operational – from help to enforcement – legislative and policy responses); and how to allocate resources to the areas that are likely to benefit from more attention. For example, audits may be targeted towards businesses which exhibit characteristics judged to indicate that they may carry more tax risk than their peers.

A key point to keep in mind is that risk management is not only about what revenue bodies do but also about which tax returns **not** to audit, which tax issues **not** to ask about and which enquiries **not** to pursue. Judging what they **will not** do assists revenue bodies to prioritise the things they **will** do.

The benefits and strategic application of a risk-management approach for detecting and responding to tax compliance risks are the subject of the 2004 FTA guidance note *Compliance Risk*

Management: Managing and Improving Tax Compliance[2]. While focused on small business, it provides a practical insight into how risk management can be used to improve compliance.

The guidance note sets out that compliance risk management is essentially about:

- deciding what are the main compliance risks to be addressed;
- understanding the factors that influence behaviour;
- identifying the mix of strategies needed to treat the main risks and determining resource allocations;
- implementing agreed risk-treatment strategies; and
- monitoring their implementation and evaluating their impact.

The key benefits of the approach for revenue bodies can be summarised as:

- a structured basis for strategic planning, including resource allocation;
- a process for identifying systemic risks to the tax system – for example, areas where the law is not operating satisfactorily or is producing unacceptably high compliance costs;
- a collection of evidence to allow revenue bodies to determine their response to risk – whether it is the deployment of additional resources or a legislative change; and
- a defensible approach to managing taxpayer compliance that can withstand external scrutiny (e.g. by external audit officials).

Aggressive tax planning is one of the many compliance risks that revenue bodies must manage. Unless there are systematic processes in place for carrying out each of the activities described in 5.5 above, revenue bodies will be less effective at identifying, understanding and addressing compliance risks, including aggressive tax planning.

Benefits to taxpayers

As well as benefiting revenue bodies, risk management can also benefit many taxpayers. For example, while taxpayers who demonstrate significant risk can expect to attract greater scrutiny and enforcement attention, taxpayers who behave transparently and who represent lower risks can reasonably expect a more co-operative approach from revenue bodies and therefore lower compliance costs.

This does not mean that transparent taxpayers should not be audited. Revenue bodies may want to audit significant risks disclosed by transparent taxpayers because disclosure and transparency are not a route to a preferential tax outcome. Moreover, revenue bodies will continue to need to apply some audit resource even to taxpayers who appear to be low-risk, in order to help sustain the integrity of the tax system and deter taxpayers from attempting to gain an unfair advantage by presenting a false, low-risk picture.

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

Where this takes the form of the taxpayer and revenue body discussing risk-assessment processes and areas of risk in real time, the taxpayer may be better able to obtain early certainty, which is particularly valued by large corporate taxpayers as chief financial officers (CFOs) and audit committees of corporate taxpayers are increasingly managing tax risk.

The Study Team therefore supports the OECD's work in this area and **recommends** that revenue bodies use risk management in allocating resources to address prioritised compliance risks, including aggressive tax planning.

What does risk assessing involve?

The question revenue bodies try to answer in risk assessment is whether to devote resources to a particular issue and if so what response is most appropriate. This is not the same as the question the taxpayer or tax intermediary focuses on, which is whether the issue has been correctly reported (and hence whether additional tax will be due and how the audit affects certainty). The latter is mainly a legal question; the former is a question of resource prioritisation.

In order to be able to carry out effective risk assessments, revenue bodies require current, relevant and reliable information. Chapter 6 sets out examples of strategies currently used by revenue bodies to obtain such information.

Risk assessing involves the revenue body taking a broad view of what it knows about potential tax issues and the taxpayer, based on the information it has gathered, in order to form an objective judgement about risk. Two key elements to this risk assessment are therefore understanding the taxpayer and understanding the tax issue.

Given that resources are limited, any measurement or assessment of risk must be capable of being compared across the revenue body's functions. This means it must allow the revenue body to prioritise issues, or respond to a taxpayer's behaviour, based on the risk relative to other possible uses of those resources. As noted above, risk management will also assist decisions about what not to audit.

In working paper 5 released on the OECD website[3], the Study Team looked at whether revenue bodies should formalise the way they take into consideration the 'risk-profile' of tax intermediaries when developing risk assessments of their clients. While recognising that some countries already undertake work in this area, the Study Team has not pursued the subject further. It will therefore be for individual FTA countries to decide how to take this forward, if at all.

Understanding the taxpayer

The Study Team identified several different dimensions that revenue bodies need to take into consideration in understanding large corporate taxpayers. The following describes these dimensions but is not an exhaustive list of the factors that need to be considered:

- *The taxpayer's commercial structure, size and activities* – the bigger and more complex the taxpayer's structure and affairs, the greater the potential for significant issues to arise. However, stakeholders were very clear in consultation that size on its own is not a good indicator of risk. There is no reason why the largest corporate taxpayer cannot be low-risk.

- *The quality of the taxpayer's processes and accounting systems.* Taxpayers need tax control and internal governance systems and processes that are adequate for the task of gathering and handling the data needed to comply with tax obligations to the necessary standard.

- *The taxpayer's behaviour* – this relates to the choices each taxpayer makes about what they share with revenue bodies and when. Chapters 7 and 8 recommend that taxpayers and revenue bodies should be open with each other. The more taxpayers co-operate and behave openly with revenue bodies, the more likely revenue bodies are to make accurate judgements about the risk they pose. Conversely, while taxpayers cannot be compelled to provide this higher level of openness, revenue bodies are likely to see lack of openness as a risk indicator. This is because lack of openness reduces information and therefore creates uncertainty for revenue bodies.

- *The extent of agreement over interpretation of the law*. Where there is broad agreement about the interpretation of the law – and appraisal of the facts to which the law needs to be applied – issues are unlikely to be significant tax risks. This is not to say that taxpayers should accept the revenue body's interpretation of the law even when they disagree with it; they are entitled to challenge revenue bodies and, where necessary, litigate. Nevertheless, given revenue bodies' focus on resource allocation, they will see persistent disagreement over interpretation of the law as a risk indicator.

Understanding the taxpayer relies on revenue body personnel being sufficiently well trained to understand the commercial context within which large corporate taxpayers operate. The importance of revenue bodies' having commercial awareness is explored further in Chapter 7.

Understanding the tax issues

There are potentially a large number of issues, in relation to aggressive tax planning and other risks that revenue bodies could choose to audit. Revenue bodies cannot audit all of them and resources should therefore be deployed to issues where there is significant risk.

This means that a broader assessment of the issues in each taxpayer's return should be undertaken to determine whether any of these issues is likely to have been dealt with correctly or not – that is, whether it is a risk. Understanding the taxpayer is therefore part of risk-assessing the issue.

This approach should involve treating taxpayers with similar facts and circumstances consistently and equitably. However, in allocating resources, revenue bodies should form a broad view of the likelihood that the facts and circumstances differ from those the taxpayer presents in the tax return. Using a risk-management approach will therefore lead to revenue bodies choosing to audit some taxpayers and not others where the facts and circumstances they present are similar.

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[1] Risk broadly refers to the tax compliance risks that a revenue body must manage, including aggressive tax planning and the two areas of concern set out in Chapter 2. The specific nature of tax compliance risks will vary between countries.

[2] Forum on Tax Administration Compliance Sub-Group, Guidance Note Compliance Risk Management: Managing and Improving Tax Compliance, October 2004.

[3] Working Paper 5: Risk Management, is available on the OECD website can be found at http://www.oecd.org/document/27/0,3343,en_2649_33749_39006683_1_1_1_1,00.html

Chapter 6 – The need for information

Key points:

- Effective risk management depends upon current, relevant and reliable information.
- Revenue bodies can obtain information:
  - Through statutory obligations.
  - By encouraging taxpayers to provide it voluntarily.

The importance of information

In the previous chapter, the Study Team recommended that revenue bodies should adopt risk management as a tool to allow them to identify and prioritise risk and to allocate resources accordingly. Revenue bodies can only manage risk effectively if they have current, relevant and reliable information and the capabilities to gather and process that information.

Revenue bodies have two broad methods of obtaining information from taxpayers and tax intermediaries. One is to obtain information using statutory powers and the other is to obtain information on a voluntary basis, going beyond statutory obligations. This chapter considers the options for obtaining information under statutory powers with particular focus on large corporate taxpayers and aggressive tax planning, and also the key revenue body capabilities for ensuring that information obtained can be effectively used for risk management. It also mentions other sources of information about taxpayers. Chapters 7 and 8 look at ways of encouraging taxpayers to provide information voluntarily.

The ability to obtain information can have a broader impact on aggressive tax planning than the provision of the information itself. An effective system for gathering information can act as a significant deterrent to aggressive tax planning, particularly for large corporate taxpayers whose audit committees and senior management are requiring increased certainty in managing tax risks. This is because there is an expectation that aggressive tax planning opportunities will be detected quickly and there will be an early operational, policy or legislative response.

Key revenue body capabilities

Revenue bodies need the capability to gather and process the information received. *Compliance Risk Management: Managing and Improving Tax Compliance*[1] sets out four key internal capabilities that affect a revenue body's ability to deliver an effective risk-management approach. These are:

- Organisational culture – compliance risk management is central to organisational reporting, governance and decision-making processes.
- Organisational structure – the structure of the organisation should reflect the risks detected and be able to respond to the changing risk environment[2].
- Information technology and business systems – revenue bodies should be able to receive and process multiple pieces of information and use this information to inform strategic planning.
- Staff and business capabilities – revenue bodies need to ensure that staff understand their roles and are able to contribute to the process.[3]

Sources of information

Primary source

The basic statutory relationship in most countries means the primary source of information for revenue bodies is the tax return and its supporting documents.[4] Revenue bodies supplement this information with intelligence gathered through a variety of other sources, including third parties and historical data.[5] This supplementary information may be provided under other statutory powers or voluntarily. For example, the Belgian revenue body, like many others, has the statutory power when enquiring into tax returns to obtain documents and other information from taxpayers or third parties (such as tax intermediaries) in certain circumstances.

Relying on the tax return as the primary source of information creates a number of potential information gaps for the revenue body, particularly in relation to aggressive tax planning. These include:

- waiting for a return to be filed means there is often a significant delay in receiving information (i.e. between the transaction being implemented and the return being filed)[6];
- it takes time to assess and analyse a return, so any legal challenge from a revenue body on a particular transaction is also delayed, therefore creating uncertainty for the taxpayer and growing risk for the tax administration, before the issue is finalised;
- since reaching agreement on the technical position can take time, any legislative response to defects in existing law can also be delayed, creating uncertainty for taxpayers in general and additional revenue loss for governments; and
- a lack of transparency in the return can mean there are often gaps in the revenue body's understanding of a particular transaction or arrangement.

One of the biggest challenges facing revenue bodies is how to fill these information gaps and increase the quality and quantity of real-time information. Revenue bodies have developed various strategies to respond to this challenge, examples of which are set out below. These strategies are often responses to specific domestic risks and it does not follow because a technique works in one country that it will have a similar impact in another.

The role of rulings

The majority of FTA countries have some form of advance ruling mechanism.[7] These are designed primarily as a service offering rather than as an information source or 'detection strategy'. Rulings provide taxpayers and those advising them with the opportunity to seek early certainty on the tax consequences of a particular set of circumstances. As set out in the next chapter, rulings can also help demonstrate a revenue body's commitment to openness.

The exact nature of the mechanism used by FTA countries varies from general ruling regimes to specific clearance processes or 'product rulings' (those limited to certain parts of the tax legislation and to specific transactions – see below). There is also variation in the extent to which the mechanisms are binding on either the revenue body or the taxpayer and on whether the outcome of the ruling is disseminated within the wider tax community.

Rulings also benefit revenue bodies, helping them to see transactions at the earliest possible stages and allowing technical and policy issues to be addressed early. This is particularly true in countries where the revenue body is willing to rule on transactions it sees as aggressive tax planning.[8] This approach is used in New Zealand where all major private ruling requests concerning the application of its general anti-avoidance provision are reviewed by policy teams. This early intelligence allows the development of rapid response strategies and provides information for the tax policy and legislative process.[9] This approach may also create an environment in which taxpayers and their advisers are more likely to seek rulings on new and innovative planning, providing key intelligence for the revenue body.

The product ruling regime in Australia is an example of a ruling mechanism that has been more explicitly designed to gather intelligence on tax planning, in particular on generic schemes intended for promotion to a number of users. The regime allows tax intermediaries to approach the Australian Tax Office (ATO) for a ruling on the tax benefits of any 'tax-effective investment' being promoted. As well as providing the ATO with valuable and timely intelligence, product rulings also appear to have had a significant impact on taxpayer behaviour. The ATO believes that Australian taxpayers are now unwilling to invest in mass-marketed schemes without product rulings. In turn, this demand for product rulings is driving tax intermediaries into the regime, increasing the intelligence being gathered. This is an example where addressing the demand side of aggressive tax planning has influenced tax intermediaries on the supply side.

Statutory advance disclosure

As mentioned in Chapter 4, several countries, including Canada, South Africa, the UK and the USA, have statutory rules that require the disclosure of certain schemes or arrangements to the revenue body in advance of the return process[10]. In these countries, the disclosure obligation often falls on the tax intermediary – reflecting a focus on closing the information gaps that relate to the supply side of the market.

Advance disclosure can provide revenue bodies with valuable information in advance of the tax return being received, for example: the types of schemes being entered into; those supplying the schemes; and the taxpayers using them. As set out in Chapter 4, such regimes can have a significant deterrent effect.

Appendices 7.1 and 7.2 contain case studies on the UK and USA approaches to disclosure. These case studies contain some observations on considerations for any revenue body designing an advance disclosure regime.

In general, revenue bodies need to:

- be clear about the objective of the regime: what risk or risks the regime is targeted to address; and the information gap (or gaps) being targeted – if not well targeted, there is the potential for disclosure rules to create heavy burdens and little gain for all parties;
- consult with taxpayers and tax intermediaries to ensure it will achieve these objectives; and
- ensure the operational implications of the regime have been fully considered – the experience of countries that have advance disclosure is that they require careful management and a significant dedication of resources in order to process and respond to the information received.

The role of international co-operation

Effective mechanisms for exchange of information between countries are another important means of obtaining information. These mechanisms are designed for the general purposes of tax administration but they are highly relevant to aggressive tax planning which often contains cross-border features.

Effective exchange of information requires that revenue bodies have in place the legal mechanisms to exchange information. For the most part, these take the form of bilateral tax treaties and in particular article 26 of the OECD Model Convention. In some cases, however, they may take the form of multilateral instruments, e.g. the OECD/Council of Europe Multilateral Convention on Administrative Assistance in Tax Matters or bilateral tax information exchange agreements.

