

OECD Tax Intermediaries Study
Working Paper 6 – The Enhanced Relationship

This is the sixth in a series of draft working papers written by the tax intermediaries study team. It has been written for the purposes of the study and has not been endorsed in advance by the Forum on Tax Administration (FTA) which established the study. It therefore does not necessarily reflect the views of the FTA.

Background

1. In *Working Paper 3: Overview – the emerging direction of the study*, we summarised the approach the OECD Tax Intermediaries study is taking. The key issue was the recognition of the mutual benefits to all parties from revenue bodies using modern risk-management concepts. In turn, to underpin the risk management approach, two further essential elements were noted: (a) an enhanced relationship between revenue bodies, taxpayers and tax intermediaries, and (b) the use of effective operational tools and techniques. This paper builds on the enhanced relationship concept.

Context – the ‘basic relationship’

2. There is a basic relationship¹ in any country between the revenue body and the taxpayer. It is one characterised by the parties interacting solely by reference to what each is legally required to do without any urging or persuasion from the other. The principal parties to the basic relationship are taxpayers and revenue bodies. Nevertheless, within this relationship tax intermediaries play an important role as they will often provide advice as to the legal boundaries of the basic relationship and the tax implications of moving beyond them. They will also interact directly with the revenue body on a regular basis in advocating taxpayer positions. Accordingly, while tax intermediaries are not direct parties to the basic relationship, they do have a significant impact upon taxpayer behaviour within (or indeed beyond) that relationship.²

¹ References in this paper to the ‘relationships’ between taxpayers, revenue bodies and tax intermediaries should be read as referring to two things. The first is the working practices between those groups, being the manner in which representatives of each interact in the ordinary course of their work. The second is the general manner, at a more institutional level, which each member of the relationship views the other institutions and groups that are parties to it.

² The study team’s *Working Paper 3: Overview – the emerging direction of the study*, posted on the OECD website at <http://www.oecd.org/dataoecd/15/34/38459182.pdf>, details how tax intermediaries may impact on the relationship between taxpayers and revenue bodies. The matter is also addressed in *Working Paper 5 – Risk Management*.

3. For taxpayers, the basic relationship typically means they must file a tax return that discloses at least a bare minimum amount of information; declare the 'right' amount of tax; and pay that amount on time. It does not oblige the taxpayer to tell the revenue body much about how that tax amount was arrived at, nor whether there are matters of uncertainty or unpredictability about which the taxpayer has chosen to claim the benefit of the doubt.
4. Some countries require more of taxpayers than others – beyond this 'bare minimum' – and the study team accepts that this means that the content of the basic relationship will vary. However, it does not alter the point that the basic relationship represents a legal minimum standard the taxpayer must maintain or risk the imposition of monetary or other sanctions, regardless of what that minimum may be.
5. For revenue bodies, the basic relationship typically means they are equipped by law with certain broad administrative tools to: (a) query the taxpayer about the tax declaration; (b) seek more information about the tax declaration; (c) if necessary, take enforcement measures to correct the calculation of the tax payable; and (d) take the required steps to collect the amount of tax payable.
6. Additionally, in most countries this means that the information collected by the revenue body from the taxpayer is to be kept strictly between the two and not shared with others either inside or out of the government.
7. The basic relationship has a number of drawbacks if the goal of tax administration is the efficient and fair collection of the 'right' amount of tax. Foremost is that the 'obligation-based' nature of the relationship means there is no incentive for either taxpayers directly or their tax advisers indirectly to disclose additional information to revenue bodies, particularly regarding areas of tax uncertainty or risk. Yet, obtaining such information is critical to revenue bodies seeking to address high-risk taxpayers or transactions and efficiently allocating limited resources. It also serves a number of other important goals, such as the better drafting of future tax laws and the early identification and correction of existing but defective tax laws.
8. Some revenue bodies have moved to a business model that gives recognition to the different factors that influence taxpayers' compliance, and different strategies to achieve improved compliance. In all cases, this has revenue bodies taking on a far broader, servicing role, in exchange for taxpayers' and tax intermediaries' adopting a more open and interactive approach.
9. The OECD's Centre for Tax Policy and Administration has described the core rights and obligations that comprise the basic relationship in a previous paper, *GAP002 – 'Taxpayers' Rights and Obligations*. Readers seeking greater detail on this concept are referred to this publication.
10. This paper seeks to describe comprehensively a new approach, first borrowing from the ideas and experiences of those countries that have already adopted some of its key elements, and then building from there based on the study group's external stakeholder consultations. We call this new approach the

