

# OECD PROJECT ON HIGH NET WORTH INDIVIDUALS

## DISCUSSION PAPER

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### Questions

#### Question 1

While the question invites a focus on the organization of the tax administration, as distinct from a framework of interaction, if a prime purpose of the organization is to encourage a particular type of interaction, it will be helpful to briefly consider the sort of behaviours one wishes the organization to encourage.

Many HNWI's view tax as simply one more business expense. As with other business expenses, they wish to minimize it to the extent that they properly can. They also wish certainty as to the quantum of the expense so that they can plan ahead. They are more likely to be interested in cooperative compliance if they see it as helping them to achieve some of their objectives. Few will think it likely that tax administrations will seek to actively assist them to minimize their tax bill. However, if they believe that certainty can be obtained on their tax affairs, there is an incentive to adopt the behavioural elements of 'disclosure' and 'transparency' identified as desirable taxpayer attributes (in Point 17 of the Discussion Paper)

Point 17 also recognizes the behaviours which, if adopted by a tax administration, are likely to encourage an enhanced relationship. Of these, the ones which HNWI's or their advisers often believe to be in short supply on the part of tax administrations are commercial awareness and proportionality. They are unlikely to be encouraged to approach their tax administration for certainty, and to display the behaviours of disclosure and openness, if they believe that the consequent dialogue with the tax administration is likely to be disproportionate to any commercial advantage.

An objective of the tax administration in considering how best to organize its resources is to encourage particular behaviours in taxpayers. However, the administration is most likely to achieve this objective if the organization adopted fosters behaviours in the tax administration which taxpayers want to see.

For the tax administration to achieve the sort of behaviours required by HNWI, that is commercial awareness and proportionality, individuals in the administration must have the experience, and the power, to exercise judgement. Individuals are more likely to gain the sort of experience required, and tax administrations are more likely to empower its officers to make judgements which relate to substantial tax liabilities, if there is a specialist unit dealing with HNWI.

## Question 2

For the reasons outlined in Question 1, the submission supports having a dedicated HNWI unit.

(a)

Insights into the behavioural drivers and the general context within which HNWI and their advisers operate will be gained by the experience of operating within a specialist unit focusing on HNWI.

The existence of such a unit would make it more likely that the tax administration could attract staff with private sector HNWI experience by giving them a natural 'home' to which their experience is directly relevant and within which they are more likely to feel valued.

As to whether there should be some form of 'advisory board', while the tax authority and the private sector will no doubt wish to have a means of exchanging views as to what is and is not working, a formal advisory board may raise expectations as to finding definitive solutions rather than the reality of dealing with an ongoing and changing series of issues and concerns.

(b)

In principle, if a HNWI unit cannot deal with the multiplicity of potential problems which arise for HNWI and their advisers, the incentive to 'cooperative compliance' is significantly reduced.

However, if a unit is set up which is supposed to cover research, risk compliance and the standard compliance functions, and if these tasks extend across the range of taxes which the interests of HNWI often encompass (income tax, corporation tax, trusts, inheritance, VAT/GST) the sheer size of the unit and the range of skills which it needs to cover is unlikely to be conducive to the focus implicit in the idea of creating a 'dedicated unit'.

A HNWI unit which did not have responsibility for research, risk assessment and audit of a HNWI affairs is unlikely to retain credibility as a unit which can provide the desired tax administration behaviours identified in Point 17. Without that credibility, it is unlikely to influence taxpayer behaviours.

As a core indicator of a HNWI's affairs, the unit could also take on responsibility for annual compliance of income tax. The IT return is also likely to link in to various other aspects of the HNWI's affairs.

Other returns, relating to corporation tax, trusts, inheritance etc, could be dealt with by the appropriate tax administration office but with a notification on file that any significant issues arising need to be dealt with in conjunction with the HNWI unit.

(c)

See (b) above.

(d)

See (b) above.