Underpinning these legal mechanisms, countries also need appropriate controls and structures to allow information flows to operate efficiently in practice. The OECD is working on improving the operational and practical aspects of exchange of information and in 2006 published the *OECD Manual on Information Exchange*. This manual is designed to improve the efficiency of information exchange and provides an overview of the operation of the provisions and some technical and practical guidance.[11]

In addition to the mechanisms already mentioned, FTA countries are co-operating in several notable initiatives:

- **The OECD's wider work on aggressive tax planning.** The OECD's work focuses on improving response times to emerging aggressive tax planning and sharing experiences in dealing with it. This work includes a platform for sharing of such information known as the Aggressive Tax Planning Directory.
- **The Joint International Tax Shelter Information Centre (JITSIC).** In 2004, Australia, Canada, UK and USA created JITSIC in Washington DC to supplement the ongoing work of tax administrations in identifying and curbing abusive tax avoidance transactions, arrangements and schemes. In 2007, Japan joined the project and a new office opened in London.
- **Seven Country Tax Haven Forum**. The Seven Country Tax Haven Forum was formed in 1998 as a partnership of the Pacific Association of revenue bodies (Australia, Canada, Japan, and USA) and the Group of Four (France, Germany, UK and USA). The Forum seeks to improve capacity to deal with offshore compliance risks.

- **Leeds Castle Group**. The Leeds Castle Group was set up in 2006 as a forum for the heads of ten revenue bodies[12] to meet regularly to discuss issues of global and national tax administration, particularly the compliance challenges each administration faces.

During the course of the study, many FTA countries highlighted the value of international co-operation and these particular initiatives. The Study Team therefore **recommends** that FTA countries continue to find ways to work together and to improve the exchange of information, particularly in relation to the issues raised in this report.

Other sources of information

Using post-transaction information such as externally sourced data (e.g. press releases, website material, public accounts, etc.) adds to revenue bodies' information about taxpayers and allows them to verify (or identify omissions from) returns and statements lodged by taxpayers.

Publicly available accounts are an important source of information on large corporate taxpayers. In many countries, these accounts must contain a reconciliation of differences between the current-year tax liability (estimated when the accounts were audited) and the tax figure stated in the profit and loss account.[13] The disclosures in these accounts are governed by rules set by the relevant national or international bodies. For example, the Financial Accounting Standards Board (FASB) in the USA requires disclosure of uncertainties with respect to tax liabilities under its FIN48[14] accounting standard.

These standards constantly evolve. FASB and the International Accounting Standards Board currently have a project to converge their standards concerning disclosure of tax uncertainties. In developing accounting standards, independent bodies have regard to the needs of users of accounts. They do not determine disclosure requirements solely to meet revenue bodies' needs. Nevertheless, revenue bodies are important users of accounts and the Study Team **recommends** FTA countries ensure those who develop accounting standards are aware of revenue bodies' needs.

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1 FTA Compliance Sub-Group, Guidance Note Compliance Risk Management: Managing and Improving Tax Compliance, October 2004, 14-17

2 There are many different ways a revenue body may choose to structure itself but, as noted in *Tax Administration in OECD and Non-OECD Countries: Comparative Information Series (2006),* a clear trend in tax administrations worldwide (including two-thirds of the countries surveyed by the report) has been the establishment of special organisational arrangements to handle the tax affairs of the more complex taxpayers. In addition the IMF has highlighted the advantages of using a sector-based structure within these large corporate taxpayer units, details can be found at: www.imf.org/external/pubs/ntf/op/215/index.htm.

3 Contributing to this the importance of revenue bodies developing understanding based on commercial awareness is explored further in Chapter 7 and Annex 7.1.

4 Tax returns and the supporting documents required vary between FTA countries. For example, in Spain in addition to the tax return there are some general obligations to provide certain information on transactions with third parties. In addition, the company's accounts are a key information source.

5 FTA Compliance Sub-Group, *Guidance Note Compliance Risk Management: Managing and Improving Tax Compliance,* October 2004, page 30 identifies data sources that are central to the risk-identification process.

6 Legislated filing periods vary between FTA countries. For more information see the FTA publication, *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2006),* October 2006.

7 For a comparative analysis of the rulings regimes available within FTA countries see table 17 in the FTA publication, *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2006),* October 2006.

8 This approach is primarily seen in countries that have a general anti-avoidance or abuse rule (GAAR). There the need to provide additional certainty is linked to the inherently broad nature of such provisions.

9 Other countries that have a GAAR and will provide rulings on transactions they see as aggressive tax planning

include Australia, Canada, France, Italy and New Zealand.

[10] Germany is also looking at a reporting regime.

[11] The OECD Manual on Information Exchange can be found at http://www.oecd.org/document/5/0,3343,en_2649_33767_36647621_1_1_1_1,00.html

[12] Australia, Canada, China, France, Germany, India, Japan, South Korea, UK and USA.

[13] For example, in the USA, the IRS requires certain corporate taxpayers to file a Form M-3 that highlights differences in reporting of financial statement (i.e., book) and tax return numbers.

[14] See glossary.

Chapter 7 - Revenue body attributes

Key points:

- Large corporate taxpayers place increasing importance on achieving early tax certainty.
- Five attributes of revenue bodies contribute significantly to this – understanding through commercial awareness, impartiality, proportionality, disclosure and transparency, and responsiveness.
- These are of general application for all taxpayers.
- Revenue bodies can apply them more comprehensively when taxpayers provide high levels of disclosure and transparency.

Background

The two preceding chapters on risk management and the need for information set out that revenue bodies have a greater ability to respond appropriately to taxpayers where current, relevant and reliable information is available. Chapter 6 looked at ways of obtaining information using statutory requirements. By contrast, this chapter explores why it is in the interests of both parties for taxpayers to provide high levels of disclosure and transparency voluntarily.

The Study Team consulted business and tax intermediary representatives for their views on what they need to see from revenue bodies to encourage them to provide this. The consistent response was that large corporate taxpayers want early certainty and a ‘problem-solving attitude’ and that the following attributes contribute directly to achieving this:

- Understanding based on commercial awareness
- Impartiality
- Proportionality
- Openness through disclosure and transparency
- Responsiveness

In working paper 6[1], these attributes were linked with what was described as an ‘enhanced relationship’. Responses pointed out that they should not only be offered to a select group of taxpayers on the basis of a revenue body’s subjective judgement as all taxpayers should be treated equitably and consistently. They should therefore be seen as fundamental attributes that underpin all the revenue body's actions.[2] The Study Team accepts this point, although it believes revenue bodies will be able to apply at least some if not all of these attributes more comprehensively when dealing with a taxpayer who provides a high level of disclosure and transparency. This is because in some circumstances the extent to which a revenue body can apply some if not all of these five attributes will be dependent on the information it has available. The application of these five attributes is developed in Chapter 8.

Revenue bodies already have considerable capability in these areas and the Study Team **recommends** that they continue to explore ways of improving.

Understanding based on commercial awareness

Chapter 3 sets out the behavioural drivers of large corporate taxpayers. They generally undertake transactions for commercial reasons with tax being one factor in their decision-making. While there is a spectrum from the very aggressive to the very conservative, most large corporate taxpayers undertake transactions for commercial considerations but structure them with a view to maximising post-tax returns. They therefore engage in planning to minimise taxes.

Revenue bodies need to be able to understand the context within which this planning takes place. Without an understanding of the commercial drivers, there is the potential for revenue bodies to misunderstand the broader context of an activity or transaction and to respond in a way that results in potentially costly disputes and uncertainty.

This understanding requires far more than knowledge of tax law and accounting standards. The level of commercial awareness needed has several components.

First, revenue bodies need to understand the 'business of how to do business' that is the broad context within which large corporate taxpayers operate. This includes:

- how companies operate and compete in domestic, regional and global markets;
- strategic and business planning concepts;
- public company financing; and
- public company financial reporting, financial disclosure and financial accounting matters.

Second, revenue bodies need to understand the characteristics of the industry sector in which a particular taxpayer operates. This includes:

- industry-wide trends and norms;
- products and marketing;
- intellectual property;
- competition and regulation; and
- commercial risks.

Third, revenue bodies need to understand the unique characteristics of the particular taxpayer's business. This includes:

- variations from the more generic industry characteristics noted above;
- the company's corporate governance, its management structure and its decision-making processes;
- the company's legal and operational structure, international relationships and ownership;
- its risk-management strategy and appetite for risk in the tax area;
- the tax function, tax control framework and tax decision-making process; and
- the interrelationship between the tax function and the company's business units.

Overall, revenue bodies need to understand both the commercial and the tax reasons for transactions. How to achieve this is explored further in Annex 7.1. The Study Team **recommends** that revenue bodies explore opportunities for working in partnership with large corporate taxpayers and tax intermediaries to deliver training on relevant issues. The Study Team also **recommends** revenue bodies consider how their organisation and structure can support the development of commercial awareness.

Impartiality

Revenue bodies need to bring a high level of consistency and objectivity to issue resolution. This is principally a matter of the overall approach taken by revenue bodies in the issue-resolution process which should be consistent and focused on the right amount of tax, not maximising the amount of tax receipts.

A more detailed examination is set out in Annex 7.2. This annex also includes a discussion of the use of alternative dispute resolution (ADR) techniques as one possible mechanism to assist impartiality in the resolution of disputes. The extent to which countries are able to consider the use of ADR and other mechanisms for dispute resolution is entirely dependent on their respective legal, administrative and cultural frameworks.

Proportionality

Revenue bodies' dealings with taxpayers generally and tax audits in particular need to be reasonable, balanced and proportionate. Proportionality is about the choices revenue bodies make in allocating resources, deciding which taxpayers, which tax returns and which tax issues to prioritise and how to respond appropriately. In determining priorities, key skills include deciding what not to ask about and, when to discontinue an audit or enquiry that is unlikely to be a good use of those resources – see Chapter 5.

Proportionality requires revenue bodies to approach these decisions from a broad perspective that takes into account the characteristics of the taxpayer in question, the relationship between the revenue body and the taxpayer, and the potential benefits of pursuing or not pursuing a line of enquiry. For example, past experience of adjustments on a particular taxpayer's returns should increase the likelihood of the revenue body putting resources into further audits of that taxpayer's returns. By contrast, a history of finding no such adjustments would lead to a reduced likelihood of the revenue body putting resources into further audits.

Proportionality also means that revenue bodies should ordinarily have regard to the overall revenue consequences of initiating a particular audit or other response. It therefore requires two things. First is that revenue bodies should focus their enquiries and examinations on the most significant issues presented by a tax return; and second is that significance for these purposes must be judged in context.

Examples of what proportionality could mean for revenue bodies are:

- to focus attention on significant issues, and only where there are sufficient reasons for doing so – for example, minimising speculative audits where taxpayers are offering disclosure and transparency and there is no reason not to trust them;
- only to ask appropriately focused questions that seek information that will lead to a conclusion of the audit;
- to complete audits quickly once the significant issues have been satisfactorily explored and it is clear that no significant differences or issues remain;
- when processes break down, to discuss the reasons and the remedial action that is necessary;
- to address efforts towards encouraging voluntary compliance, which in appropriate cases will mean helping taxpayers learn from errors and reduce the risk of recurrence; and
- to discuss the implications of decisions before taking them.

Openness and transparency

Taxpayers will want to see openness and transparency from revenue bodies. The extent of this is a matter for each country to decide at both a conceptual level and on a case-by-case basis. While the Study Team does not recommend detailed solutions, there are some considerations that are of general application.

First, consultations with stakeholders suggest that rulings play a key role in providing taxpayers and their advisers with greater disclosure and transparency on particular transactions or issues. These mechanisms provide taxpayers and those advising them with the opportunity to seek early certainty on the tax consequences of a particular set of circumstances. As set out in Chapter 6, the majority of FTA countries have some form of advance ruling mechanism[3] and countries need to consider how these can be developed, if appropriate, to encourage additional levels of openness and transparency.

Second, taxpayers want to know more about how revenue bodies approach risk management. The Study Team sees three levels to this:

- The broadest is the risk-management strategy. The Study Team **recommends** that revenue bodies should consider providing greater transparency on their broad approach to risk management, including the types of behaviours or transactions the revenue body sees as risks and how it will respond to them.[4]

- The mechanisms by which taxpayers or issues are selected for audit, including the algorithms used in computerised risk engines. The Study Team **recommends** that revenue bodies should **not** publish full details of these since to do so could invite inappropriate behaviour by some taxpayers.
- The revenue body's risk assessment of a particular taxpayer. Some revenue bodies are already open with particular taxpayers about their overall assessment of risk and have seen benefits from discussing how the assessment has been reached and how it translates into particular responses.[5] The Study Team therefore sees greater openness as an important element in building mutual trust under the enhanced relationship described in Chapter 8 and **recommends** that individual countries decide whether and how to pursue this.

Taxpayers also want their collective voice to be heard through consultation on changes in tax policy and tax administration, with engagement early enough to influence final decisions. In view of this, the Study Team **recommends** that countries review their approach to consultation although, for many countries, levels of openness and transparency are wholly or partly a matter for consideration by wider government, including tax policy- and law-makers.

Responsiveness

What taxpayers, particularly large corporate taxpayers, most want in relation to tax is early certainty. And they want it quickly. Revenue bodies therefore need to be responsive. Taxpayers should receive prompt, efficient and professional responses when they make requests of revenue bodies. They can also expect a fair and efficient decision-making process and definitive resolution of issues (although some issues will need to be discussed at length and even litigated before they can be resolved).

They also expect revenue bodies to appreciate the value of certainty and to help them achieve it whenever it is possible to do so. As noted above, some countries have introduced rulings regimes designed to provide certainty for taxpayers; other countries have different ways of providing certainty through more informal dialogue.

Revenue bodies also need to ensure that decisions taken at the operational level are consistent with the instructions and guidance of senior management. Certainty cannot be attained if decisions by local revenue officials are subsequently overruled when submitted for approval or if positions taken by the revenue body management are not consistently applied at the operational level.

1 http://www.oecd.org/document/27/0,3343,en_2649_33749_39006683_1_1_1_1,00.html.

2 For the avoidance of doubt, this includes dealings with tax intermediaries as well as taxpayers and others.

3 For a comparative analysis of the rulings regimes available within FTA countries see table 17 in the FTA publication, *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2006)*, October 2006.