'enhanced relationship'. Its starting point is a mutual understanding of each party's needs and aspirations, the development of the tools and techniques most appropriate for achieving these, and a path to implementing what needs to be done. Fundamental, to the long-term success of the enhanced relationship is the establishment and maintenance of trust³ amongst all the parties.

21st Century 'enhanced relationship' models

11. The move away from the basic relationship has been driven by the recognition that tax compliance can be improved by blending incentives to full compliance with the traditional penalties for non-compliance. We colloquially describe this as a 'carrot and stick' approach to tax compliance and it is driven by the recognition that revenue bodies should bring balance to their service and policing roles. This approach can be seen in the following examples from the Netherlands, Ireland, and the United States.

The Dutch 'horizontal monitoring' programme.

12. In 2005, the Netherlands Tax and Customs Administration (TCA) initiated a pilot 'horizontal monitoring' programme involving 20 of the country's largest corporate taxpayers. At the core of the programme is a concerted effort by the TCA to build greater trust with this taxpayer constituency as a means of encouraging greater disclosure of tax uncertainties and risks.

13. The TCA and all participating taxpayers enter into a non-binding but written 'agreement', by which the taxpayer undertakes principally to "*actively notify the Tax Administration of any issues with a possible and significant tax risk.*" In turn, the TCA promises, having received such disclosure, to "*state its views concerning any legal consequences*" of the matters disclosed, and to "*take into account real commercial deadlines*" when doing so. Importantly, the agreement covers both uncertain tax positions taken by the taxpayer in the past, and those which it is contemplating taking in the future.

14. Responses to the programme have been generally positive, with the majority of participating taxpayers and of relevant tax collectors agreeing that it has resulted in more effective and efficient working relationships.

The United States 'compliance assurance process' (CAP)

15. In 2005, the United States initiated a Compliance Assurance Process (CAP), fundamentally a real-time, year-by-year audit for large companies that starts at the beginning of the company's financial year and then concludes shortly after the tax return is filed. The idea is for the taxpayer to disclose fully on a current-time basis all transactions and issues that are likely to be of interest or concern to the Internal Revenue Service (IRS) and then, if there are disputes, attempt to resolve them on a current basis before the tax return is filed so they are

³ References in this paper to 'trust' should be read as reference to situations in which each party to a relationship interacts on the basis of mutual confidence and respect.

properly reflected. If all goes well, the issues are resolved when the return is filed and the taxpayer then gets ready for the next year's examination.

16. The programme is in pilot phase and all but one of the 73 low-risk companies that accepted the IRS's original invitation to join have agreed to continue, thus beginning the fundamental process of establishing a lasting relationship of trust with the IRS.

The Irish 'co-operative compliance programme'

17. In September 2005, the Irish Revenue Commissioners initiated their 'Co-operative Compliance' programme with large corporate taxpayers. The programme is designed to provide, for Revenue, greater levels of compliance from this tax constituency and, for the taxpayers, greater levels of certainty as to Revenue's position where there is any degree of uncertainty about the interpretation of tax or customs law and practice.

