



The OECD Project on High Net Worth Individuals

The Institute of Chartered Accountants of Scotland welcomes the opportunity to respond to the consultation document issued by the OECD looking at co-operative compliance and high net worth individuals (HNWI).

1. The Institute of Chartered Accountants of Scotland (ICAS) received its Royal Charter in 1854 and is the oldest professional body of accountants in the world. It has approximately 17,000 members of which around 10% work overseas. ICAS members often hold influential positions across the business sector in industry, commerce, public practice, financial services, education and local and central government. As practitioners, they are often involved in offering advice and services to HNWI persons. The Institute's primary duty is to the public, a principle which distinguishes it from a trade association whose prime concern is to its members. The Institute is also a member of the Global Accounting Alliance (GAA) which we understand will be submitting a response separately.

2. Background

- 2.1 The OECD project has formed a focus group to explore how tax administration resources could be used most effectively and what role co-operative compliance approaches might play in this regard. We welcome any approach by fiscal authorities to provide a better service to taxpayers and to use better the tax administration resources. It is in everyone's interests that taxpayers are encouraged to pay the right tax at the right time. We believe that there is an obligation on the part of fiscal authorities to help taxpayers who wish to comply. It is necessary to provide taxpayers with early certainty and a guarantee that any discussions which occur between an individual and the tax authorities will remain confidential. It is essential that employees of the fiscal authority have the necessary technical skills as well as other skills which would include commercial awareness, integrity and interpersonal skills which will help them win the confidence of high net worth individuals.

It is regrettable that within the United Kingdom politicians and apparently the fiscal authorities have confused the watershed between avoidance and evasion. No one condones evasion and without exception we would encourage the fiscal authorities to pursue relentlessly those who attempt to evade tax. Avoidance is a different matter and to the extent that taxpayers claim reliefs to which they are legally entitled this should be accepted by the fiscal authorities without challenge. If the fiscal authorities believe that the exercise of the claim is not within the spirit of the legislation, they should attempt to draft the legislation better and ensure that the reliefs are targeted better for those who are entitled to claim. The existence of tax loopholes demonstrates an underlying problem within the UK regime which is that the regime is excessively complex and is viewed by too many as burdensome and at times unfair.

Culturally, in common with many developed nations, the UK society is increasingly litigious. A consequence of this is that tax advisers are damned if they offer advice on ways to mitigate tax yet equally would be damned if they fail to offer clients the opportunity of considering ways of mitigating their tax liability. This was clearly established in the case of *Slattery v Moore Stephens*, 2003 BTC 483 which concerned a firm who failed to advise an individual of Irish origin who was normally resident in Canada of the advantages of split contracts of employment and not remitting earnings from overseas work to the United Kingdom where he was working temporarily. The firm was held to be negligent in failing to advise Mr Slattery of the opportunities that his status of not being ordinarily resident offered.

We do recognise that not all taxpayers are compliant and that there is much to be gained by identifying a way to encourage taxpayers with undisclosed assets or income to come forward voluntarily and make a full disclosure of their past non compliance to the tax administration of their country of residence. Other jurisdictions have introduced periods of amnesty to encourage such behaviour and there can be little doubt that such amnesties have increased tax yield. Equally, there can be little doubt that non compliant taxpayers have remained non compliant and not taken advantage of the amnesty. Initiatives like the offshore disclosure facility recently offered by the UK HMRC, have encouraged people to come forward to take advantage of the certainty of a fixed penalty. It is, at this time, too early to comment further on whether this has been successful and this will not be known until those who did not take advantage of the offer are identified and the additional tax being lost quantified.

The consultation aims to improve compliance relationships within the existing legal framework of OECD member countries. In the UK, we have recognised that individuals of high net worth are more mobile and often have commercial arrangements that are complex and rapidly changing. We believe it is important to such individuals to have a fiscal regime which offers stability and a degree of certainty. It is equally important for high net worth individual taxpayers to be reassured that their affairs will be dealt with in confidence and that any data held by the fiscal authorities will have a high degree of security attached to such data. High net worth individuals are attracted to fiscal certainty and a regime which encourages early resolution of matters.