4 For example, the ATO already publish taxpayer alerts as well as details of their 'compliance program', which sets out the areas of risk to compliance and how they intend to respond, including a wide range of measures to help those people trying to comply. Further details can be found at: http://atogovau/corporate/content.asp?doc=/content/88713.htm

[5] For example, the countries that have developed business models designed to produce greater cooperation (see Annex 9.1) see higher levels of revenue body openness about taxpayer risk assessment as an integral part of the programme.

Chapter 8 - The enhanced relationship

Key points:

- There is an opportunity to establish more co-operative relationships between taxpayers and revenue bodies.
- This will require:
  commercial awareness, impartiality, proportionality, openness and responsiveness by revenue bodies; and
  disclosure and transparency by taxpayers in their dealings with revenue bodies.
- Positive engagement with tax advisers also offers significant benefits.
- Revenue bodies need to commit resources to developing the enhanced relationship.

Background

The three previous chapters described risk management, information needs and revenue body attributes. This chapter brings these together and explains 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. This is the enhanced relationship. It is a relationship that favours collaboration over confrontation, and is anchored more on mutual trust than on enforceable obligations

The Study Team developed the conceptual framework for the enhanced relationship through extensive consultation with FTA countries and external stakeholders. It was also informed by the experiences of those countries and large corporate taxpayers who have established, or are beginning to establish, co-operative relationships. Countries that have developed business models aimed at improving the tax system through greater co-operation include Ireland, the Netherlands and the USA. Their experiences are set out in more detail at Annex 8.1.

The basic relationship

There is a basic relationship in any country between the revenue body and the taxpayer. This basic relationship varies between countries but broadly it is characterised by the parties interacting solely by reference to what each is legally required to do. While the principal parties are taxpayers and revenue bodies, tax advisers also play an important role.[1] They provide advice to clients as to the legal boundaries of the relationship and, acting on behalf of their clients, often interact directly with revenue bodies.

As set out in Chapter 6, the basic relationship typically means taxpayers file a tax return that discloses a limited amount of information as required under the law, including their taxable income – and, in self-assessment systems, the tax payable – and pay that amount on time. It may not oblige the taxpayer to set out how those amounts were arrived at, nor whether there are matters of uncertainty or unpredictability. Revenue bodies typically have administrative tools to: (i) query the taxpayer about the tax declaration; (ii) obtain additional information; (iii) correct the calculation of the tax payable; and (iv) collect the tax.

Some countries require more of taxpayers than others, so the precise scope of this legal standard and hence of the basic relationship varies from country to country.

Comments in response to consultation asked that the enhanced relationship should not deter countries from continuing to develop their basic relationships. The Study Team accepts this. The basic relationship is built upon fundamental taxpayer rights such as access to an independent judiciary through appeal processes. The enhanced relationship also needs these underpinnings.

The basic relationship is obligation-based and some taxpayers may perceive little incentive to go beyond minimal disclosure, particularly regarding items of tax uncertainty or risk. Yet, as noted in Chapter 6, such information is important both to revenue bodies and to taxpayers as it enables revenue bodies to allocate their resources efficiently according to risk and differentiate their responses accordingly.

The enhanced relationship

By contrast, the enhanced relationship is based on establishing and sustaining mutual trust between taxpayers and revenue bodies. This can be achieved through the following behaviours:

- in dealings with taxpayers, revenue bodies demonstrating understanding based on commercial awareness, impartiality, proportionality, openness through disclosure and transparency, and responsiveness; and
- in dealings with revenue bodies, taxpayers providing disclosure and transparency.

The Study Team **recommends** revenue bodies establish a tax environment in which trust and co-operation can develop so that enhanced relationships with large corporate taxpayers and tax advisers can exist. The rest of this chapter explores the conceptual framework for such enhanced relationships.

Benefits for revenue bodies from an enhanced relationship

Risk management should guide the way revenue bodies deploy resources with the overarching objective of encouraging voluntary compliance. Information is key to effective risk management and resource allocation. Therefore, the more **transparent** taxpayers (and their advisers) are in their communications and dealings, **disclosing** significant risks in a timely manner, the better informed revenue bodies will be. Better information should lead to more effective risk assessment and more appropriate resource allocation, and early disclosure may also facilitate more timely responses, including remedial legislation.

Benefits for taxpayers from an enhanced relationship

Based on discussions with the corporate tax community, as well as the early experiences of pilot programmes in the USA, the Netherlands and Ireland, we believe that early disclosure and resolution of issues will give taxpayers tangible benefits in their management of tax risks. The desirability of early certainty and its importance for large corporate taxpayers has been a significant feature of these consultations.

In particular, disclosures arising from shareholder reporting requirements or corporate governance issues for publicly traded companies as well as unnecessary audit time can be greatly minimised when complex transactions involving potential tax disputes are resolved early, preferably in real time.

Additionally, we believe in the longer term there will be a noticeable financial advantage for taxpayers through reduced compliance costs. If revenue bodies are able to succeed in directing more of their resources into high-risk issues and high-risk behaviour by taxpayers, there will be a long-term gain for lower-risk taxpayers.

Our consultations also indicated that real-time scrutiny by the revenue body leads to better integration of tax issues as deals are being structured.

Disclosure and transparency by taxpayers

In the context of an enhanced relationship, what would revenue bodies expect from a taxpayer in terms of disclosure and transparency?

Disclosure goes beyond information taxpayers are statutorily obliged to provide. It should include any information necessary for the revenue body to undertake a fully informed risk assessment. This includes any transaction or position where there is a material degree of tax uncertainty or unpredictability, or where the revenue body has indicated publicly that the matter is of particular concern from a policy standpoint and will, therefore, be scrutinised.

A key theme from consultations was a demand that, in order for taxpayers to provide this level of disclosure, revenue bodies should provide detailed rules on their requirements. The Study Team does not share this view and believes that a relationship based on trust and openness cannot be based on detailed rules; it must be based on broad principles. Countries with initiatives based on enhanced relationship concepts (see Annex 8.1) have not used rules-based frameworks but have left the parties to establish the appropriate level of disclosure.

Transparency is the ongoing framework within which individual acts of disclosure take place. It describes the manner in which the parties to an enhanced relationship approach tax issues which give rise to a material degree of risk or uncertainty (or may give rise to such a degree of risk or uncertainty in the future).

Transparency has three levels: individual, cultural and structural.

- The *individual* aspect refers to the individual relationships by which taxpayers (and their external advisers) and revenue officials interact. Ensuring that, so far as possible, relationships at this level are built and maintained is a key task, both for revenue bodies and for taxpayers. Continuity can lead to a familiarity and ease of communication upon which mutual trust and respect can be built.

- The *cultural* aspect refers to the collective manner in which taxpayers and revenue bodies, at the institutional level, view the other party to the relationship. A culture in which trust is developed between the parties is a significant facilitator of transparency.
- The *structural* aspect refers to the protocols by which taxpayers and revenue bodies communicate. There needs to be a readily accessible and mutually accepted means by which information can be passed from one organisation to the other. This can be tailored to fit the circumstances of a particular relationship – there may be regular meetings or discussions only as necessary.

These three aspects of transparency are co-dependent. For instance, attempting to foster an institutional culture of openness will be of little use if the necessary individual relationships are not created, and *vice versa*. Equally, the creation of such individual relationships will not be possible unless an appropriate structure for communications is established. Achieving a relationship based on transparency requires all three aspects.

In summary, the twin expectations of disclosure and transparency for large corporate taxpayers are to:

- volunteer information where they see potential for a significant difference of interpretation between them and the revenue body that may lead to a significantly different tax result; and
- provide comprehensive responses so that the revenue body can understand the significance of issues, deploy appropriate resources and reach the right tax conclusions.

As to when disclosure and transparency should be provided, there are basically three timescales: when the transaction takes place, when the transaction is required to be reported to the revenue body, and when discussions about the tax liability take place. More specifically:

- The latest time for disclosure is when the transaction is reported, e.g. in the tax return. Later disclosure would be of little help to revenue bodies in risk assessing the taxpayer.
- Earlier, real-time disclosure and dialogue can be of great benefit to revenue bodies and taxpayers, as the experiences of the USA, Ireland and the Netherlands have shown.
- Transparency, by contrast, is not related to any specific time. It is about the openness of the continuing dialogue between revenue bodies and taxpayers.

Building the enhanced relationship

The enhanced relationship is not an end in itself. Building the enhanced relationship is about creating a wider tax environment in which relationships based on trust and co-operation can develop – it is the outcome of the various strategies identified in this report.

It is for revenue bodies to make the first move and this means using risk management effectively and developing capability in the five attributes described in Chapter 6 in order to provide large corporate taxpayers with earlier certainty. In turn, large corporate taxpayers should then be willing to provide the additional disclosure and transparency to feed the risk-management process, allowing revenue bodies to allocate their resources effectively.

It is for countries to decide what mechanisms, or combinations of mechanisms, to adopt in building the enhanced relationship. The Study Team has identified three possible mechanisms that may assist:

- A unilateral statement or declaration by the revenue body, setting out how it intends to work.[2] This would include what the revenue body asks of taxpayers and tax advisers and the consequences for them if they do or do not provide what is asked for. It would then be for taxpayers to decide whether and how to respond.
- A charter adopted jointly by or on behalf of all stakeholders setting out how all participants intend to work together.[3] This would include what all the participants – revenue body, taxpayers and tax advisers – are expected to do and the consequences for each of them if they do not.
- A formal or informal agreement between the revenue body and a specific taxpayer.[4] These could be tailored to suit the specific needs of different taxpayers. They could include how they intend to work together and how the agreement could be terminated.

The Study Team has identified three steps that may need to be considered in designing these mechanisms:

- *A statement of intent*. This will depend upon the mechanism that has been chosen. What is important is to be clear whether or not the taxpayer and the revenue body intend the mechanism to apply in their relationship. It may need to apply for some periods but not others.
- *An assessment of capability*. Two factors that will strongly affect whether the enhanced relationship can be established are resources and expertise. Consequently, taxpayers and revenue bodies should each consider whether they have the capability to deliver. For example, revenue bodies will need to consider whether staff are appropriately trained. And taxpayers will need to consider whether their tax-control processes are sufficiently robust.
- *High-level endorsement*. To succeed, the relationship needs to last despite changes in personnel in either the revenue body or the tax department of the large corporate taxpayer. This means that the decision to enter into an enhanced relationship should be made at the corporate level, not just by the current personnel. Consequently, we believe countries need to decide at what level a decision to establish an enhanced relationship should be endorsed; this may need to be above the level of the day-to-day relationship. For example, it may be appropriate for the taxpayer's CFO and the revenue body's operational director to provide the endorsement.

As well as clarity on expectations, each of the parties also needs the ability to monitor and evaluate the relationship and to be able to challenge behaviour constructively, particularly where expectations are not met or where the benefits are not being fully realised. Measuring the success of the enhanced relationship is another key issue, including for revenue bodies who are accountable to taxpayers, to government and to society.

Revenue bodies already have a range of mechanisms to challenge taxpayer and tax adviser behaviour (examples include statutory information powers). However, the mechanisms available to taxpayers and tax advisers for challenging revenue bodies in this context are less clear. This inequality could lead taxpayers to doubt that they will benefit from participation. The consequences of a failure by either party to meet its commitments should be clearly expressed.

Therefore, the Study Team suggests that any *statement of intent* by revenue bodies clearly set out:

- how they will monitor the relationship;
- how they will be held accountable for their actions – mechanisms for achieving this could be formal or informal; and
- how they will measure success.

How they do so will be for FTA countries to decide according to their national circumstances.

An enhanced relationship with tax advisers

What about the relationship between revenue bodies and tax advisers?

Chapter 3 considered the behavioural drivers of tax advisers and acknowledged that they have a primary responsibility to their clients. However, this should not stop a mutually beneficial relationship developing between revenue bodies and tax advisers, with dialogue on broader non-client-specific issues.

In many countries, this relationship already exists. A strategy of positive engagement with tax advisers offers potentially significant benefits to all parties in the tax system. In particular, it can add to revenue bodies' understanding of tax advisers and the role they play in the tax system, as well as understanding of their clients and broader developments in the economy. This, in turn, should result in improved risk and compliance strategies and better-focused information requests and dialogue with taxpayers, resulting in reduced compliance costs for all. For taxpayers and advisers, such a dialogue can lead to the development of advance rulings, public guidance, standards for evaluation of administrative programmes and other steps to increase certainty and responsiveness.

Building from this, the Study Team believes there is the potential for a form of enhanced relationship to develop in appropriate circumstances between tax advisers and revenue bodies. This would be based on the premise that greater openness can lead to better relationships.

For revenue bodies, the principal benefit is greater understanding of how tax advisers go about their business, what drives their business practices, how they can be equitably influenced and, most importantly, what impact they have on the decisions made by their clients in relation to tax. This understanding is a key part of the commercial awareness identified in Chapter 7 as a key attribute that revenue bodies must demonstrate.

Just as revenue bodies need commercial awareness in dealings with taxpayers, the Study Team believes it is beneficial for tax advisers to develop and maintain a level of 'policy awareness'. Policy awareness is the ability to predict which transactions and issues the revenue body will want to be disclosed. By gaining greater understanding of revenue bodies, their decision-making processes and general areas of concern in relation to tax planning, tax advisers should be better placed to give best advice to their clients. This may include advice on the tax control frameworks needed and the levels of disclosure and transparency that revenue bodies expect in order to maintain the enhanced relationship.

Tax advisers cannot be expected to match revenue bodies ‘policy awareness’. Just as revenue bodies will need to devote significant time to developing commercial awareness, tax advisers will need to devote significant attention to developing their policy awareness if they are to be in a position to help their clients maintain an enhanced relationship. In turn, this may also require revenue bodies to engage in significant outreach to and engagement with tax advisers to help that process.

In addition, tax advisers have a role to play in helping revenue bodies increase their commercial awareness and understanding their clients’ businesses – see Chapter 7 and Annex 7.1 for further detail on how this might be achieved.

The enhanced relationship between tax advisers and revenue bodies should also result in opportunities for tax advisers and revenue bodies to collaborate on projects such as the production of early explanations of new tax laws, or greater consultation in respect of law-reform proposals.

There are resource and other costs to both revenue bodies and tax advisers in engaging in such dialogue; therefore this must represent valuable benefits to both parties. It will be for countries to strike the appropriate national balance.

One route to consider is for some of this dialogue to take place with professional bodies who often represent the views of a wider population of tax advisers and taxpayers. This allows revenue bodies and professional associations to work together to improve the ‘strength’ of the tax system without limitations imposed by obligations to a particular client. This is not, however, intended to recommend any limit on tax advisers’ direct access to revenue bodies.