18. Participation in the programme is not by formal agreement; rather, those taxpayers willing to participate enter into discussions with Revenue with a view to formulating 'compliance action plans.' The basic expectation of participating taxpayers is that they will be open with Revenue with respect to their *"tax planning strategies."* In turn, Revenue undertakes to *"respond, as quickly as possible, to requests for interpretation assistance from business and their tax advisers."*

19. The programme specifically addresses the position of tax intermediaries, emphasising that it is not designed *"to undermine, in any way, the relationship between business taxpayers and their tax advisers."* Rather, the position has been taken that: *"The extent of involvement of tax advisers in any aspect of the tax affairs of a business, including cooperative compliance, remains a matter for the business and its advisers. In practice much of the discussion on tax risk analysis and on the formulation and implementation of action plans for tax risk management is likely to involve tripartite contact between Revenue, business and their tax advisers."*

Defining the parties' profiles

20. In each of the three countries that have moved in the direction of an enhanced relationship, the taxpayer has two common characteristics: (a) a large corporate, whose shares usually (but not always) are publicly traded, and (b) a taxpayer that has a history of, or a stated desire to be assessed as one having, low-risk tax behaviour. Also, these large corporates typically seek tax advice from large firms with sophisticated advisers in the accountancy and legal professions. These constitute the external stakeholders that provided the study group with meaningful input to assist in formulating the components of the enhanced relationship and we envisage at the outset they will also be the parties to it.

Defining the Enhanced Relationship

21. It is worth first taking stock of what the study team has learnt during consultation that each party will be likely to want from the enhanced relationship.

The Enhanced Relationship — what revenue bodies want

22. The fundamental duty of revenue bodies is to ensure that a high proportion of taxpayers meet all their tax obligations voluntarily and accurately. The enhanced relationship does not, and indeed could not, seek to change this position. Rather, it envisages a different means of fulfilling this fundamental duty by positing a form of tax administration that is built and maintained in common with taxpayers. That is to say, the enhanced relationship is not an end in itself but a means of establishing the right amount of tax payable by taxpayers in a quick, fair and efficient manner.

23. To achieve this, the revenue body will expect taxpayers and their advisers to be fully **transparent** in their communications and dealings and to **disclose** all significant risks in a timely manner. This means that taxpayers and, where appropriate, tax intermediaries will: (i) volunteer information about tax return positions where they see potential for a significant difference of interpretation between them and the revenue body; and (ii) provide comprehensive responses so that the revenue body can understand the significance of issues, deploy the appropriate level of resources and reach the right tax conclusions.

24. Disclosure here envisages anything that the taxpayer reasonably believes is of interest to or necessary for the revenue body to undertake a fully informed risk assessment. Normally, this will include any transaction or position that can reasonably be considered to carry a material degree of tax risk or unpredictability, judged by reference to considerations such as the existing law, the potential for the law to be changed with retrospective effect, whether the revenue body has identified the type of transaction or position to be of concern, and, more generally, the level of disclosure that can be expected of a party to a relationship based on trust and openness. However, disclosure will also extend to tax positions that are beyond challenge on the present state of the law but involve transactions of a type that the revenue body has indicated publicly are either areas of concern or otherwise exploit an unintended or unexpected tax consequence.

25. This could therefore be seen, in very broad terms, as the taxpayer accepting a responsibility to provide what might be described as a “self-risk-assessment”. Of course, the study team acknowledges that there will be circumstances where the price-sensitivity of a particular transaction, or commercial confidentiality or similar considerations, will restrict the extent of real-time disclosure.

26. It is of course the taxpayer who will make the decision as to what items or transactions to disclose and also what specific information and documentation will be provided to support the disclosed position. Provided that these choices include at least disclosure of the fundamental and essential transactional facts and how tax conclusions were reached, the enhanced relationship is not about forcing

'waivers' of information privileges, or about requiring disclosures of accountants' work papers or financial statement items of 'uncertain tax positions'. It is about taxpayers making choices regarding information that they believe will support their tax positions, adopt the spirit of the enhanced relationship and enable them to present low-risk profiles to the revenue body.