(e)

It would be helpful if each HNWI and relevant advisers be assigned a designated contact point, preferably a named officer, within the unit. Apart from helping the HNWI, this would also be useful for the unit in identifying any potential problems in those areas of tax for which it did not have direct responsibility.

(f)

Such an annual or periodic report could be useful both for sharing between tax administrations and/or for sharing between the tax administration and its private sector colleagues in boards or working parties. However, as such a Report is likely to take up considerable amounts of time and expertise within the unit, it would be preferable if such a Report addressed an identified need rather than being written as an administrative exercise which then needs to be justified.

(g)

The requirement for additional safeguards and security procedures implies that the affairs of non HNWIs are not securely held by the tax administration. Rather than additional measures, HNWIs and their advisers may be content if they are persuaded that existing procedures are rigorously applied.

There may be a particular request from a HNWI, for example that communication is conducted in a particular way. Where it is possible to comply with such a request, and the request is reasonable, the spirit of cooperative compliance would suggest that the request be seriously considered.

### Question 3

Not applicable

### Question 4

#### *1 Low or no further compliance activity*

While such an assessment would be a very desirable destination, the question which will interest HNWI's and their advisers is how difficult will be the journey to arrive. Assuming that a HNWI might be so categorized after a pre-filing meeting, if such a meeting is itself a preliminary to a substantial audit of the HNWI's various financial interests, it is unlikely to be much of an incentive.

From the viewpoint of the tax administration, it is unlikely to wish to give a low risk rating without a fairly detailed consideration of the taxpayer's affairs.

It is unclear how these two opposing concerns might be reconciled.

Also, assuming that one was categorized as low risk, the HNWI or his adviser would presumably be under an obligation, moral or legal, to alert the tax administration where, at a future point, there is a material degree of uncertainty as to the filing position. Issues then arise as to:

- (i)
  - how material is 'material' and
  - how uncertain is 'uncertain'.

If set such that a low degree of materiality or uncertainty should trigger a disclosure to the tax administration then, given the complexity of the legislation and scope for interpretation of case law on particular fact patterns, the adviser could consider that he is under an obligation to put on the table a number of points. Where these points arise from advice given to the taxpayer in good faith, this could lead to tensions with one's client.

If set too high, the tax administration may fear that they are losing the benefit of 'cards on table' which they hoped to gain from cooperative compliance.

- (ii)

The principle of risk-assessing has been adopted by various tax administrations in relation to publically quoted corporates. However, such corporates are subject to internal and external governance obligations and will have boards whose responsibility is to shareholders. As such, there is a degree of consistency in their approach to risk, including tax risk. Consequently, the risk assessment given on year 1 is more likely than not to be valid in subsequent years.

By contrast, the circumstances under which a HNWI is risk assessed in Year 1 are more likely to be variable by changes in the HNWI's own objectives, by changes in his family

circumstances, by changes in his advisers and a wide range of personal and business factors. If the adviser is expected to update the tax authorities on this changing environment, this will be viewed as a hugely intrusive requirement.

Consequently, while one sees the advantages of giving a formal risk assessment, if this involves a concomitant requirement on advisers to anticipate potential tax challenges on a range of areas and to provide ongoing updates on changing drivers in HNWI behaviour, this will be unrealistic.

## *2 Enhanced responsiveness*

In practical terms, this must equate to faster decisions being made in the case of those HNWIs who sign up to some form of cooperative compliance approach. To achieve faster decisions, the HNWI unit will presumably short circuit the usual detailed accumulation of information via the enquiry process (letters requiring information, consideration of information, further requests for information) by means of a meeting (or meetings) at which information would be exchanged. The HNWI is signing up to full and frank disclosure. The tax administration, via the HNWI unit officer, is signing up to take an early decision on the basis of his judgement.

However, even assuming both parties act in good faith, enhanced responsiveness is unlikely to work if it is implicit that there must be agreement. If the judgement of the HNWI unit is not accepted by the HNWI, one assumes that the normal procedures would be applied and, if required, the matter would be litigated.