In the UK generally, it is understood that HMRC have a sophisticated risk assessment system which is based on mathematical models and awards points on identified parameters

within tax returns. Although these mathematical models work well across the large volume of the populace, it is known that they do not apply for individual cases or individual behaviour. For many years, the fiscal authorities have had specialist offices to deal with the specialist or more complex taxpayers. For example, the Leeds Underwriter Unit has existed for many years after it was formed to deal with the complexities of underwriters and the life insurance industry.

In the UK, HMRC is a bulk business and it aims to use its limited resources where it identifies there are significant risks of customer non compliance. In 2002, nine complex personal return teams were set up around the UK and a number of these deal with expatriate employees. These complex personal return teams carry out processing, customer service and compliance activities. Initially, the teams dealt with over 50,000 complex taxpayers and had around 450 staff but it is understood that the number of taxpayers dealt with by these teams is in the process of reducing. The definition of what constitutes a complex personal return is not absolute but it will ensure that those with substantial share schemes, property rental income, overseas income either from earnings or property, trust income, capital gains and non residence status will feature in the profile of those dealt with by the CPR districts. In general, most high net worth individuals who are dealt with by the CPR specialist districts will have high levels of income as well as exhibiting the features of complexity mentioned previously.

The aim of the CPR districts is to provide a quality service on capturing returns, improving customer relationships and giving certainty to taxpayers. The opinion on whether success has been achieved or not is very variable but there is concern that to date many of the HMRC staff who work within the CPR districts lack the right technical and personal skills to be as effective as they should have been. It is intended that each high net worth individual dealt with by a complex personal return team will have a case owner and a direct dial telephone number for a point of contact. These arrangements were set in place to mirror the arrangements of professional advisers who advise the high net worth individuals on their UK tax liabilities.

Earlier this year the OECD published a study into the role of tax intermediaries. This recognised the benefits of co-operation and trust to improve the compliance relationship and identified that an enhanced relationship was only possible if the tax administration were able to demonstrate:

1. An understanding based on commercial awareness
2. Impartiality
3. Proportionality
4. Openness
5. Responsiveness

On the part of taxpayers, it identified disclosure and transparency being essential components.

This consultation document recognises that high net worth individuals are not a homogenous group. They demonstrate greater diversity, higher mobility and differing attitudes. The paper also recognises that the interaction between the fiscal authority and the

high net worth individual may not be direct but will take place using an intermediary. What the paper does not seem to recognise is that different intermediaries provide different services. Therefore the person advising in tax may well be regulated by his professional body but the high net worth individual may be influenced by unregulated persons who may be offering schemes and whose services are outside the control of the taxation intermediary.

Before turning to the specific questions within the consultation document, we wish to add that within the UK there is a statutory disclosure regime. We do not think it is an incentive to taxpayers to encourage disclosure by suggesting that forgiving penalties are an incentive. If a taxpayer is well advised yet makes an error in their tax return, the question of penalties is unlikely to arise. The taxpayer will have taken reasonable care and the underlying fault is the complexity of the UK legislation. It is because of this complexity that taxpayers would appreciate a mechanism to resolve problems and give early certainty.

Our members have repeatedly requested that there should be a service provided by HMRC to provide rulings in advance of any complex transaction occurring. They also would welcome the opportunity to discuss at meetings with HMRC any areas of uncertainty but there should not be an obligation on the part of the taxpayer to disclose everything because this could prove counterproductive. This concern arises because experience shows that the level of technical expertise in HMRC staff is often found wanting. Furthermore, HMRC officers are often of a suspicious nature and frequently tend to raise questions which are irrelevant to settling the taxpayer's liability.

3. Organisational Aspects

The questions raised in this part of the consultation document are designed to explore how tax administrations would be able to engage in co-operative forms of compliance. We have followed the order of the questions raised within the consultation document.

Q1: What are the important features of tax administration that may facilitate the co-operative compliance approach? Please build on positive and negative experiences in dealing with your tax administration.