27. Full and timely disclosure and transparency are major departures from the basic relationship and cannot reasonably be expected to be provided to the revenue bodies without meaningful reciprocity from the revenue body. We now turn to that exchange.

The Enhanced Relationship — what taxpayers want

28. The principal goal of taxpayers is to have tax matters resolved quickly, quietly, fairly and with finality. There is common ground here with the position of revenue bodies, in that the quick, quiet, fair and final resolution of tax issues will come with increased disclosure and transparency; and vice versa. However, there is a slight divergence in interests because compliant taxpayers and, in particular, those that seek the enhanced relationship should believe that their tax return already declares the 'right' amount of tax due. So in order for taxpayers to be comfortable that the revenue body will understand and pay due regard to this view when risk-assessing taxpayers and their returns, taxpayers have a legitimate expectation that the revenue body will demonstrate certain characteristics and possess certain aptitudes. These are listed and discussed below.

29. A point to note, however, is that if a particular taxpayer is not willing to engage meaningfully in the enhanced relationship, then, of course, it will be less likely to receive the reciprocal benefits of that relationship. This means that taxpayers who choose not to act in a transparent and open manner, or who adopt narrow, 'black letter' legal positions in order to exploit unintended and unexpected tax consequences, are less likely to be able to obtain the early certainty or the other benefits offered by the enhanced relationship regarding their tax position.

30. The five things that the study team's consultation has suggested revenue bodies need to demonstrate in order to give taxpayers the incentive to engage in the enhanced relationship are set out below.

31. **Requirement one: commercial awareness.** It is trite to say that corporate taxpayers generally undertake transactions and adopt tax positions for commercial as well as for revenue reasons. Accordingly, the study team believes that taxpayers will be reluctant to provide voluntary disclosure about such matters if they cannot be certain that the revenue body will understand the former as much as it does the latter. Unless revenue bodies possess such 'commercial awareness', which goes beyond staple tax and accounting knowledge, the risk is that taxpayers will not disclose for fear that the revenue body will misunderstand the information and use it to the disadvantage of the taxpayer.

32. What the study team perceives to be the requisite commercial awareness has two aspects; a general and a specific. The general aspect requires revenue bodies to have an understanding of the 'business of how to do business',

including how companies operate in domestic and global markets, the dynamics of market competition, public company financial reporting and accounting matters, and corporate governance issues. The specific aspect requires an understanding of:

- the peculiarities or unique characteristics of a taxpayer's industry and business, including corporate governance, management structure and decision-making processes; and
- the taxpayer's risk-management strategy, appetite for risk-taking in the tax area, tax function and tax decision-making process, and the interrelationship between the tax function and the company's business units.

33. Overall, therefore, this process involves revenue bodies ensuring that they are connected to the businesses they examine. The underlying goal is to get to a situation in which the revenue body understands the commercial **and** tax reasons for tax positions taken by taxpayers. Where it is considered that improvement in this area is required, this could involve recruiting and developing business and industry experience; structuring revenue body administration around business and industry segments; general business management training programmes; and industry and taxpayer business-specific training programmes. The study team envisages revenue bodies and corporate taxpayers working in partnership to develop appropriate levels of knowledge, a process with which some taxpayers have already indicated a willingness to engage. Tax intermediaries will also play an important role in this educational process and here the study team's consultation has again revealed a willingness to form partnerships.

34. **Requirement two: an impartial approach.** The second expectation that taxpayers will have involves the culture, attitude and mindset that revenue bodies bring to the overall issue resolution process. In most countries, the stated aim of revenue bodies is to collect the 'right' amount of tax, often expressed in the revenue bodies' statements of purpose to be a matter of what is fair for taxpayers to pay and reasonable for revenue bodies to seek. Many corporate taxpayers, through direct experience or anecdotal information, do not generally perceive this to be 'real world' practice.