Dealing with those unwilling to offer disclosure and transparency

How should revenue bodies respond where taxpayers or tax advisers are unwilling to offer levels of disclosure and transparency going beyond statutory obligations?

Some taxpayers will not operate on the basis of disclosure and transparency beyond the statutory minimum but will prefer to continue under a basic, obligation-based regime. As Chapter 7 indicates, all taxpayers are entitled to understanding based on commercial awareness, impartiality, proportionality, openness (disclosure and transparency) and responsiveness from revenue bodies, whether or not they enter into the enhanced relationship.

The Study Team **recommends** that revenue bodies should risk assess these taxpayers on the basis of the information available (which will be less complete than the information on other, more open taxpayers), applying the five attributes to the best of their ability given the circumstances. This should lead to the deployment of appropriate resources. This may result in significantly more resources being used in auditing and pursuing exploratory issues with these taxpayers than the revenue body needs to use in dealing with more transparent taxpayers. This is because if the revenue body has no other information or explanation, it will have greater difficulty determining that the taxpayer is low-risk.

Some tax advisers will also be unwilling to engage in the specific form of enhanced relationship as described above. They will prefer instead to continue to operate in the ways set out in Chapter 2, promoting aggressive tax planning without transparency.

The Study Team **recommends** that revenue bodies should use a risk-based approach to direct significant attention to such advisers, with a view to making it apparent that there are consequences for advisers of behaving in this way. For example, where such advisers are suspected of non-compliance with their statutory obligations, revenue bodies may wish to ensure they make resources available for investigation, with a view to obtaining evidence to discuss with the particular firm and, if ultimately appropriate, imposing civil penalties or other sanctions (see Chapter 4 for details). Furthermore revenue bodies may wish to consider reporting professional tax advisers to their professional bodies or to other regulatory bodies when they fail to meet their statutory obligations.

[1] In some circumstances, in some countries, tax advisers can also be a party to the basic relationship where they act under a valid power of attorney. For example, in the USA this is common practice for large businesses and HNWIs.

[2] For example, this is broadly the approach used by Ireland in their 'Co-operative Approach to Tax Compliance' - see annex 8.1

[3] For example, Switzerland has a '*Code of Conduct for Tax Authorities, Taxpayers and Tax Advisers*'. This code of conduct provides a very basic list of 'dos' and 'don'ts' which apply not only with respect to communications between tax advisors and the tax administration, but ultimately with respect to any citizen approaching an administrative authority. The Code of Conduct is supported by the Federal Tax Administration, by cantonal tax administrations and by the 'Schweizerische Treuhandkammer'. A copy of the code of conduct can be found at: www.amcham.ch/switzerland/content/code_of_conduct_complete_sep06.pdf. In addition the Study Team also noted the 2006 draft code of conduct developed by KPMG's Tax Business School which sets out to develop "a voluntary code of conduct focused around behaviours [to] help set the environment for trust. The [code] could regulate the behaviour of taxpayers, tax collectors and tax advisers and could be devised and regulated by that group.". David F Williams for KPMG's Tax Business School, *A Code of Conduct for Tax,* October 2006, 4.

[4] For example, this is broadly the approach used by the Netherlands in 'Horizontal monitoring' and the USA in their 'Compliance assurance program' (CAP) – see annex 8.1

Chapter 9 - Banks

Key points:

- Some banks' structured finance departments play a significant role in developing and implementing aggressive tax planning …

… both for clients and also for the banks' inter-bank and proprietary trading so this duality distinguishes them from other tax intermediaries.

- Developing an enhanced relationship with banks would enable revenue bodies to identify and respond to aggressive transactions.
- The Study Team did not sufficiently deepen its understanding of how this sector operates and will continue dialogue to design appropriate strategies.

Introduction

In the course of this study, many stakeholders told the Study Team that some banks develop, or play a role in developing, aggressive tax planning strategies for their own and/or for their clients' use. The term 'bank' includes investment/merchant, retail/commercial, private and mortgage banks; many banks are involved in a mixture of these types of banking. This chapter deals primarily with investment banking activities (including where carried on by some predominantly retail/commercial banks).

Banks are highly regulated and depend heavily upon the value of their reputation and franchise. They maintain and enforce regulatory- and management-driven controls aimed at managing general risks to their business, including tax risks.[1]

Banks' facilitation of aggressive tax planning needs to be kept in perspective. Not all countries find banks at the centre of aggressive tax planning. In those countries that do, not all banks are involved or they may do no more than provide routine banking services. Moreover, banks engage in a wide range of activities so the provision of aggressive solutions involving tax planning forms only a small part of their activities. Nevertheless, the amounts involved in aggressive tax planning transactions can be very large, with single deals involving funding of €billions and tax advantages of €100s millions.[2]

This chapter briefly looks at the types of activity undertaken by banks and the discussions the Study Team has had with banks. It also contains examples which are intended to describe transactions that are likely to be of concern to revenue bodies.

Aggressive tax planning and structured finance activities

Much aggressive tax planning involves the use of financial instruments: loans; repos; derivatives; etc. The more sophisticated the transaction, the more sophisticated the financing may need to be. Those instruments are largely obtained from banks.

Some, but not all, revenue bodies have noted banks becoming less active in providing aggressive solutions for the HNWI market than they used to be, particularly those that are 'mass-marketed'. But these schemes continue.

> *Example of a HNWI scheme*
>
> An offshore subsidiary of a major European bank helped design and implement a scheme which generated tax losses for HNWIs. The bank entered into forward purchase and option contracts over government securities with the HNWIs, acting as lender, seller, buyer and custodian for the time, less than one hour, the HNWI owned them. Schemes of this type were sold to many hundreds of HNWIs who claimed repayments of, on average, over €½ million of income tax.

Some banks continue to offer aggressive tax planning to their large corporate clients.

> *Example of a corporate scheme*
>
> A large corporate (non-bank) taxpayer was in financial difficulties. A UK bank offered it a scheme to turn the large corporate taxpayer's accumulated losses (intended only to be deducted from future business profits) into cash. The scheme used a stock-lending arrangement to create taxable interest in the corporate taxpayer's tax return and an interest deduction in the bank's tax return. The bank's fee was 50% of the tax benefit of around €300m.

But banks do not only provide aggressive tax planning for use by clients. Some use aggressive tax planning themselves, and a significant amount of their involvement in aggressive tax planning relates to:

- the inter-bank finance market; and
- trading by banks on their own account ('proprietary trading').

This leads to an important distinction – banks are both taxpayers and tax intermediaries. In their taxpaying role, they have an internal tax department like other large corporate taxpayers. In their tax intermediary role, they may see tax as a 'front-office' function in which they seek to generate profit.

Some banks have structured finance departments that include both deal- or 'rain'-makers as well as tax and other professionals. Their role involves identifying and exploiting opportunities to devise transactions or structures which provide solutions to the structured finance department's internal and external clients and partners. In doing so, they can generate very large profits for the bank. These deals optimise regulatory, accounting, commercial and other outcomes, including tax.

The structured finance department will see tax as one of a number of variables, hoping to reap far greater rewards from a structured transaction that produces significant financial/tax benefits than from a ‘plain-vanilla’ banking transaction. A bank might hope to make a margin of 15 basis points on straightforward lending to a major corporate but 75 basis points or more on a transaction structured to take advantage of differences between the tax laws of two countries. In essence, the bank and the customer share the tax savings the structuring achieves. For example, take a scheme in which a client pays tax-deductible interest but the bank is not taxed on its receipt. If the normal lending rate was 5% and the tax rate 30%, the interest would be worth 3.5% after tax, so a tax-free return of 4% would be 50 basis points higher than expected for the bank but 100 basis points below the normal interest rate for the client – worth 70 basis points after tax.

Most of the aggressive tax planning solutions that are designed by structured finance departments involve cross-border transactions, although they can also exploit weaknesses in the tax rules of a single country to produce an unintended tax result.

Example of a domestic scheme

A UK bank entered into a shares-as-debt arrangement of well over €1 billion with a UK insurance company, using a ‘special purpose vehicle’ (SPV). The insurance company’s losses offset the SPV’s profits, and the bank’s return of €60 million each year was in the form of non-taxable dividends. The precise structure has evolved to circumvent legislation intended to tax shares-as-debt arrangements.

Many of these transactions take advantage of differences in national tax rules to produce what is known as a ‘double dip’. These often involve the use of ’hybrid’ instruments or entities that are treated or characterised differently for tax purposes by the two (or more) tax authorities involved. For example, a financial product may be characterised as debt in one country with an ‘interest’ deduction and equity in another, resulting in the ‘dividends’ being exempted from tax. Or an offshore entity may be taxed as a partnership in one country with the tax attributes passing through to the partners and as a corporation in another with the attributes taxed at the entity level.

Double-dip transactions are not necessarily aggressive. A transaction may be appropriately structured and yet be characterised differently by different jurisdictions. A simple arrangement can lead to a double dip where policy-makers in both countries regard their rules as achieving the correct national outcomes.

Example of a potentially acceptable double dip

For example, a European bank’s shares are held by a branch of a foreign parent. The parent makes a loan to the branch which pays interest of €150m. The interest is deducted both in taxing the foreign parent (as the branch is part of the company) and in taxing the branch whose losses are available for off-set against the European bank’s income. €300m tax relief at standard tax rates is claimed in total.

But there are also examples of arrangements where the facts are far more complex and unrelated to commercial considerations, often involving ‘special purpose vehicles’ (SPVs). Typically these transactions are designed to generate tax losses that are separate from the mainstream of the taxpayer’s business activities and shelter unrelated income; and they often lack economic substance independent from the tax benefits. Complexity does not necessarily indicate tax abuse; nor does the use of SPVs. However, some aggressive arrangements are designed to obscure the real economics of the transaction.

Examples of more complex transactions include the generation of foreign tax credits from transactions with third parties that the banks can use to offset against their other operating income – income unrelated to the transaction generating the tax credit. Here, banks might seek out other corporations or financial institutions in high-tax countries that are unable to claim the tax credit. An offshore entity is created to 'purchase' dividend rights on stock of the third party. The tax credit is then claimed against the dividend income. This eliminates the tax on it and the 'excess' credit is used to shelter other bank income from tax. This effectively shifts the benefit of the foreign tax credit (and hence the incidence of tax) from the third party to the bank.

Transactions of this type cannot easily be characterised and different countries may view them differently – as potentially inoffensive by one country and aggressive by another.

Example of the use of SPVs – seen as potentially inoffensive in the USA

For example, a US bank financed its UK subsidiary mainly by loans routed through a carefully designed chain of intermediate entities. The €150m interest paid each year was deductible in the UK but, because the paying and receiving entities were both disregarded for US tax purposes, there was no tax on the interest received.

Example of the use of SPVs – seen as potentially aggressive in some countries

For example, a US bank set up a €5bn liquidity back-up facility via a repo arrangement. This involved loan and share subscriptions between the bank, two specially created UK subsidiaries and a counterparty which subscribed for preference shares in one of the subsidiaries and entered into their forward sale to the bank. The subsidiaries are disregarded entities for US tax, thus their interest payments and receipts are US 'tax nothings', but the bank claimed a tax credit, thought to be €100m a year, for UK tax paid.

The most aggressive of these schemes involve no real banking activity at all – the bank takes on no economic risk beyond the tax advantages. Less extreme but still potentially of concern to revenue bodies are transactions with real economic risk which are structured very aggressively.

Banks and the enhanced relationship

The study principally focused on ways to increase efficiency and effectiveness in revenue bodies' risk management and relationships with taxpayers. This approach proceeds on the basis that shrinking the taxpayer-demand for aggressive tax planning will lead to a reduction in the tax intermediary-supply.

As noted in paragraph 8, banks have two functions that are relevant to the study. They provide sophisticated financial products for use by clients, and they also use these themselves in their inter-bank and proprietary trading. The supply/demand model may help in understanding the way banks serve their capital market corporate clients. But it may not be as helpful in relation to their proprietary trading and inter-bank activities. The Study Team therefore viewed banks as different from other tax intermediaries.

Consultation

The Study Team engaged with banks and their tax advisers in New York and London[3] to deepen its understanding of the way structured finance operates and the risks it poses from revenue bodies' perspective. At one level, this was good engagement but the Study Team believes that more work will be required on both sides to reach the level of understanding it was seeking

The engagement with banks and their tax advisers was principally at tax director level. Many countries' experience of responding to aggressive tax planning across a wide range of industries including banking shows that engagement with the CFO or the main board directors is often necessary, focusing on governance issues, before a change of behaviour occurs.

The Study Team did not therefore sufficiently deepen its analysis of banks to develop firm recommendations. Nevertheless, the Study Team can make some preliminary observations about banks' attitudes towards building an enhanced relationship with revenue bodies.

Banks' tax directors are no more or less likely to be attracted to the enhanced relationship than tax directors in other sectors. They may therefore find a co-operative relationship attractive as the existence of such relationships in some countries shows. And they may see the same benefits to real-time working as other large corporate taxpayers as regards their corporate tax liabilities.

But the constantly evolving and highly competitive nature of the business, as well as the number and complexity of the tax issues that arise, may present a challenge to the implementation of an enhanced relationship in the context of structured finance activities.

The Study Team expects that some banks may not see real-time working as sufficiently attractive for their inter-bank and proprietary structured finance transactions. They operate in an environment where risk is all around and where uncertainty is accepted. Moreover, structured finance transactions are fast-paced and the tax issues that arise are often highly technical. Even in countries where rulings regimes exist, banks may not expect them to result in timely responses and hence certainty.

For products developed by banks for their customers, any perceived disadvantage of real-time disclosure may be offset by the advantages of early certainty and a high comfort level a favourable advance ruling can bring to the marketing of a financial product. How important this consideration is in inter-bank and proprietary transactions was unclear and will require further study. Although many banks view tax certainty as desirable and largely beneficial, some banks may not take the same view. The Study Team's consultations suggested that some banks may instead perceive benefit from uncertainty and delayed disclosure that provides an opportunity to profit from aggressive transactions before any legislative change occurs.

The way forward

Banks are not a homogenous group; their motivations and financial structures differ within and between countries and they have different opportunities than most other corporate taxpayers or other tax intermediaries. In particular, inter-bank transactions are extremely extensive, involve huge volumes and are highly competitive; and their proprietary transactions can be highly profitable.

Revenue bodies have well developed ways of meeting the challenges taxpayers and tax intermediaries present. These include the approaches described in Chapters 4, 5, 6 and 8 of this report. These should in general be effective in managing banks' and their clients' risks.

However, revenue bodies would benefit from an enhanced relationship that encourages banks to adopt a more collaborative approach and helps them to identify, and to take prompt action to curtail, abusive transactions. Banks would benefit from an enhanced relationship that facilitates prompt and informed regulatory responses to new financial products.