A: In the United Kingdom, some 26 million taxpayers have their liability to tax deducted at source mainly through the PAYE system. Those required to self assess are about 8.5 million taxpayers and of these only a few would fall into the category of high net worth individuals. The definition of a HNWI needs to be clarified. We have stated earlier that the tax administration must display:

- an understanding based on commercial awareness;
- impartiality and fairness;
- proportionality in all that it does;
- openness and;
- responsiveness

It is a significant concern to all taxpayers that the cost of complying with completing and dealing with a tax return annually can be excessive. There needs to be trust that the fiscal

authorities will ask sensible questions and will be decisive in resolving any areas of uncertainty or dispute. As much as anything else, people who have trained to work in a fiscal administration are often culturally inclined to be suspicious and this can be unhelpful in trying to achieve the objective of a co-operative compliance approach.

Under the banner of impartiality and proportionality, it is essential that the skills of the staff in the tax administration include good interpersonal skills, good skills of negotiation and outcomes that demonstrate that in all they do they act in a reasonable and fair manner.

It is unhelpful when a fiscal authority threatens to litigate anything about which it has suspicions and it should be incumbent on any tax administration to aim to provide a better quality of service of fast response and early decisiveness to resolve areas of uncertainty. To achieve this, it is necessary for the tax administration staff to be well trained and well informed and able to deal with complex situations.

Q2: Do you think that having a dedicated unit (or units) as part of your tax administration (either at national or at regional level) with particular responsibility for HNWI's is a good idea? If you are generally supportive of such an idea, what roles and responsibilities do you think such a unit should assume? In particular do you have any views on the following points?

A: Before looking at the list of points which has been included in the consultation document, we wish to comment that in response this question has received a quite mixed response based on individual experience. Where people have received a good level of service, they believe that concentrating resources and bringing together people of high net worth category is a good idea. Conversely, a number of people have a poor opinion of the experience of dealing with HMRC and its complex personal return districts. This is because the greater concentration of officers to a smaller number of taxpayers results in annual questions being raised that often display an embarrassing lack of understanding or commercial awareness or even any appreciation of what might or might not be material to that taxpayer. Questions are raised on trivial amounts of expenditure. It is however recognised that there are benefits of having meaningful conversations with well informed and commercially aware individuals who work for the tax administration. There can be little doubt that providing a better service will ensure there is better compliance.

Q2A: How should a tax administration best gain insights into the behaviour of drivers and the general context within which HNWI and their advisers operate? For instance, by employing staff with relevant private sector experience perhaps on secondment, on short term contracts at the end of successful careers, or on permanent contracts. Should there be some form of advisory board involving advisers and other relevant market participants (for example private banks) or some other structured form of providing relevant background and context to the tax administration?

A: Trust is something which needs to be earned. It is therefore difficult to encourage openness against a background that in the past, an openness about matters often led to further questions and additional unnecessary costs being incurred to answer those irrelevant questions. It is important therefore that this is viewed as a process and that at the start, there is no obligation to discuss everything but there is a recognition that tax administration staff often require an

understanding of commercial awareness. We think that secondments are a good idea. We believe that some form of advisory board might be helpful particularly on issues around overseas property ownership and savings regime. Concern was expressed that this question focuses on behavioural drivers and it may be that the term 'behavioural drivers' is just not well defined.

Q2B: What role and responsibility should the unit assume with respect to the affairs of the taxpayer (for example research and risk assessment are fully responsibility for the file including potential audit)?

A: It seems advantageous for HMRC or other tax administrations to build a portrait based on their experience of dealing with the high net worth individual. To this extent, a background knowledge of the individual should enable the tax administration to achieve greater efficiencies and effectiveness. This seems to be a matter of internal training of case handlers and not a taxpayer facing matter but it should be understood by all taxpayers that HMRC has a considerable database holding a lot of personal information about high net worth individuals, their assets and their activities. The unit should process and settle the tax relating to the return of the HNWI.

Q2C: What taxes relating to the high net worth individuals and their affairs should such a unit deal with and why? For instance should it be limited to income tax or also cover inheritance tax and estate duties, VAT/GST etc?