35. The study team believes that adherence by revenue bodies to this stated aim is necessary in order for the enhanced relationship to function. This is because to follow an approach to the issue-resolution process that is driven by the desire to extract the maximum amount of tax receipts or other considerations providing leverage not germane to the merits will again be a barrier to full disclosure by taxpayers. Why? Because taxpayer voluntary disclosures of uncertain tax positions will provide revenue bodies with a "roadmap" to find the issues where the taxpayer has doubts; and therefore the taxpayer will expect that in following that map, revenue bodies will act fairly and proportionately.

36. Acting fairly and proportionately necessitates revenue bodies bringing a high level of independence and "revenue detachment" to the issue resolution process, especially if the matter under consideration is detected through a

voluntary taxpayer disclosure. This approach can be assisted by the use of alternative dispute resolution techniques such as mediation and arbitration, which have been used successfully in some countries. However, the study team believes that the impartial approach is principally a matter of the philosophical and cultural attitudes taken by revenue bodies as to the manner in which the issue-resolution process is undertaken.

37. The study team appreciates that the impartial approach is a nuanced and, in some respects, difficult concept. A more detailed examination is set out in Appendix One.

38. **Requirement three: proportionality.** It is important that revenue bodies' dealings with taxpayers generally and tax examinations in particular be reasonable, balanced and proportionate. There is an overlap with impartiality in that a departure from this value is also likely to be a departure from proportionality. But it adds a further dimension. The impartial approach concerns the general means by which taxpayers and revenue bodies go about seeking the "right" amount of tax. The concept of proportionality, by contrast, addresses the fact that there is often no single, right amount of tax, but a range of possible answers, all of which may be within a range that is considered 'acceptable' by the revenue body. This is because the overall tax liability of large corporate taxpayers is comprised of many individual tax items, the determination of each of which is often a matter of judgment.

39. Determining whether the total amount of tax said by the taxpayer on its return to be due is the 'correct' amount would therefore require the revenue body to test all of these individual judgments to verify if, or to what extent, they accord with the revenue body's view of the tax law. Time and resource considerations mean that it would be impossible for the revenue body to undertake comprehensive examinations of this nature in respect of every single judgment made by every single taxpayer. The ultimate task of the revenue body is therefore to determine whether the taxpayer has pitched the total tax liability disclosed on its return within a range which is 'acceptable.' However, a prior issue is how the revenue body goes about deciding which aspects of, and to what extent, a particular taxpayer's return is to be examined. It is these decisions with which the principle of proportionality is concerned.

40. Proportionality requires that the revenue body 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 benefit to the revenue body of pursuing or not pursuing a line of inquiry. This means that a return from a taxpayer with no history of errors on its returns and a low-risk profile should ordinarily be subject to less examination than a taxpayer presenting the opposite characteristics. It also means that revenue bodies should ordinarily have regard to the overall revenue consequences of initiating a particular enquiry. At bottom, therefore, proportionality requires two things. The first is that revenue bodies must focus their enquiries and examinations on the most significant issues presented by a return; and the second is that the significance for these purposes must be judged by reference to context as much as to concept.

41. From the taxpayers' perspective, the benefits of proportionality principally take the form of reduced compliance costs. If revenue bodies focus their examination and collection activities on areas that are the most significant, taxpayer costs will not be incurred responding to protracted inquiries into minor or incidental areas. But there is also a broader benefit. Taxpayers generally do not mind answering reasonable, proportionate enquiries but find it frustrating to be asked about minor issues or about matters that have no tax consequence. This frustration can lead to a reduced willingness to be compliant and hence can be counter-productive for revenue bodies.

42. A more detailed discussion of what the study team envisages that proportionality will demand of revenue bodies is set out in Appendix Two.