Banks in London and New York told the Study Team that they believe there would be significant benefits from an enhanced and improved relationship between the financial services industry and tax authorities, and that they are committed to continuing to work with the Study Team to achieve these objectives.

In the course of this short study, the Study Team was unable to deepen its understanding of this area of aggressive tax planning as much as it would have liked. This means the Study Team does not have a clear view on the extent to which the recommendations in this report can have the impact on banks' behaviour that revenue bodies wish to see. Accordingly, the Study Team will undertake a follow-up study that is focused on investment banking:

to improve understanding of the role banks play in designing and implementing aggressive tax planning and how this relates to their wider commercial activities;

- to assess the prevention, detection and response strategies applied by different revenue bodies in responding to the challenges banks pose; and
- to identify what benefits revenue bodies and banks could offer each other from which a mutually beneficial enhanced relationship could be constructed.

[1] In this context, risk is not the same as the risks to tax collection revenue bodies need to manage.

[2] In this report, all currency amounts have been expressed in Euro to aid comparability.

[3] Time and resources available to the Study Team did not allow consultation with banks based in other key global financial centres (e.g. Tokyo, Switzerland, Frankfurt).

Chapter 10 - Conclusions and recommendations

This OECD study began following the FTA meeting in Seoul, Korea in September 2006. The heads and deputy heads of revenue bodies who attended that meeting were unanimous in noting concerns about the role of tax intermediaries in the promotion of 'unacceptable tax minimisation arrangements'. This study addressed one of the areas in which the FTA decided to intensify its work. While tax intermediaries are vital to tax systems, helping taxpayers understand and comply with their obligations, these concerns were borne out by the study's findings: that some tax intermediaries continue to develop and promote aggressive tax planning.

The Study Team concluded that to understand the role of tax intermediaries and, more importantly, to influence their behaviour, it needed to take a broader view. Tax intermediaries are the supply side of a relationship in which taxpayers, their clients, form the demand side. This is a tripartite relationship in which revenue bodies are the other party.

The Study Team focused on large corporate taxpayers and in this context the relationship between the revenue body and the taxpayer is the significant one. It is the large corporate taxpayer, not the tax intermediary, who sets the overall strategy and appetite for tax risk, and who decides whether or not to adopt particular tax planning opportunities. It is in the context of this relationship that the main opportunities exist for revenue bodies to influence the use of aggressive tax planning.

The Study Team concluded that risk management is an important tool enabling revenue bodies to prioritise risk and allocate resources effectively.

To be fully effective, risk management depends upon current, relevant and reliable information. The most comprehensive source of information is the taxpayer, so the study focused on exploring how to develop a relationship between revenue bodies and large corporate taxpayers that would encourage the flow of information from taxpayers through early disclosure of potential tax issues and greater transparency.

Through consultation, the Study Team identified five attributes that large corporate taxpayers want revenue bodies to demonstrate and which would encourage them to offer early disclosure and greater transparency. These are:

- understanding based on commercial awareness;
- impartiality;
- proportionality;
- openness (disclosure and transparency); and

- responsiveness.

These are fundamental for any revenue body and should underpin all their actions. The Study Team concluded that where revenue bodies demonstrate their capability in these five attributes, taxpayers should be more willing to offer increased levels of disclosure and transparency. This in turn would mean better information for revenue bodies' risk-management processes, allowing for differentiated responses from the revenue body and better tax-risk management in real time and hence earlier certainty for taxpayers. This is the enhanced relationship.

Some taxpayers will continue to engage in aggressive tax planning and some tax intermediaries will continue to act as promoters of aggressive tax planning. In these circumstances, revenue bodies will continue to respond appropriately, using a variety of response strategies.

The Study Team was unable to deepen its understanding of aggressive tax planning by banks. This means the Study Team does not have a clear view on the extent to which the 'demand-focused' approach can have the impact on banks' behaviour that revenue bodies wish to see.

The Seoul Declaration focused on the supply of aggressive tax planning by tax intermediaries. We believe that if the approach set out in this report can be successfully implemented, enabling revenue bodies to improve their effectiveness, aggressive tax planning will become less attractive to large corporate taxpayers and demand for such schemes should be reduced. A reduction in the supply of aggressive tax planning would then occur.

Recommendations

As noted throughout this report, relationships between revenue bodies, taxpayers and tax intermediaries differ widely between FTA countries. Furthermore these relationships are shaped by different administrative, legal and cultural frameworks. It is therefore for each country to decide how to apply the recommendations in their own context. This is the context in which the following recommendations should be considered.

In relation to risk management, the Study Team **recommends** that FTA countries:

- use risk management as a tool to allocate resources to address prioritised compliance risks, including aggressive tax planning;
- continue to support the OECD's on-going work on risk management;
- continue to find ways to work together and to improve the exchange of information, particularly in relation to the issues raised in this report;
- formulate their own methods of dealing with tax intermediary risk; and
- ensure those who develop accounting standards are aware of revenue bodies' needs.

To improve their capacity to respond to the needs of taxpayers, the Study Team **recommends** that revenue bodies continue to improve their capabilities in the following areas:

- understanding based on greater commercial awareness
- impartiality
- proportionality
- openness (disclosure and transparency)
- responsiveness

To develop understanding through commercial awareness, the Study Team **recommends** that revenue bodies (i) explore opportunities for working in partnership with large corporate taxpayers and tax intermediaries to deliver training on relevant issues and (ii) consider how their organisation and structure can support the development of commercial awareness.

In relation to openness, the Study Team **recommends** that:

- revenue bodies should consider providing greater transparency on their broad approach to risk management, including types of behaviours or transactions the revenue body sees as risks and how it will respond to them;
- revenue bodies should not publish full details of how taxpayers or issues are selected for enquiry, including the algorithms used in computerised risk engines, since to do so could invite inappropriate behaviour by some taxpayers;
- individual countries decide whether and how to be open with individual taxpayers about their overall assessment of that taxpayer's risk; and
- countries should review their approach to consultation.

In relation to the enhanced relationship, the Study Team **recommends** that revenue bodies establish a tax environment in which trust and co-operation can develop so that enhanced relationships with large corporate taxpayers and tax advisers can exist.

In relation to taxpayers and tax advisers who are unwilling to offer enhanced disclosure and transparency, the Study Team **recommends** that:

- revenue bodies should risk assess taxpayers on the basis of the information available and respond accordingly; and
- revenue bodies should use a risk-based approach to direct attention to tax advisers who are unwilling to engage in mutually beneficial relationships with a view to making it apparent that there are consequences.

Next stages

To build on the study, the Study Team **recommends** that the FTA:

- establish a small task group to review and share experiences on the issues raised in this report, including the enhanced relationship; and
- undertake further work to consider whether the enhanced relationship or other strategies are needed for addressing the risks posed by aggressive tax planning by HNWIs, closely co-ordinating this with other OECD work in this area.

In addition, the Study Team will undertake a follow-up study that is focused on investment banking, building on the activities of the OECD's Committee on Fiscal Affairs (CFA):

- to improve understanding of the role banks play in designing and implementing aggressive tax planning and how this relates to their wider commercial activities;
- to assess the prevention, detection and response strategies applied by different revenue bodies in responding to the challenges banks pose; and
- to identify what benefits revenue bodies and banks could offer each other from which a mutually beneficial enhanced relationship could be constructed.

Annex 4.1

Background

Japan Certified Public Tax Accountant (CPTA)[1] or 'Zeirishi' is the tax profession qualified, regulated and supervised by the National Tax Agency (NTA) under the CPTA Law. The mandate of the CPTAs stipulated in the Law is to promote voluntary compliance with tax obligations as independent and impartial tax professionals in view of the principle of the self-assessment system.

Any person who wishes to do the following business is statutorily required to register as a CPTA with the Japan Federation of CPTA Associations that is mandated to do so by the CPTA Law and supervised accordingly by the NTA:

- act as an agent for filing tax returns, applications, claims or petitions with tax authorities or advocating for taxpayers with respect to their tax returns or against actions by tax authorities;
- prepare tax returns, applications, claims or petitions, to be filed with tax authorities, on behalf of taxpayers; and
- provide taxpayers with any advice on tax matters such as calculation of a tax base or tax planning.

As such, CPTAs are subject to stringent regulations and supervision by the NTA so that their conduct will not diverge from the mandate of the CPTAs and ultimately the fundamental objective of the CPTA system.

Key Features

Regulations in the CPTA Law give the NTA the authority to take disciplinary action against misconduct of CPTAs, while the Japan Federation of CPTA Associations is also allowed to cancel the registration of CPTAs on grounds of a lack of certain qualifications. The key provisions of the law in this connection include:

- prohibition against engaging in instructions or advice on tax evasion or any other similar conduct;
- prohibition against discreditable or disgraceful conducts;
- protection of taxpayer confidentiality; and
- observance of professional standards set by the CPTA Associations and the Japan Federation of CPTA Associations.

Any conduct against these statutory codes of practice in the law, whether intentional or by negligence, would cause a disciplinary action by the NTA Commissioner by virtue of the statutory authority. The disciplinary measures specified in the law are:

- Reprimand.
- Suspension of business (no more than one year).
- Termination of business

Since the business of the CPTA is permitted only for qualified CPTAs, the latter two sanctions are particularly powerful in regulating their conduct though due diligence is required on the part of the NTA. In Japan's fiscal year 2006, nine CPTAs were terminated from the CPTA business, whereas eighteen CPTAs and one CPTA were imposed suspensions of business and a reprimand respectively.

Impact

Although no systematic study on assessment of its success is currently available, it is generally viewed that the CPTA system has significantly contributed to enhancing the public trust in tax advisers and to raising self-esteem as well as awareness among CPTAs as the independent and impartial profession mandated to serve for the fairness of the tax system. Consequently, through more than 50-year history of the interactions under the CPTA Law, it has worked as a major impetus for and has provided the building block of co-operative relationships[2] between CPTAs and the NTA. Thus, the CPTA system constitutes the backbone of the tripartite relationship between taxpayers, tax advisers, and the revenue body in Japan.

[1] Annex provided by the National Tax Agency of Japan.

[2] In Japan's fiscal year 2006, consultations by NTA field offices with CPTA associations of their jurisdiction amounted to 4,796 times.

Annex 4.2

USA – Office of Professional Responsibility (OPR) and Circular 230[1]

Background

The Office of Professional Responsibility (OPR) sits within the Internal Revenue Service (IRS) under the Deputy Commissioner, Services and Enforcement and is responsible for setting, communicating and enforcing standards of competence, integrity and conduct among tax practitioners.[2] Regulations governing ‘tax practitioners’ appear in Circular 230 (C230).[3] C230 defines tax practitioner as an attorney, or certified public accountant (CPA), who is in good standing, enrolled agent or enrolled actuary. Attorneys and CPAs are admitted to practice if they are in good standing with their state licensing authority. ‘Enrolled Agent’ status is achieved by those who demonstrate technical competence and pass a background check. In addition, to come within C230’s jurisdiction, he or she must practice before the IRS. Practice is broadly defined and Congress has clarified that C230 always has applied to opinion writers. Accordingly, C230 could apply to those within large corporations offering corporate-law advice that impacts on the tax position. The IRS has also started pursuing C230 violations in parallel with other enforcement and compliance activities.

The development of C230 is a continuously evolving part of the IRS’s strategy; the regulations are seen as a useful tool that can be adapted to reflect changes in behaviour within the tax community.

Key Features

C230 has existed for over 100 years and allows the IRS to inquire into referrals about possible violations by tax practitioners and to take appropriate action where a violation is found to have occurred. Sanctions for violations range from a reprimand to disbarment. Examples of unacceptable behaviour include:

- Failure to exercise due diligence.
- Providing false or misleading statements.
- Contemptuous conduct towards IRS personnel.
- Failure to meet requirements for covered opinions.
- Failure to meet personal tax obligations.
- Loss of state licence to practice law or certified public accounting.
- Conviction of a federal crime which reflects upon their fitness to practice.

The IRS has become increasingly interested in the role of tax practitioners in aggressive tax planning and is increasing efforts to tackle the promoter or supply side of the market. A civil penalty was introduced into C230 in 2004 and is seen as a key factor in shifting the risk/benefit analysis that a tax practitioner undertakes before marketing a tax shelter and has also been linked with the need for tax practitioners to introduce greater internal-control and risk-management procedures.[4]

A further amendment to C230 is proposed to preclude the use of contingency fees in original return filings and limit the use of such fees in other situations.

The rules relating to 'covered opinions' are also relevant.[5] A covered opinion is written advice that concerns federal tax issues arising from:

- listed transactions (see Annex 6.1);
- any entity, investment plan or arrangement the principal purpose of which is avoidance or evasion of tax; or
- any entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of tax and the written advice is (i) a reliance opinion, (ii) a marketed opinion, (iii) is subject to conditions of confidentiality, or (iv) is subject to contractual protection. A reliance opinion is one that concludes that it is more likely than not (i.e., greater than 50% likelihood) that one or more significant federal tax issues would be resolved in the taxpayer's favour. A marketed opinion is written advice where the practitioner knows or has reason to know that the advice will be used or referred to by another practitioner in promoting, marketing or recommending an entity, investment plan or arrangement to one or more taxpayers.

Written advice will not be treated as a reliance opinion if the practitioner prominently discloses in the written advice that it was not written to be used and cannot be used for the purpose of avoiding penalties.

Under C230, a practitioner providing a covered opinion must comply with the following requirements:

- The practitioner must use reasonable efforts to identify and ascertain the facts and the opinion must identify and consider all the relevant facts.
- The practitioner must not base the opinion on any unreasonable factual assumptions. Significantly, it is unreasonable to assume that a transaction has a business purpose or that a transaction is potentially profitable apart from the tax benefits. In addition, it is unreasonable for a practitioner to rely on a projection, financial forecast or appraisal of the value of an asset if the practitioner knows or should know the projection, etc. is incorrect or incomplete or was prepared by a person lacking the necessary qualifications.
- The practitioner must not base the opinion on any unreasonable factual representations of the taxpayer or any other person. For example, the practitioner cannot rely on a representation that the transaction has a business purpose if the representation does not include a specific description of that purpose.
- The practitioner cannot assume a favourable resolution of any significant tax issue or base the opinion on unreasonable legal assumptions or conclusions.
- Generally, the opinion must cover all significant federal tax issues and provide the practitioner's conclusion as to the likelihood that the taxpayer will prevail on the

merits with respect to each issue. The opinion must provide the reasons for the conclusions. In the case of opinions other than a marketed opinion, if the practitioner cannot conclude that the taxpayer is more likely than not to prevail on one or more significant federal tax issues, the opinion must include a disclosure statement that the opinion cannot be used by a taxpayer for the purpose of avoiding penalties with respect to those issues. In evaluating issues, the practitioner cannot take into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised.