In these circumstances, one would hope that both HNWI and tax administration would accept that this represents an honest difference of opinion rather than a failure to engage fully in the cooperative compliance project.

## *3 Early certainty for planned transactions*

The discussion paper refers to the possibility of providing 'different levels of certainty'. From the taxpayer's point of view, this will be providing 'different levels of **uncertainty**'. A taxpayer is unlikely to be attracted to a cooperative compliance relationship if the advantage is measured in degrees of uncertainty.

The prospect of early certainty is likely to be an attractive prospect for HNWIs, As mentioned above (Question 4(1)), a concern will be the extent of the preliminary dialogue with the tax administration which is required for the certainty to be achieved.

Most HNWIs, and certainly most advisers, will appreciate that the degree of certainty offered by the tax administration will be dependant on the degree of full disclosure offered to the tax administration.

## *4 No or reduced penalties*

The fact that penalties will not be imposed where the taxpayer has been fully open at a pre-filing meeting or at the time of filing a return, even if the filing position in question is subsequently shown to be incorrect, is an incentive for the taxpayer to be open.

However, where his filing position is made in good faith, after appropriate consideration, and after disclosure of the consideration process, the non application of penalties does not seem to be a consequence of opting in to a cooperative compliance project. Rather it would seem to follow from an application of the legislation where such legislation limits penalties to where there is carelessness, or negligence or fraud.

### Question 5

When discussing voluntary disclosures with HNWI's or their advisers, concerns which arise include:

- (i) The lack of any contemporaneous records
- (ii) The right of the tax authorities to contact third parties
- (iii) The possibility that by disclosing a failure in one element of one's tax affairs, one may encourage a broader challenge
- (iv) The ability to fund a settlement which incorporates an as yet unquantified tax bill, penalties which can be up to 100%, and interest which can go back 20 years (and in some instances such as death duties for an unlimited period)

For (i)

While experienced advisers are aware that tax authorities are prepared to take a pragmatic approach, some statement to this effect from the tax authorities may be useful. A specialist HNWI unit may find it easier to formulate an appropriate statement than a national tax administration.

For (ii)

The worry is often not related to any fear that the tax administration would find out something to the disadvantage of the taxpayer. Rather it is the fear of social embarrassment if a former or current acquaintance (such as business partner or accountant) discovers that the taxpayer has acted dishonestly.

This worry might be mitigated by an assurance to the effect that, where there is a voluntary disclosure, such third party enquiries will be deemed unsuitable other than where there is evidence to suggest that the taxpayer is hiding something.

For (iii)

Where the disclosure relates to one aspect of one's affairs, such as an offshore account, the tax administration could give an assurance that they will not seek to extend the subsequent enquiry into broader elements of the taxpayer's affairs (such as trading

entities which he controls) unless there is evidence to suggest that they are part of the disclosed problem (for example if the source of funds into the offshore accounts is unclear).

For (iv)

For **tax quantum**, one assumes that the tax administration will be reluctant to offer much in the way of reassurance (other than in relation to acceding to a reasonable methodology as for (i)).

For **tax penalties**, certain national initiatives will often 'cap' the penalty. A HNWI unit wishing to encourage ongoing disclosure may wish to put together guidelines to reassure potential disclosers as to the advantages in terms of limited penalties.

For **interest on tax**, where the tax underpayment derives from an offshore account, the period covered can be in excess of 20 years. While the period in relation to the income tax is limited to 20 years, with periods of high inflation the interest charge can be huge. This can seem particularly harsh where the initial action of putting monies offshore was not done by the taxpayer but, perhaps, by parents long since deceased. It would be a major incentive to consider disclosure if, for those who disclosed voluntarily, where there was no fraudulent intent on the part of discloser when the monies were placed offshore, interest could be waived or limited.