43. **Requirement four: disclosure and transparency.** Taxpayers will want the openness and transparency expected of them under the enhanced relationship to be reciprocated by revenue bodies. Again, this is a matter which revenue bodies and taxpayers in several jurisdictions have already addressed, and the extent to which revenue bodies are willing and able to disclose information relating to their internal processes will vary between countries. However, the study group envisages that the minimum amount of openness on the part of revenue bodies that will be necessary for the enhanced relationship to function will include:

- an openness about why the revenue body perceives particular behaviour or tax positions to be a risk, why the revenue body has asked particular questions or is seeking particular information (and requirement 5 also expects a willingness to discuss how to answer them); and
- a willingness to disclose such information without invoking (except in the very rare case where the public interest requires otherwise) executive and other governmental privileges and immunities to suppress documents and other information reasonably sought by the taxpayer.

44. There are also further steps that might be appropriate for a revenue body to undertake in order to meet this transparency goal. These might include the provision of early explanations of new laws (perhaps formulated, where appropriate, together with interested taxpayers and tax intermediaries), the provision of guidance, or the giving of reasons for decisions in areas such as audit, requests for rulings and issue resolution. Finally, on a macro level beyond the specific examination process, taxpayers will expect their collective voice to be heard through consultation on changes in tax policy and tax administration, with open engagement early enough to influence final decisions.

45. **Requirement five: responsiveness.** The four items above should help taxpayers, especially large corporate taxpayers, achieve what they most want in relation to tax – certainty. If revenue bodies can be commercially aware, act with impartiality and proportionality, and provide appropriate levels of disclosure and transparency, taxpayers will be able to get more certainty. But they also want it quickly, and revenue bodies therefore also need to be responsive. Taxpayers

should expect prompt, efficient and professional responses when they make queries or requests of revenue bodies. They can also expect a fair and efficient decision-making process and a definitive resolution of issues other than those that the revenue body may choose to take to court.

46. They should also expect revenue bodies to appreciate the value of certainty and to help them achieve it whenever it is possible to do so. For example, businesses may wish to prioritise settlement of particular issues and revenue bodies should be willing to co-operate where it is reasonable to do so – and should explain the reasons when it is not. Additionally, revenue bodies must work to ensure that, so far as possible, decisions taken at the revenue official level are consistent with the instructions and guidance of revenue body management. It would be destructive of the certainty sought by taxpayers for decisions by revenue officials to be overruled regularly by management when submitted for approval.

The role of tax intermediaries in the enhanced relationship

47. As already noted, tax intermediaries are not direct parties to the enhanced relationship. However, they have the capacity to influence taxpayer behaviour, and they assist taxpayers in complying with their tax obligations and in dealing with revenue bodies. Accordingly, the study team envisages that some of the expectations of taxpayers under the enhanced relationship will fall to be carried out by tax intermediaries. Specifically, it is expected that tax intermediaries – or, more precisely, tax advisers – will often be the facilitators of the disclosure and transparency that typifies the new relationship.

48. In the consultations undertaken by the study team on this point, tax advisers were concerned that greater disclosure and transparency would compromise their various legal and ethical obligations to act solely on behalf of, and in the best interests of, their client. Accordingly, from the perspective of the tax intermediary the enhanced relationship should call upon revenue bodies to:

- recognise the important and constructive role that they play in the tax system and respect their professional responsibilities to their clients;
- recognise that the client's interests are paramount and cannot be compromised in any case resolution; and
- encourage and facilitate constructive "guidance" from the tax intermediaries in bringing enquiries to a quick and responsible conclusion.

49. The study group recognises the various obligations of tax advisers to act in their client's best interests and respect their client's confidences. The enhanced relationship does not require tax advisers to act in a contrary manner. Rather, it is expected that the adoption of the enhanced relationship by corporate taxpayers will be likely to temper aggressive tax planning by tax advisers because the *demand* for such planning will be reduced. Tax advisers will still act in their client's best interests; but one of those interests will be the maintenance of an enhanced relationship with the revenue body.

A specific enhanced relationship for tax intermediaries?