- The opinion must provide the practitioner's overall conclusion as to the likelihood that the federal tax treatment of the transaction is the proper treatment and the reasons for that conclusion.
- If the opinion is a marketed opinion, it must conclude that the taxpayer will prevail on the merits at a confidence level of at least more likely than not with respect to each significant issue. If the practitioner is unable to reach such a conclusion with respect to each significant federal tax issue, he/she must not provide the marketed opinion but may provide advice provided that he/she discloses that the advice may not be relied upon to avoid penalties, that it is written to support the promotion of the transactions/matters discussed, and that the taxpayer should seek the advice of an independent tax adviser.

This description above is very general and is not intended to be an exhaustive description of the C230 rules.

Impact

The IRS has not undertaken any analysis of the success of the changes to C230, but there is anecdotal evidence that it has changed behaviour. It is also seen as a useful channel for highlighting the IRS's concerns, as tax practitioners tend to pay attention to any changes to the regulations.

C230 has its limitations as it is a unilateral code of conduct which has an impact on the behaviour of some tax intermediaries but not others, such as banks and financial advisers – or of the IRS itself.

[1] Annex developed with the IRS.

[2] For further details see: http://www.irs.gov/taxpros/agents/article/0,,id=123812,00.html

[3] For C230 regulations see: http://www.irs.gov/pub/irs-pdf/pcir230.pdf

[4] In one particular case a deferred prosecution agreement entered into between the US Justice Department and a tax intermediary includes the specific condition that section 10.36 of C230 is complied with. This section relates to internal control and risk management processes that are appropriate to the nature of the practice.

[5] It should be noted that the US Treasury are currently considering revising these rules and so the details set out here may be subject to change.

Annex 4.3

USA – Future Compliance Agreements[1]

Background

Future compliance agreements are used by the IRS as part of their approach to managing the behaviour of tax intermediaries. They may be one element of a wider penalty assessment.

A future compliance agreement sets out in writing the future expected behaviour of a particular tax intermediary and is signed by both the IRS and the tax intermediary. The IRS currently has agreements with a wide range of tax intermediaries.

Key Features

Common key components of future compliance agreements include:

- A commitment by the tax intermediary to establish processes for reviewing transactions for the purpose of disclosure in line with the revenue body's requirements.
- Additional record-keeping requirements.
- The establishment of periodic internal checks.
- The maintenance of a central database on arrangements and transactions developed and undertaken.
- Identification of key personnel with dedicated responsibility.

Impact

Future compliance agreements are very case specific and it is difficult to measure whether they have any secondary deterrent effect on the wider tax market-place.

Lessons Learnt

Future compliance agreements need to be tailored to address the specifics of the behaviour seen. It is not a 'one-size-fits-all' approach.

Future compliance agreements need to be monitored and reviewed to ensure compliance. This can be resource-intensive.

1 Annex developed with the IRS.

Annex 6.1

USA – Reportable transactions[1]

Background

The main drivers for the US 'Reportable Transactions' regime are increasing transparency; deterring promotion of abusive tax avoidance schemes; and ensuring that aggressive tax planning is discovered early.

The Reportable Transactions regime requires disclosure to the IRS of:

- 'Listed Transactions' – those that are the same or substantially similar to transactions that the IRS and US Treasury have identified in public guidance to be tax avoidance transactions; and
- 'Reportable Transactions' – those (other than listed transactions) that are potentially abusive but have not been determined to be tax avoidance transactions.

Key features

The disclosure requirements apply to taxpayers who use reportable transactions and material advisors who promote them.

Listed transactions are issued in published guidance and posted on the IRS website. There are currently 33 listed transactions on the IRS website.[2]

There are 4 categories[3] of **Reportable transactions** other than listed transactions:

1. Transactions offered under conditions of confidentiality.
2. Transactions where the taxpayer has a right to full or partial refund of fees if the intended tax consequences are not sustained, or the fees are contingent on the intended tax consequences being sustained.
3. Transactions resulting in the corporate taxpayer claiming a loss of at least $10 million in one year or $20 million in multiple years; with similar rules (in lesser amounts) for partnerships and individuals.
4. Transactions publicly identified by the IRS and Treasury as a 'transaction of interest.'

Former categories of reportable transactions include those done by large companies in which tax treatment differs by more than $10m from its treatment for book purposes, and any transaction resulting in a tax credit exceeding $250,000 if the taxpayer holds the underlying asset for less than 45 days. These categories were removed in July 2007.

The American Jobs Creation Act of 2004 strengthened the US Government's ability to tackle abusive tax shelters. Its provisions included new penalties on taxpayers for failure to disclose reportable transactions and for understating the tax liability on them; extension of the statute of limitations for unreported listed transactions; penalties on material advisors for failure to furnish information on reportable transactions and for failure to maintain and produce a list of advisees to the transaction.

Impact

The US is introducing more (and quicker) legislative and regulatory fixes as a result of the increased intelligence provided by the advance disclosure regime. The regime has also provided a framework for the IRS to impose considerable penalties for non-compliance, aimed at both taxpayers and the promoters of tax shelters.

The greater intelligence provided by the regime has also allowed the IRS to undertake national settlement initiatives for substantially similar schemes. A further benefit is that the IRS is better able to identify users of schemes where the statute of limitations is short, allowing greater prioritisation of cases.

Lessons learnt

The IRS has received large numbers of substantially similar, or 'comfort' disclosures (where the taxpayer or promoter is being over cautious). This potentially creates resource issues in processing and analytical difficulties in identifying trends. This demonstrates the need to ensure that any regime is well targeted and that there are operational processes in place to manage the information received. The IRS is currently looking at electronic filing and analysis in order to increase efficiency in processing the disclosures received.

Where a 'listing' approach to transactions is used, this will require intelligence by the revenue body to reflect changes in the market and successful challenges by the revenue body.

[1] Annex developed with the IRS.

[2] Listed transactions can be found on the IRS website at: www.irs.gov/businesses/corporations/article/0,,id=120633,00.html.

[3] In September 2007, a proposed fifth category of reportable transaction was announced that involves tax strategy patents.

Annex 6.2

UK – Disclosure regime[1]

Background

The UK's disclosure regime was designed primarily to provide HMRC with earlier information on aggressive tax planning. The regime is designed to allow HM Revenue and Customs (HMRC) to get pre-return information about tax arrangements, how they work, who is selling them and who is using them.

The disclosure regime was introduced in 2004 and was aimed at specific areas of corporation tax, income tax and capital gains tax; a separate regime was introduced in parallel for Value Added Tax (VAT). The regime has since been expanded to cover the whole of corporation tax, income tax, and capital gains tax. Stamp duty land tax and National Insurance contributions have been added to the regime. Whilst there are differences between the regimes, the overarching purpose and effect are similar.

Key features

In general for direct taxes, a tax arrangement must be disclosed when:

- it will, or might be expected to, enable any person to obtain a tax advantage;
- that tax advantage is, or might be expected to be, the main benefit or one of the main benefits of the arrangement; and
- it is a tax arrangement that falls within any description ('hallmarks') prescribed in the relevant regulations.

The 'hallmarks' are as follows:

- Wishing to keep the arrangements confidential from a competitor.
- Wishing to keep the arrangements confidential from HMRC.
- Arrangements for which a premium fee could reasonably be obtained.
- Arrangements that include off-market terms.
- Standardised tax products.
- Arrangements that are loss schemes.
- Certain leasing arrangements.

In most situations where a disclosure is required, it must be made by the scheme 'promoter' within 5 days of the scheme being made available. Upon disclosure, HMRC issues the promoter with an

8-digit scheme registration number for the disclosed scheme. By law, the promoter must provide this number to each client that uses the scheme, who in turn must include the number on his or her tax return. A person who designs and implements their own scheme must disclose it within 30 days of implementation (for example, in-house tax departments).

Promoters are liable to penalties for failure to disclose: an initial penalty of up to £5,000 and penalties of up to £600 per day for continued failure to disclose. Recent changes allow for the daily penalty to be increased up to £5,000 in certain circumstances. However, for most promoters, it is the reputational risk for the promoter on the imposition of a penalty that is seen as important rather than the amount of the penalty.

Promoters who fail to give registration numbers to their client will be liable to a maximum penalty of £5,000. Taxpayers who fail to show scheme registration numbers on tax returns will be liable to an initial penalty of £100 rising to £500 for subsequent failures.

Impact

Early evidence suggests that there has been a significant reduction in the marketing of avoidance schemes since the introduction of the disclosure regime in 2004. While there are many potential reasons for this, such as wider changes in the economic environment, anecdotally disclosure has been cited as directly contributing to this reduction.

In particular, disclosures have provided early and detailed information about tax avoidance schemes leading to anti-avoidance legislation being introduced during 2005, 2006 and 2007.

The full impact of disclosure on HMRC's wider compliance strategy has yet to be felt as there are many schemes that have been disclosed by the promoter which have yet to appear on returns.

Lessons learnt

Throughout the development of the regime, HMRC worked closely with both taxpayers and tax intermediaries to ensure that it was appropriately targeted and did not unduly burden the vast majority of taxpayers and tax intermediaries undertaking low-risk transactions. There is a clear consensus that this on-going consultation has produced a much more robust regime. In particular it has helped to ensure that HMRC receives information only about new and innovative schemes, rather than large numbers of disclosures on known arrangements.

As with any set of rules, there will be those who attempt to find their way around the regulations. The revenue body needs to be aware of this and to have the ability to amend the regulations to respond to new and emerging risks and changes in the market-place.

Robust operational processes need to be put in place to handle the disclosures received. The revenue body needs to be able to identify common themes and arrangements and respond to these in a consistent way. The UK has introduced a 'project management' approach to support collation of the information received, with 'lead offices' assigned to co-ordinate particular schemes from disclosure through to investigation and potential litigation. As any disclosure regime produces an increase in both legislative change and litigation, the revenue body needs to give consideration to its ability to select and prioritise cases for both responses.

[1] Annex developed with HMRC.

Annex 7.1

Achieving Commercial Awareness

The Study Team considered how commercial awareness can be achieved. Two important themes emerged from consultations – organisation and education/training. These are considered in more detail below. In summary, there are many ways to gain a broad understanding of the business of how to do business as well as to obtain sector and taxpayer-specific knowledge. Examples are:

- development programmes and other ways of giving revenue body personnel a taste of life in business (e.g. mentoring, secondments to industry, short-term attachments, exchange schemes, non-executive directorships) or participation in wider community activities (e.g. school governor);
- learning from engaging with business taxpayers on a day-to-day basis;
- working in teams where knowledge and expertise can be shared;
- other self-help methods such as sector committees and peer support to facilitate sharing of knowledge and insights;
- in-house training and induction for staff who are new to particular sectors;
- the recruitment of people with external experience working in commerce (whether in business or for accounting or law firms advising business) – for example, those who have worked in a particular sector can act as analysts/experts;
- partnering with business and representative bodies to deliver specific training requirements; and
- informal networking events.

Organisation

The main way in which revenue bodies gain understanding of business is by dealing with taxpayers and their advisers on a day-to-day basis. However, revenue bodies often need to move people around, both for their own career development and to reduce business risks – e.g. to protect integrity and objectivity. This can create a tension since business would often like to develop long-term relationships with specific individuals, in order to achieve continuity and the best return on the investment they are making in that individual's commercial awareness.

As noted in *Tax Administration in OECD and Non-OECD Countries: Comparative Information Series (2006)*[1], a clear trend in tax administrations worldwide (including two-thirds of the countries surveyed by the report) has been the establishment of special organisational arrangements to handle the tax affairs of the more complex taxpayers.

Whilst there are various models employed, this generally involves moving away from a rigid geographical basis for handling taxpayers' affairs to one in which specialist offices deal with taxpayers whose financial affairs demand more specialist skills. This move also enables the revenue body to take a more holistic view of the taxpayer, across tax heads and economic entities. Examples are Agencia Estatal de Administración Tributaria (AEAT) in Spain which has a large taxpayer central office and the South African Revenue Service (SARS) which has created the Large Business Centre (LBC).

The move away from reliance on a strict geographical base for managing taxpayers' affairs may also allow a further stage of development, concentrating the tax affairs of particular sectors in specialist offices. For example, banks in the USA are dealt with by a financial products group attached to Large and Mid-Size Business Division (LMSB) and 'oil and motor' in Ireland are dealt with by a single group within the Irish Revenue's Large Cases Division (LCD). This 'sector' approach is allowing industry expertise to be acquired as revenue body personnel compare different taxpayers competing within the same sector, gain deeper understanding of the issues that arise in the sector, and notice potentially significant issues by omission as well as by commission.

The expertise of the revenue bodies' personnel can also be supplemented and enhanced by external recruits, where revenue bodies are able to buy in industry experience, at both senior management level and field/examination level[2]. For example, HMRC has recruited small but significant numbers of accountants and tax specialists from accounting firms and industry to act as consultants.[3] These individuals have tax, accounting or financial backgrounds, and also bring with them practical knowledge and business experience of a particular industry sector. This broad understanding of how business operates and how taxpayers and advisers think is likely to be of more enduring value to revenue bodies than any knowledge of particular types of transaction. When undertaking such recruitment, revenue bodies need to consider how the knowledge and experience of a limited number of individuals can be best disseminated to appropriate parts of the organisation.

Training and education

The second broad theme involves the training and education of existing staff. The examples listed above demonstrate there is ample opportunity for creativity here.

The starting point in training and education is the staple tax and accounting areas. Some revenue bodies supplement these with training in other personal skills such as negotiation, listening and relationship management.

In the professional tax firms, training in the technical tax areas has also developed to include more general, commercially focused programmes. The Study Team believes there is the opportunity to develop external partnerships with these groups without requiring significant new costs or investment by either party – through revenue body personnel participating in existing programmes,.

Corporate training programmes similarly provide a promising opportunity and there would be benefits in establishing partnerships between the corporate taxpayer and the revenue body to provide education for the examination team about a host of business and industry issues. It would be beneficial for revenue body auditors to become familiar with the corporate headquarters and business units to understand a company's strategic vision, its organisational culture and its day-to-day business operations and decision-making processes.

In the course of consultations a banking professional body also indicated their willingness to explore ways of developing reciprocal education and training programmes to help understanding of complex financial products.