A: For the UK, a HNWI would typically have income tax and capital gains tax as well as property income dealt with at one place but that place would vary often with employment. Capital taxes like IHT or trusts would be dealt with separately. Bringing together all of the relevant facts about the HNWI is viewed as helpful to ensure that HMRC highly trained staff could gain access to this as required. This would mirror the typical relationship for HNWI in larger advisory practices and has the benefit of seeing the interaction between taxes. However, such is the complexity of UK fiscal law, we do not believe it would be advantageous to include indirect taxation or indeed all of the entities controlled by the HNWI.

Q2D: Should the unit be responsible also for the affairs of all/certain entities controlled by an HNWI (for example only the personal affairs of the taxpayer, all operating entities and all non trading entities or only non trading entities)?

A: If the tax administration wishes to improve compliance and provide a better service to HNWI's, it is essential that they are able to make decisions and give certainty as well as reassure that all information will be treated in confidence. Because of the complexity of the UK tax system, it is felt that there is little merit in attempting to include all operating entities especially as the question of what is controlled by the HNWI will be open to dispute. We recommend that the tax administration should concentrate on the main relationship with the HNWI ensuring that their personal taxes are given priority treatment and resolved as quickly as possible. Where there are disputes concerning connected entities that are controlled by the HNWI, we believe these should be dealt with on an ad hoc basis to resolve the areas of risk identified within the enquiry.

Q2E: Should HNWI's and their advisers be assigned a designated contact point within the unit?

A: We believe this is in everyone's interest especially if the objective is to achieve a degree of openness and disclosure. The short answer is therefore 'yes'.

Q2F: Should the unit be tasked with preparing an annual or periodic report about the overall environment and key developments, including the most pressing issues identified by HNWI and their advisers for the use of heads of tax administration and finance ministries?

A: This point appears to address how tax policy is shaped and it is best that it is properly informed. Approaching this at a generic level, it would therefore appear a useful piece of information to be provided to those who shape tax policy. At the individual level, we do not think there is any merit in summarising individual experiences for onward reporting.

Q2G: Should additional safeguards and security procedures apply to the information held by the unit?

A: It is essential that tax administrations treat the information which it obtains about individuals as strictly confidential. All taxpayers should be entitled to the same privacy guarantees but perhaps those of HNWI are more concerned that confidentiality must be absolute. This concern arises because it raises issues that their wealth might jeopardise their or their families' security. There can be little doubt that a fiscal jurisdiction which is unable to protect the data it receives would place itself at a competitive disadvantage in a highly mobile world.

Q3: If you are from a country that currently has a dedicated unit dealing with HNWI's what advantages or disadvantages have you seen in having such a unit and do you have any comments on the way it was set up and is operated? What are the features that you find most useful?

A: In the UK the tax administration has a certain cynicism towards the boundary between avoidance and evasion. Accordingly, HNWI's experience a very diverse spectrum of treatment from the tax administration. Some find themselves subject, each year, to a detailed list of questions whereas others comment that the formation of the CPR districts has improved service and enabled them to resolve areas of uncertainty better.

There appears to be a common thread in the responses which have been received. Where it is possible to have a meaningful conversation with the officers within the tax administration, the view is that the service provided by the units dealing with high net worth individuals is worthwhile and efficient. Unfortunately, not all officers have adequate training or discretion and as a result some HNWI's experience cynicism, recurrent detailed questions and excessive compliance costs. In addition, when the reorganisation occurred in 2002, many HNWI's reported that on allocation to the new CPR district their tax affairs were subject to a detailed ten year review and answering questions following this increased their cost of compliance, often to no effect and no additional tax yield as these individuals were well advised.

Q4: If the tax administration offered this or a similar approach, what would encourage HNWI's and their advisers to opt for it? In your answer please consider the points discussed below and indicate which points may be more important and which may be less important. Please also describe any other elements of concerns that you think would be relevant for HNWI's and their advisers (for example privacy concerns), and how these may be addressed.