50. It follows from the discussion in the previous section that the enhanced relationship between taxpayers and revenue bodies is likely to result in greater interaction and dialogue between revenue bodies and tax intermediaries. Indeed, for the reasons discussed in *Working Paper 5 – Risk Management*, it is expected that revenue bodies will often seek to initiate such contact with tax advisers in any event, so as to gauge the impact a particular tax adviser has on the risk profiles of his or her clients.

51. Revenue bodies will benefit from this greater interaction with tax advisers through the disclosure that tax advisers will give on behalf of their clients and through the risk-management process. The study team expects that tax advisers will also benefit from such interaction. Shortly stated, there should be scope for tax advisers and revenue bodies to develop their own form of ‘enhanced relationship’ that, while very different from the enhanced relationship between taxpayers and revenue bodies, will similarly be based upon fostering the mutual benefits that can flow from increased dialogue, trust and openness.

52. The principal benefit to tax advisers relates to revenue bodies gaining a 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 increased understanding by revenue bodies will be likely to 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.

53. Conversely, tax advisers should gain an understanding of revenue bodies, their decision-making processes and their general areas of concern in relation to tax planning. This will be likely to enable tax advisers to give accurate and informed advice as to the revenue body’s likely response to a particular tax position, and access to revenue officials in the event that a client wishes to seek an advance clearance from the revenue body in respect of a particular transaction.

54. Certainly, there will be an inevitable cost to both revenue bodies and tax advisers in engaging in such dialogue; therefore the respective benefits must represent value for money. The cost/benefit analysis may suggest that there would not be sufficient benefit to revenue bodies and tax advisers in gathering and processing knowledge about a large volume of smaller, locally operating, tax advisers and entering into direct dialogue with these firms separate to a dialogue with the professional associations to which they belong. Accordingly, the study team envisages that there could be direct dialogue between revenue bodies and (i) the larger firms of tax advisers, (ii) others where there are particular reasons, such as a specialised tax practice area of particular interest to the revenue body, and (iii) professional associations representing the remainder.

When should disclosure occur, and how does it relate to transparency?

55. Disclosure and transparency are key requirements of both revenue bodies and taxpayers under the enhanced relationship. In a general sense, while 'disclosure' refers to individual acts of communication between the parties to the enhanced relationship, 'transparency' refers to the general relationship framework in which such individual acts take place. At a more specific level, disclosure and transparency require different things of the different parties to the enhanced relationship, and a more detailed discussion of them can be found in Appendix Three.

56. However, we need at this stage to be clear **when** disclosure under the enhanced relationship will be expected. Viewed from the revenue bodies' perspective, there are basically two timescales that are relevant here: first, the time the transaction takes place (where the matter to be disclosed is a transaction); and, second when discussions about the tax liability take place. More specifically:

- The requirement for transactional disclosure to be effective is for it to take place, optimally, prior to or at the time the return is submitted or, in limited justifiable circumstances, prior to the time discussions about tax liability occur. It is of very little use for the revenue body to receive disclosure several years after a transaction has occurred and a tax return has been filed. Accordingly, revenue bodies have a legitimate expectation that disclosure should be before the revenue body decides whether to initiate enquiries, so as to give it the information needed to make a meaningful risk assessment. There should also be transparency in the on-going dialogue which ensues where enquiries are initiated about disclosed transactions.
- In some circumstances, there also needs to be openness when the transaction is being planned and implemented. This will often be the case when the taxpayer is undertaking a transaction with an uncertain tax result, and voluntarily and willingly makes a real-time disclosure in order to obtain (if possible) clarity and certainty from the revenue body in advance. Here, revenue bodies will expect full transparency throughout the process.
- Additionally, real-time disclosure is required when the matter concerns a transaction in respect of which the relevant law-making body has decreed mandatory disclosure. A few countries have statutory regimes legally requiring contemporaneous disclosure or notification of specified transactions. However, the study team views such requirements as an addition to the basic relationship rather than a step towards the enhanced relationship. What the enhanced relationship adds in this situation is that there should be an attitude from the taxpayer and tax intermediary that does not ponder strict and technical interpretations of the statutory rules and one where disclosure is the default position.