In discussions with external stakeholders, two issues were raised that would need to be addressed by countries that wish to follow this approach:

- confidentiality concerns over unwanted disclosures of corporate financial or proprietary information; and
- concerns regarding the impact of a revenue body 'presence' and the possible 'chilling' effect on existing training programmes.

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[1] See Large taxpayer operations, Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2006), October 2006, 23-25.

[2] Revenue bodies could give thought to making posts attractive to tax professionals with external experience in order to recruit and retain them.

[3] Within HMRC's Large Business Service (LBS), as at September 2007 there are 32 externally recruited tax specialists, a further 8 are being actively recruited. The Anti-Avoidance Group (AAG) has recruited 8 anti-avoidance advisers from the private sector.

Annex 7.2

The impartial approach

Introduction

This annex expands on the concept of an ‘impartial approach’ to the resolution of potential disputes and how it can operate in practice.

At the conceptual level, the impartial approach refers to revenue bodies adopting and fostering an institutional attitude that approaches dispute resolution consistently and objectively and solely by reference to: (a) the merits of the case: and (b) reasonable legal positions.

This does not mean that revenue bodies should not challenge reasonably arguable legal positions adopted by taxpayers in circumstances where the revenue body also has a reasonable legal position it wishes to advance, reflecting what it believes to be sound tax policy.

Taxpayers have a reasonable expectation that revenue bodies will act consistently, objectively and fairly. It would seriously undermine trust and confidence for a revenue body to seek to extract as much tax from the taxpayer as possible regardless of whether it is due under the law, using whatever commercial or other leverage can be brought to bear.[1]

The need for an impartial approach

Revenue bodies administer a broad range of administrative powers in their application of tax laws, giving them broad discretion. The application of this discretion can have immediate and sometimes serious financial or reputational consequences for the taxpayer. For example, a company may be required to make provision in its accounts for an adverse tax position asserted by a revenue body, or, in the case of a listed taxpayer, an announcement to the market on the same matter. Whilst the exercise of such discretion is always subject to administrative or judicial appeal, challenging a revenue body’s decisions can be costly and time-consuming. In practice, conventional checks and balances are not sufficient to allow taxpayers to withhold these public disclosures. This means that revenue bodies are in a position of power in relation to their administration of tax laws. This power needs to be wielded wisely – it would certainly be perceived as an abuse of power for revenue bodies to advance arguments without a reasonable legal basis since this can not only define the parameters of any dispute but will sometimes define the ultimate result – even one that may not in fact be ‘right’ – where the taxpayer cannot afford not to settle.

In addition, some revenue bodies have targets for the amounts of revenue collected. These can provide incentives to behave inappropriately, if not well designed, or at minimum leave taxpayers perceiving that disputes will not be resolved impartially.

What is the impartial approach?

The impartial approach requires revenue bodies to resolve disputes consistently and objectively and solely by reference to: (a) the merits of the case: and (b) reasonable legal positions.

Where a revenue body concedes its position is unmeritorious and could not be sustained in court proceedings, it is inappropriate to allow the dispute to go unresolved and the issue should be conceded. The legislative process, rather than the taxpayer dispute process, is ordinarily the most appropriate means of addressing undesirable revenue or tax policy consequences of current law.

Dispute resolution can be driven by extraneous factors unrelated to the merits of the dispute. Today's environment of intense scrutiny of public companies by non-tax regulators over financial reporting disclosure and corporate governance creates an environment and strong incentive for speedy resolution of disputes. Yet, in many countries, tax audits often do not begin for a number of years after the tax return is filed, and the actual dispute resolution process can add more years' delay. In these circumstances, taxpayers may be prepared to pay a premium over the right amount of tax to obtain early certainty and finality. To some extent, it can be difficult to prevent this from happening – for example, where a dispute cannot be resolved without litigation. But it is inappropriate for revenue bodies to use these extraneous factors to influence resolution.

In some countries, tax advisers, in pursuing their obligations to act as zealous advocates for their client's interests, are not subject to any obligation to ensure that the positions they are advocating are ones that will have benefits for the broader development of tax law or administration or will be appropriate for the generality of taxpayers. In contrast, the revenue body must have regard to the effect it may have on the entirety of the tax system.

Alternative dispute resolution mechanisms

The development of a detached, consistent and objective approach to revenue enforcement should bring consensus rather than conflict to the forefront as the principal basis for the resolution of revenue disputes. In some countries, consent-based outcomes can, of course, be reached simply by a process of negotiation between the revenue body and the taxpayer – often assisted by the tax adviser and as prescribed by the law. However, recent developments in the dispute resolution field have demonstrated that 'alternative dispute resolution' (ADR) may be of assistance. While ADR is not widely used in the resolution of tax disputes (and may not be appropriate for all revenue bodies), its effectiveness in a commercial setting suggests that revenue bodies may wish to consider the technique as a way to assist the process of cultural and attitudinal change that underlies the impartial approach.[2] However, the impartial approach is not dependent on the use of ADR mechanisms.

This is because 'consent-based' ADR has been said by ADR professionals[3] to be of particular use when the parties expect to continue in a relationship following the resolution of the dispute. Litigation is often a hostile and adversarial process which, by its very nature, can only have one 'winner'. It can involve conflicts of evidence and processes of examination that, while not intended to do so, can undermine any trust and goodwill that exists between the parties. Consent-based ADR, by contrast, is a form of dispute resolution that is based fundamentally on consensus, which, in turn, often provides a better basis upon which the parties can continue their relationship.

In countries where ADR mechanisms can be applied, ADR will not be suitable to all cases; as already noted, in appropriate circumstances it is necessary for revenue bodies to use litigation as a strategic tool.[4] There may also be other cases in which the need for the judicial determination of an important issue means that ADR may not be appropriate.

ADR takes a variety of forms. At the most general of levels, ADR refers to any form of dispute resolution that takes place separately from orthodox court litigation. From this starting point, the principal distinction is between 'adjudicative' and 'consent-based' processes. The former refers to mechanisms by which the parties agree to submit their dispute for determination by a neutral third party, which then becomes binding in a manner similar to a court judgment. The usual example is arbitration. The Study Team does not consider ADR of this nature, which may sometimes be close in style to the formalism and adversarial style of litigation, to be well-suited as a general rule to its vision of dispute resolution carried out in accordance with the impartial approach or, for that matter, the broader concepts of the enhanced relationship. However, in certain contexts, arbitration mechanisms may indeed contribute to the fair and efficient resolution of disputes in a way that does satisfy the broader objectives of the impartial approach. The Study Team notes as one such example: the inclusion of an arbitration provision in the Mutual Agreement Procedure article of the OECD Model Tax Convention, to resolve international tax disputes that remain unresolved after two years of mutual agreement procedure negotiations between tax administrations' competent authorities.[5]

By contrast, in consent-based ADR, 'ownership' of the outcome remains solely with the parties. It ordinarily involves a neutral third party facilitating negotiations, or offering non-binding views on the strength of the parties' respective positions. Three widely-recognised processes include:

- 'mediation', in which a neutral third party assists in a series of structured negotiation sessions which aim to achieve resolution through encouraging parties to focus on the real issues in dispute, whether legal or otherwise. Here, the mediator is merely a facilitator, and does not express any concluded view on the parties' cases nor recommend that a particular outcome be adopted;
- 'conciliation', which is similar to mediation but involves the third party being more active in suggesting appropriate settlements or outcomes; and
- 'early neutral evaluation', in which the third party, often an industry or other specialised expert, conducts a preliminary, non-binding assessment of the parties' respective cases as a means of creating a basis for negotiations and avoiding unnecessary escalation in the early stages of a dispute.

It will be apparent that the effectiveness of such ADR mechanisms depends on, and thereby tends to foster, participants' bringing a detached and objective approach to the process. For this reason, the Study Team believes that revenue bodies should consider them as one possible mechanism for facilitating change that leads to an impartial approach to revenue disputes. It should be noted that the extent to which ADR can be considered will be dependent on the legal, administrative and cultural frameworks of respective countries.

Use of ADR tools in a tax context is under way in some jurisdictions. In 2001, for example, the US Internal Revenue Service launched a 'Fast Track Settlement' (FTS) scheme for large corporate taxpayers. In brief, the FTS procedure involves the facilitation of negotiation between the taxpayer and the IRS by the Office of Appeals, which is an independent dispute-resolution division of the IRS. The taxpayer can elect that the Appeals officer play one of two roles in the negotiations – either as a classic facilitator-mediator or as a more interventionist 'conciliator' prepared to offer positive settlement recommendations. In either case, participation in the scheme is voluntary and the taxpayer may withdraw at any time. Results of the programme thus far are that 86% of the cases have ended in resolution and the overall appeals cycle time was reduced from an average of 684 days to 84.

[1] Michael D'Ascenzo, the Australian Commissioner of Taxation, in a speech titled Fairness for taxpayers and a level playing field for business has said that being open, transparent and seeking input from the taxpayer community reflects a value of 'prevention as better than cure' rather than a 'gotcha' mentality.

[2] The extent to which countries are able to consider the use of ADR and other mechanisms for dispute resolution is entirely dependent on their legal, administrative and cultural frameworks.

[3] See generally: Julie Macfarlane (ed.), Rethinking disputes: the mediation alternative, Cavendish, 1997.

[4] The Study Team also noted that in certain countries, such as Austria, the application of ADR mechanisms is restricted to certain areas and cannot be exercised in all areas of tax matters.

[5] See Centre for Tax Policy and Administration, Improving the Resolution of Tax Treaty Disputes, February 2007. This document can be found at: http://www.oecd.org/dataoecd/17/59/38055311.pdf

Annex 8.1

Ireland – The Co-operative Approach to Tax Compliance[1]

Overview

In September 2005, the Irish Revenue's Large Cases Division (LCD) introduced a new approach to managing tax compliance - The Co-operative Approach to Tax Compliance (Co-operative Compliance). By end November 2007 over 80 large corporate taxpayers had agreed to engage with Revenue on this basis. In short, this new approach to managing tax compliance seeks to:

- promote a collaborative, mutually beneficial approach to compliance;
- facilitate more efficient use of business and Revenue resources;
- reduce tax uncertainty; and
- recognise trust and openness.

Co-operative Compliance envisages a new form of relationship between the Irish Revenue and large business, one where both parties work together to achieve the highest possible level of compliance across the taxes and duties for which particular businesses need to account.

This is achieved through:

- the large business sharing knowledge of the business, business events and emerging tax risks in real time with the LCD case manager;
- the Revenue case manager working with the large business to focus on the important issues and, where possible, resolving those issues; and
- selective Revenue checks and audits to reassure the case manager that the business is complying with it obligations.

A copy of the Co-operative Compliance publication can be found at:
http://www.revenue.ie/index.htm?/services/bus_large_business.htm#1

Status and duration

Start date: September 2005

Review date: 2008.

Scope

The businesses currently participating were invited following a review of their' compliance history and risk profile. Cases that were considered to be high-risk were not considered for the initial phase of the programme.

The role of tax advisers

The Co-operative Compliance approach is structured so as not to undermine, in any way, the relationship between large corporate taxpayers and their tax advisers. The dialogue with business operates in parallel with Revenue's traditional relationship with tax advisers.

When introducing this approach, it was made clear that the extent of involvement of tax advisers in any aspect of the tax affairs of a business, including Co-operative Compliance, is a matter for the business and its advisers.

The experience has been that much of the discussion on tax risk analysis and on the formulation and implementation of action plans for tax risk management has involved tripartite contact between Irish Revenue, large corporate taxpayers and their tax advisers.

How are standards of behaviour established and agreed?

The first stage involves the LCD case manager and management of the large corporate taxpayer discussing and agreeing a compliance plan within which they will operate the Co-operative Compliance approach. This compliance plan typically covers two elements – key activities and a timetable for those activities. The process is intended to be flexible, where the detail can be tailored to suit the particular circumstances of the large business and Irish Revenue's requirements.

It is open to the case manager as well as the management of the business to identify risks to be included in the compliance plan. The only interventions will be those agreed in the compliance plan provided that new significant issues do not emerge and there is no reason to believe that the taxpayer's management have not been open with the case manager.

Monitoring

Given that this initiative is relatively new, an in-depth analysis of its effectiveness has not yet been undertaken. However, there are plans to undertake such a review in 2008. However, progress is monitored on an ongoing basis to ensure that the Irish Revenue and the large corporate taxpayers that agreed to engage in this approach actually deliver on their respective commitments.

Evaluation

While an evaluation exercise has yet to be undertaken, anecdotal evidence from Business Unit managers is that Co-operative Compliance is having a positive impact on compliance behaviour. This is supported by an increasing number of requests for assistance and interpretation from those large taxpayers engaged in this approach. Irish Revenue is also seeing an increasing number of unprompted voluntary disclosures and expressions of doubt.

What happens if the relationship breaks down?

Revenue reserves the right to discontinue Co-operative Compliance with businesses that do not operate on the basis of the understandings reached. Equally, large corporate taxpayers that have engaged can also decide to opt out at any stage.

Businesses engaging in cooperative compliance or their advisers have full access to the appeal process and to the facility to seek internal review within Revenue or external review. Decisions by businesses and their advisers to opt for the appeal route or any form of review are regarded as fully compatible with the cooperative compliance approach.

An additional feature, which can be brought into play to help solve emerging problems, is the right of either party to escalate the problem issue to senior management in the business and in Irish Revenue.

Impact

The impact on the revenue body

The experience to date has been positive. The ongoing interaction between large corporate taxpayers and LCD has provided a channel for constructive dialogue within an environment of trust where issues can be resolved in a professional manner. The Co-operative Compliance approach has also helped Irish Revenue gain a better understanding of the needs and behaviour of large corporate taxpayers and to further refine its strategies (including provision of suitable and targeted services), to improve compliance based on this understanding.

The response of taxpayers

While Irish Revenue has not surveyed their case base to establish views on this initiative, the feedback on a case-by-case basis has been positive.

The response of tax advisers

Tax advisers have broadly cooperated with the cooperative compliance initiative

Future plans and next stages

Irish Revenue plans to review the Co-operative Compliance approach in 2008. It also intends to use the direct communication with business management strategy, which is at the heart of the cooperative compliance approach, to confront situations where businesses are indulging in what Revenue considers to be unacceptable tax strategies. To date the programme has focused only on businesses which were perceived to have records of high compliance or which clearly intended to put themselves on this footing.

Netherlands – Horizontal monitoring[2]

Overview

In 2002 the Scientific Council for Government Policy envisaged that the relationship between government and its citizens - individuals as well as corporate taxpayers - would change from a vertical to a (more) horizontal one. In a horizontal relationship there is mutual trust and a model of co-operation between government and its citizens in upholding the laws and regulations. This vision was endorsed by government in its programme ‘Andere Overheid’ (whole of government approach).