A: In the UK it has been recognised since the Veltema decision of the Court of Appeal occurred that there is a defect in the legislation which denies taxpayers the certainty which was intended if full disclosure occurred. The legislation at Section 29 TMA 1970 does not offer the taxpayer the protection which it should and it is recognised that until the defect is remedied the fiscal authority's power to raise discovery assessments is greater than the spirit of the legislation intended. Accordingly, within the UK there is little incentive to explore what would constitute full disclosure. It is also often viewed as impractical that a tax adviser would have to make a judgement about what the tax administration would want to know. Further, the tax adviser or those involved in preparing the return may not be the only adviser to the HNWI. The problem may therefore lie elsewhere.

It is believed that the UK tax return form already asks for disclosure where valuations are used. It would be beneficial for there to be the opportunity to resolve satisfactorily any areas of uncertainty and this would include agreeing valuations in advance of filing. In the UK, experience of dealing with valuations and especially capital valuations with the fiscal authority has not been good. For taxpayers to have confidence in the valuations conducted by a fiscal authority, the fiscal authority valuers need to improve their valuations. In particular, they need to become more reasonable and more decisive as it is unacceptable that valuation disputes can be prolonged over many years. Until the tax administration valuation performance is improved, it is not practical to think that the taxpayer could achieve greater certainty by making a full disclosure of the valuation.

As part of its risk assessment process, the UK tax administration often takes the view that tax planning is indicative of a high risk strategy. By way of contrast, tax planning is often only possible where there is a clear view of the law and a loophole has been identified. The uncertainty is then created that the tax authorities would attempt to close the loophole. Indeed in certain areas of the law, the Government has made it clear that it will consider introducing legislation that has retrospective effect where it believes avoidance has abused a loophole of the law. In such circumstances, it is difficult to demonstrate material improvements in certainty or any other benefit to the HNWI.

What is and would be welcomed is where it is possible for the taxpayer to obtain early certainty and resolution of grey areas. For most people understanding the tax effect and economic consequence of transactions would be a genuine improvement. To achieve this, the tax administration should introduce an advanced ruling system for complex transactions such as they have in other European jurisdictions so that, if these are fully disclosed, it is possible for the taxpayer to obtain certainty in advance of the transaction occurring in the framework which has been outlined.

In the UK a disclosure regime has been a statutory requirement for tax avoidance. When first introduced, most felt that the disclosure regime inhibited some taxpayers from mitigating their

tax but the feeling is that tax mitigation is still possible and remains legal and appropriate in many circumstances.

1. Turning to the specific questions outlined in paragraph 32, it is felt that not all taxpayers would welcome a meeting as this will often incur professional costs to prepare and attend a pre-filing meeting such as outlined. However, it is felt that the offer of such a pre-filing meeting would be welcomed by many particularly those in the low risk category.
2. Taxpayers are entitled to even handed treatment and it would be wrong to have a discriminatory regime in place that gave a better treatment to HNWI. The offer being made is that the taxpayer must be more open and co-operative with the tax administration but in principle it is felt that all taxpayers should expect the same standard of response regardless of participation or not.
3. Advanced clearances are generally to be welcomed although it is recognised that this has a substantial cost to the tax administration up front but should lead to considerable savings when reviewing returns.
4. It is recognised and is a cause of concern that the UK fiscal regime is overly complex and quite inappropriate for a self assessment tax regime. It is only right that where a taxpayer has fully disclosed the tax position the tax administration should not, on discovering an error has been made, seek penalties. In areas where there has been no agreement, it is appropriate that penalties should not be sought if the taxpayer has disclosed the position fully.

Before responding to question 5, the narrative in paragraphs 33 to 35 looks at offshore tax evasion. A number of respondents commented that having an offshore bank account is a perfectly normal and legitimate commercial arrangement for people of high net worth who may have property overseas and find it convenient to hold accounts overseas. In general, those of high net worth are more mobile than less well off people.

We acknowledge that other jurisdictions have offered taxpayers a period of amnesty to encourage voluntary disclosure and compliance with that jurisdiction. Recently, HMRC in the UK offered a facility of a 10% penalty regime again to encourage people who had failed to declare interest and other matters arising on offshore accounts and a failure to make a complete and correct return. Deliberate evasion should be regarded on a separate basis from this exercise on HNWI compliance given that deliberate evasion is driven by a different set of behaviours often involving criminal conduct.