In cases where monies were placed abroad by parents or relatives, then the question of death duties can arise. There is no time limit on this and so interest can arise over periods in excess of 20 years. Again, it would be a huge incentive to disclose, and a sign of the administration's good faith in encouraging a cooperative compliance approach, if interest could be waived in those instances where there was no fraudulent intent on the part of the discloser at the time when death duties arose..

### Question 6

Were a 'product ruling' regime to be introduced by a tax administration, one would expect the Australian experience (of the general public heavily favouring investment products with positive rulings) to be replicated. However, such mass marketed products probably have more appeal at the lower end of the HNWI market. Also, while the ruling is intended to apply to the product rather than a particular taxpayer, one can imagine circumstances in which less scrupulous advisers misrepresent the nature of a complex product and it is the taxpayer who is left to deal with the consequences.

There could be a significant consequence for resources. Product providers are likely to be under market pressure to apply for positive rulings. The tax administration is thus likely to be required to cope with many applications. In some instances, an initial rejection will result in an amendment and a reapplication.

Also, successful applications are themselves likely to inspire related products. Apart from generating further applications, the question of at what point a distinction from the original product requires a separate product ruling is likely to arise.

From the point of view of helping to develop a cooperative compliance approach, if a 'product ruling' approach is introduced and the tax administration is unable to cope efficiently and effectively with the probable significant increase in workload at a high level of technical complexity, then it could have a negative rather than a positive impact on relationships with HNWI's, their advisers and the developers of the products.

### Question 7

The submission supports the establishment of HNWI units and the attempt to develop a cooperative compliance approach. There are concerns.

(a)

In considering how best to develop their relationship with HNWI's, a major aim of tax administrations seems to be to encourage disclosure and openness. Where these terms reflect a desire to encourage a careful attention to one's tax affairs, few advisers would not support the initiative.

However, the project seems more ambitious than simply encouraging correct compliance. Cooperative compliance seems to imply going beyond the point at which taxpayer and adviser make every effort to ensure that the position adopted in the return is proper. It wants them to share with the tax administration where there is a material degree of uncertainty or where the filing position is tenable but potentially challengeable. As indicated in the response to question 4, this raises various points, not least judgement issues as to: how tenable; how material; how uncertain.

Similarly, the offer of certainty offered by tax administrations as a quid pro quo for openness, is likely to be a modified type of certainty, subject to undisclosed information (not necessarily deliberately withheld) coming to the attention of the authorities.

Unless there are very clear guidelines, and unless both tax administrations and tax advisers agree on their respective obligations, a cooperative compliance project could result in a deterioration in relationships arising from unrealistic expectations from both sides.

(b)

In providing advice to HNWI's, tax advice is often simply one element of the business advice and the business advice can be linked to changing personal considerations. Consequently, many HNWI's will view with some bemusement any suggestion that they should invite the state to become a participant in what they see as private considerations.

Given the cross border interests of many HNWI's, the reality could be that they are being asked to involve more than one state in considering their affairs.

This is in the context of individuals who tend to value privacy and, in some instances, who have a cultural background where the state is not seen as a benign force.

(c)

Consequently, the cooperative compliance project is more likely to succeed if there are clear carrots for engaging and clear sticks where there is a failure to engage.

Some tax administrations have clarified the ‘stick’ element, as in the UK where there have been public pronouncements as to the likelihood of criminal prosecution for those individuals who do not take advantage of the voluntary disclosure in relation to offshore accounts and are subsequently discovered to be in breach of their tax obligations.

Some tax administrations have clarified the ‘carrot’ element, as in Ireland which has introduced an ‘Expression of doubt’ facility which, when invoked by the taxpayer, protects him from an interest charge should the tax administration successfully challenge the filing position on which doubt was expressed.

A cooperative compliance regime is most likely to succeed where the sticks are seen as fair, the carrots are seen as attractive, and the expectations of all sides are realistic.