In April 2005 the State Secretary of Finance (responsible for the Tax and Customs Administration) wrote to the Dutch Parliament that ‘maintaining complex rules in a complex changing society is nearly impossible without information from and co-operation with that society’.

The Netherlands reached the conclusion that the way they were dealing with large corporate taxpayers was not the most efficient and effective one. In the large business area the need to change was also underpinned by feed-back from the organised business community on the policy of the Tax and Customs Administration. Pilots were announced to develop instruments and new forms of co-operation for large businesses, small businesses, individuals, advisers and in the Customs field. International developments like the development of corporate governance codes, the Sarbanes-Oxley-act and IFRS forced large corporate taxpayers to be in control - also on their tax position - to document their tax position and to be increasingly transparent. Those developments appeared to be very important in developing new forms of co-operation in the large businesses segment.

Scope, status and duration

In 2005 the Tax and Customs Administration started a pilot with twenty very large corporate taxpayers in order to conclude supervision agreements. The basic principle of the relationship with the large corporate taxpayers is mutual trust, transparency and understanding. It goes without saying that everything has to take place within the boundaries of laws and regulations of the Netherlands. The supervision agreement does not create any additional rights or obligations, nor does it limit any rights and obligations. The board of the Tax Administration demands from the company at board level (CFO) to commit itself to full transparency on current tax issues. In return the Tax Administration will give its binding opinion on that issue expediently. The advantages for the company are certainty, being in control of its tax position, having a better relationship with the tax administration and meeting less administrative burdens. In order to be able to focus on current issues, it was necessary to solve the issues from the past first. This appeared to be an attractive proposal for the executive board.

Teams started to work out the high level agreement with the tax department of the company. In that process a written document is agreed upon by the parties and signed off by the CFO and the manager of the local tax office responsible for the company in question. The supervision agreement includes a description of the principles and the process agreed upon and is about one and a half pages long (see the draft example agreement at the end of this annex). In 2006 the Tax Administration expanded the pilot with another twenty large corporate taxpayers. In both pilots were companies that we considered as high-risk taxpayers. With reference to the Sarbanes-Oxley-act and IFRS, in a letter to Parliament in June 2006 it was indicated that in order to enter into the enhanced relationship an adequate tax control framework needs to be developed. The Tax Administration and tax advisers are working on this together.

Standards of behaviour

The Netherlands did not work with a detailed blueprint. A small group of people from the Tax Administration explained their ideas and goals to the other colleagues responsible for dealing with the first twenty large corporate taxpayers in the pilot. During the process the concept developed. The main thing is that there are no definitions of transparency or significant tax risk. This is a key point to be discussed in a bilateral dialogue between the company and the tax team dealing with that company. The expected and shown behaviour should be a topic of ongoing dialogue between the company and the tax administration. It is expected that people from both sides address this.

Early in the process it was understood that Tax Administration staff could not show different behaviour without support. They are expected to build and maintain relationships, to have a problem-solving attitude and understand the different interests of the taxpayer and the tax administration, to have empathic and listening skills and to understand how communication processes work. A masterclass on personal effectiveness and negotiation skills was developed and is mandatory for all the technical staff in the large corporate taxpayers' segment. And, although co-operation is the basic principle an escalation model is always discussed.

Monitoring and evaluation

In 2007 the first part of the pilot was evaluated. A questionnaire was sent to the tax departments of the companies in question and to the staff of the Tax Administration involved. The results are very positive and encourage the Netherlands to move forward along this road. Some of the large corporate taxpayers even mentioned in their public annual accounts the conclusion of a supervision agreement. The results of the evaluation were sent to Parliament in April 2007.

Tax advisers (role and response)

Their first reactions were rather sceptical. Over time this has changed into approval. The role of the tax adviser is still to advise their clients but their work is also shifting to working in real time on current issues. Furthermore we see that tax advisers are developing a business in the tax compliance and tax assurance market.

Future

In 2008 the Netherlands want to make a major step ahead. The form and intensity of supervision of the large corporate taxpayers will be based on the quality of their tax control framework and their level of compliance. In 2008 they aim to have gained a clear insight into the quality of the tax control framework for 60% of the large corporate taxpayers. Our basic values will be trust, transparency and understanding.

This new direction is aimed at more co-operation, less regulations and working in real time.

Example of a supervision agreement

Preamble

Parties aim at realising effective and efficient working procedures based on transparency, understanding and trust. They aim at getting lasting insight into current tax risks and at swiftly determining up-to-date standpoints within legal, regulatory and case-law in order to increase legal certainty. This agreement contains the basic principles and the way in which we wish to deal with each other, both with regard to the future and settling the past.

1. Basic principles

- This agreement concerns Dutch taxation of X (hereafter: X) with regard to all taxes and the tax collection;
- Legal and regulatory rights and obligations remain applicable without any restrictions;
- Parties express their intention to base their mutual relationship on transparency, understanding and trust.

2. Agreements between the Tax Administration and X

(a) With regard to the past:
(b) With regard to the future:
X:

- shall actively notify the Tax Administration of any issues with a possible and significant tax risk;
- shall without any restraint and without any conditions notify the Tax Administration of any

relevant facts and circumstances;

- shall provide the Tax Administration with its view on the legal consequences pertaining to the facts and circumstances and adopted standpoints;
- shall facilitate that, if required, staff of the Tax Administration may contact staff of the large enterprise of the Tax Administration's choice. The presence of the tax consultant and/or person dealing with tax matters of the large enterprise during the meeting shall not meet with any resistance;
- shall provide requested information forthwith and as complete as possible;
- shall submit a tax return concerning an expired period as soon as possible after expiry of that period.

3. The Tax Administration

- shall as soon as possible after having been notified of an adopted or to be adopted standpoint state its views concerning any legal consequences, as much as possible in consultation with X;
- shall when stating its views on the legal consequences take into account real commercial deadlines; if necessary, the procedure shall be expedited;
- shall assess the corporate tax assessment as soon as possible after submission of the return and as much as possible in consultation with X;
- shall discuss any fiscal risks it may perceive at (regular) intervals with X;
- shall provide information at hand on reported tax risks so far as the requirements for confidentiality allow
- shall and is able to clarify and explain at all times why certain information is requested from X; the time within which a response is required shall be determined in mutual consultation;
- shall at all times when starting an audit specifically state which tax risks are investigated, unless prevented by the obligation to observe confidentiality.

4. Duration, regular evaluation and termination

This agreement shall be evaluated annually by (the management board of) X and the Tax Administration/Office.

If, in the interim, a party objects to this agreement, parties will confer in order to determine the possibilities for adapting the agreement before taking any steps to terminate this agreement.

Both parties may terminate this agreement with immediate effect. However, they shall not do so before having notified the other party of their intention in writing, stating the reasons of their intention. Besides, termination shall not become effective until oral discussion has taken place if at least one of the parties has expressed the wish to that purpose.

5. Entry into force

This agreement shall enter into force upon signing of both parties.

For the management board of X [signature]	For the Tax Administration [signature]

USA – Compliance assurance program (CAP)[3]

Overview

Reason for Change

The traditional audit process fails to timely resolve issues for compliant taxpayers and to deter abusive activities by noncompliant taxpayers

- Audit resolution for our largest taxpayers takes 60 months on average from filing date, and for the 27% of these largest taxpayers that go to Appeals resolution takes an additional 26 months on average
- The long audit process inhibits early identification of emerging issues, including potentially abusive tax shelter transactions
- Lack of resolution of open issues over an extended period prevents large corporate taxpayers from effectively managing tax reserves and could impact reporting of financial statement earnings

The IRS can make significant improvements to the timeliness of the current process using a private sector model of real time issue resolution to strengthen corporate governance and improve overall compliance

Goals and Objectives

- Significantly reduce post-filing examination time
- Save time and resources
- Resolve issues prior to filing
- Create real time environment
- Provides quicker guidance to tax issues
- Addresses emerging issues consistently and contemporaneously
- Avoids potential controversy
- Serves to potentially reduce prolonged litigation
- Consistent with the financial statement model
- Complements current corporate governance and accountability responsibilities
- Enhances corporate reputation
- Enhances tax reserve integrity impacting financial statements reporting
- Increases investor confidence
- Improves tax administration
- Rewards compliant behaviour
- Focuses on material issues

- Improves the audit process
- Achieves currency for that year

Status and duration

Pilot began for Tax Year 2005 and continues in pilot status

Scope

The number of taxpayers involved were:

- Tax year 2005 17 taxpayers
- Tax year 2006 34 taxpayers
- Tax year 2007 73 taxpayers

All were large entities who published their financial statements.

The criteria for tax year 2005 included:

- Industry leaders who have demonstrated interest in improving tax administration.
- Post-Filing Audit History – taxpayer is currently under post-filing audit and working toward currency on open years.
- Working Relationship with IRS – the taxpayer and IRS have a good working relations due to cooperation and transparency of information. The taxpayer has participated in other IRS initiatives.
- Tax shelter issues prohibit ease of transition. The Taxpayer has no known tax shelter issues or the taxpayer is working collaboratively to resolve those known and/or identified.
- The taxpayer's financial statements have not been restated due to improper accounting practices.
- The taxpayer has minimal compliance risk, thus facilitating process changes.
- The taxpayer is not involved in major litigation which may impede the ability to develop collaborative relationships and process changes.
- IRS resources need to be available to meet demand
- Industry Diversity

The role of tax advisers

The role of tax advisers was minimal at best.

How are standards of behaviour established and agreed?

Roles for the successful completion of a CAP case are agreed upon through a Memorandum of Understanding (MOU) signed by the Taxpayer and the IRS. The MOU is not a legally enforceable document.

Monitoring

Measures include:

- Cycle time
- Months in process
- Time to tax certainty
- Currency
- Applied time
- Coverage
- Customer satisfaction
- Employee satisfaction

Evaluation

Limited post implementation review of pilot indicates significant progress has been made toward intended CAP benefits. Many of the program challenges are similar to those in post-filing. Identified risks can be mitigated.

What happens if the relationship breaks down?

CAP MOU generally provides that if either party is unable or fails to comply with its responsibility and obligations under the MOU, the parties will elevate the issues to resolve any disputes. If the issues cannot be resolved, the IRS will issue a CAP Termination letter.

Impact

For the limited number of cases within CAP for years 2005 to 2007:

- Time charged on cases is decreasing
- Examination cycle time has decreased
- Resolution of significant unresolved issues has accelerated
- Emerging issues have been identified earlier
- Through CAP, have leveraged corporate governance such as access to audit committee reports and real time identification of issues
- Number of taxpayers interested in program continues to increase

Future plans and next stages

Continue with the program in a pilot stage while adding an additional, limited number of taxpayers.

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[1] Annex provided by the Irish Revenue Commissioners.

[2] Annex provided by Belastingdienst, the Dutch Tax and Customs Administration.

[3] Annex provided by the IRS.

Glossary

Aggressive tax planning. This refers to two areas of concern for revenue bodies:

- **Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences**. Revenue bodies' concerns relate to the risk that tax legislation can be misused to achieve results which were not foreseen by the legislators. This is exacerbated by the often lengthy period between the time schemes are created and sold and the time revenue bodies discover them and remedial legislation is enacted.

- **Taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law**. Revenue bodies' concerns relate to the risk that taxpayers will not disclose their view on the uncertainty or risk taken in relation to grey areas of law (sometimes, revenue bodies would not even agree that the law is in doubt).

Audit. All revenue bodies have processes to check the accuracy of tax returns and to allow them to obtain further information to verify the accuracy of items included. The means by which these processes are undertaken and the mechanisms and objectives of each country differ. Terms such as audit, examination, enquiry, control, intervention and investigation (although in some countries the term 'investigation' is only used for criminal matters) are used by different countries. For the purposes of this report, the term 'audit' describes all these processes.

Auditor. Revenue bodies' staff who carry out audits.

Business and Industry Advisory Committee (BIAC). BIAC is the officially recognised representative of the OECD business community. BIAC's members are the major business organisations in the 30 OECD member countries. For more information see http://www.biac.org/.

Boutique. Small, independent tax adviser firms that provide specialised advice or niche services.

Cross-border transactions. Transactions involving parties in more than one country

Demand side. The study distinguishes between the supply of aggressive tax planning by tax intermediaries and the demand for such advice by large corporate taxpayers.

External stakeholders. As well as working with FTA countries, the Study Team also undertook extensive consultation with external stakeholders in the private sector. At an international level meetings were held with the 'Big Six' and other accounting firms, with major law firms, banks and their respective representative bodies. Business groups including the Business and Industry Advisory Committee (BIAC -see above) and the Tax Executives Institute (TEI) were also involved. Drafts of the key chapters of the report were issued on the OECD's website for public comment. In addition individual FTA countries also held their own national external consultations.

FIN 48. An accounting standard issued by the US Financial Accounting Standards Board that determines the income tax disclosures required in publicly available accounts.

Financial institutions. Collective name for firms operating in the financial sector (e.g. investment and retail banks, insurers, asset managers).

High-Net-Worth Individuals (HNWIs). The term high-net-worth individuals (HNWIs) denotes the wealthiest individuals within a tax system. Other terms for this group of taxpayers exist, including high-wealth individuals (HWIs). Banks and tax advisers sometimes have separate business units serving HNWIs – they are often referred to as ‘private clients’.

Professional Bodies. Bodies which set professional and ethical standards for tax advisers and in some countries act as regulators. Professionals will typically need to meet certain standards or pass tests before being allowed to join, and may impose requirements for continuing professional development.

Risk assessment. This involves revenue bodies identifying, analysing and prioritising particular risks.

Risk Management. This is a more generic term covering the strategies revenue bodies employ to manage risk, as well as their risk-assessment processes.

Risk-led resource allocation. This is about revenue bodies using risk assessment to allocate their resources

Study Team. Those who worked full-time on the study from HM Revenue and Customs in the UK and the OECD Secretariat in Paris. The Study Team also included tax professionals on short-term attachments from major accounting and law firms.

Supply side. See **Demand side** above.

Tax advisers. Collective term for accountancy firms, law firms and other tax advisory firms, including boutiques. And also the individual tax professionals within those firms and within corporate tax departments.

Tax intermediaries. Collective term for tax advisers and financial institutions.

Unacceptable tax minimisation arrangements. The Study Team concluded variations between the legal frameworks of FTA countries mean it is not appropriate or feasible to attempt to reach a definition of ‘unacceptable tax minimisation arrangements’ as used in the Seoul Declaration. Instead consultations led to the identification of two areas of concern – see **aggressive tax planning** above.