Q5: The focus group seeks input from HNWI's and their advisers about the framework for voluntary disclosure and what particular elements would encourage taxpayers to come forward, for example solutions to issues such as lack of back year records, inability to calculate final tax liability, concerns regarding privacy.

A: In the light of the previous comment, respondents felt that their limited experience of dealing with fraudulent conduct and deliberate evasion meant that it would be better to rely on tax administrations analysis of the effectiveness of their facilities like the offshore disclosure facility or amnesties. For those who have not engaged in evasion but have made mistakes, a question to resolve is how can these people be encouraged to declare properly their income.

Individuals of high net worth will be concerned that confidentiality is preserved but they will wish early resolution and certainty. It is necessary for tax administrations to adopt a pragmatic and reasonable attitude including an acceptance that where records have been lost with the passage of time the calculation of the final tax liability (and any tax geared penalty and interest) needs to be done on a basis of reasonable accuracy without relying on an accuracy to absolute figures.

Q6: Please express your views on the merits of a product ruling regime in connection with HNWI's. In addressing this question please take a broad view of the term 'product ruling' to include any form of advanced certainty (whether formal rulings or not) and also consider which segment of HNWI's you think would be the users of the types of products for which product rulings could be made available (i.e. certain HNWI's might be more likely to enter into tailor made arrangements that do not lend themselves to product rulings).

A: Product rulings have proven attractive when they confirm eligibility for reliefs for example enterprise investment scheme, venture capital trusts and certain areas such as film partnerships where relief is available. It benefits not only the HNWI's but also the tax authorities in agreeing tax treatment in the return. In essence, product rulings guarantee a safe harbour and give the advantage of certainty to the taxpayer. The availability of safe harbour and therefore improved tax shelters can then act as a disincentive to the more risky non approved products.

In the UK there is a disclosure regime which should also help HMRC in the UK identify and challenge those arrangements which it wishes.

Q7: Do you have any other comments which you wish to make?

A: The role of a tax intermediary and adviser is to give the best advice to the client and assist the client in paying the right tax at the right time, completing any fiscal returns as are required. In general, there is considerable merit in a co-operative approach but tax advisers may be required to comment upon and advise about certain tax mitigation arrangements but in general these will be identified to the HNWI by sales persons promoting whatever tax mitigation arrangement is of interest to the HNWI. It follows that the tax adviser is not always in a position to influence the client.

However, there is a second observation which is that some tax advisers may have been appointed because the client has chosen the tax adviser to have a similar approach to tax mitigation and tax risk, whether high, medium or low. In that case, any influence by the taxpayer would be a simple reinforcement of an existing view rather than any change in perspective of the HNWI. All taxpayers but especially HNWI expect tax administrations to provide a speedy turnaround of any queries and to be structured to deliver this. In principle, a tax system should be clear enough to allow taxpayers certainty but in practice, especially with the evolution of business, most jurisdictions' tax system are viewed as excessively complex.

Penalties are viewed as a deterrent but there is also a view that tax administrations do not do enough to assist taxpayers in getting it right. There is scope for providing advanced clearances or certainty in transactions before the transaction occurs. For many taxpayers including HNWI, taxation is a cost which is managed to the extent that this is possible. In order to

achieve co-operative compliance, it is necessary for there to be a culture of trust by the taxpayer and by the tax administration. Wherever possible, difficulties and friction points in the tax system should be removed where it is not necessary. There should be incentives available to the taxpayer to encourage openness and disclosure. For example, if there is disclosure but an error then there should be no question of any penalty.

Members of the Institute's Taxation Committee have considered the OECD paper. There will be further discussion on this complex topic in 2009 and, should there be further consultation, we should be happy to consider this and respond as appropriate.

Yours faithfully

A handwritten signature in black ink that reads "Derek Allen". The signature is written in a cursive style with a large, stylized initial 'D'.

Derek R Allen
Director, Taxation