57. In turn, the timing of the disclosure and transparency expected of revenue bodies under the enhanced relationship depends on the type of disclosure in question. The common ground with the disclosure required of taxpayers is that

disclosure by the revenue body must be early and on-going. So, for example, revenue bodies must be open from the start as to why certain matters are perceived as high-risk, must promptly disclose risk-profiles to taxpayers (and any changes to those profiles), and must respond with due speed and commercial awareness to disclosures made by taxpayers with a view to seeking the revenue body's view on the tax treatment of a particular transaction or position.

The benefits of the enhanced relationship

58. Throughout this paper the study team has touched on the benefits to revenue bodies and taxpayers and their tax advisers from engaging in the enhanced relationship. This section provides focus and context to these benefits.

59. It is relatively easy to see why revenue bodies will benefit from and relish the early and full disclosure and transparency by taxpayers. Obtaining relevant and timely information from taxpayers is the key to effective risk-management of taxpayers and tax intermediaries which, in turn, is at the root of resource allocation. Any improvement in risk-assessment information and techniques impacts directly on the revenue body's ability to devote resources to enquiring into and auditing high-risk issues. Conversely, risk assessment also impacts directly on the revenue body's ability to reduce resources spent enquiring into and auditing low-risk issues and taxpayers. So disclosure and transparency improve the revenue body's ability to move resource from low- to high-risk issues.

60. It is important to note, however, that in order for revenue bodies to recognise these benefits fully, their success as organisations must be measured by reference to more than intervention yield alone. The study team believes that the implementation of the enhanced relationship would lead to the increased efficiency and effectiveness of revenue bodies – enabling tax to be collected more efficiently from the majority of taxpayers and more effectively from high-risk taxpayers – and help make countries more attractive locations for investment. But collecting tax in a more cooperative way is likely to lead to a fall in intervention yield. Unless it is possible to measure the impact on tax compliance directly (which we doubt), it will therefore be important to measure revenue bodies' performance indirectly, for example by reference to broader factors such as the creation and maintenance of effective enhanced relationships with taxpayers, the ability to identify at an earlier stage tax laws operating in an unintended and unforeseen manner, and the ability to allocate resources in a more effective manner.

61. At a more concrete level, the timely disclosure of information offers other benefits:

- Current information and documentation, particularly involving complex transactions, will always be preferable and more reliable than a stale version years later, whether or not there is any tax dispute between the parties.
- Early disclosure allows revenue bodies to manage systemic risks better. These risks are, principally, that tax legislation is either defective or

perceived by tax intermediaries and taxpayers to work in a way that may lead to an unacceptable leakage of tax receipts. Early disclosure in these circumstances allows policymakers and lawmakers to be advised quickly and, therefore, given ample opportunity to make changes in the law. It should be noted here, however, that reciprocity in disclosure will be appropriate in such circumstances as taxpayers and tax intermediaries will expect to be kept abreast of intended changes to the law so that they may be certain of their future position.

- Early identification of potential ‘industry-wide’ issues that will allow revenue bodies to respond in a more timely manner in dealing with other taxpayers similarly situated.
- In acquisition transactions, contemporaneous disclosure can lead parties that otherwise might take inconsistent tax positions (colloquially known in the United States as “whipsaw”) to harmonise those positions.

62. Turning to the benefits of the enhanced relationship for taxpayers, the study team envisages that the early disclosure and resolution of issues will give taxpayers the benefit of greater certainty as to their tax exposure. The desirability of certainty in this respect has been a significant feature of the consultations with taxpayers that the study team has carried out. Additionally, the study team envisages the most noticeable financial advantage will be reflected in reduced compliance costs – particularly in the long-run. 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 an increased difference in compliance costs incurred by taxpayers, with those who are seen as the highest risks incurring the highest compliance costs while those seen as low-risk incur lowered compliance costs. So transparency potentially offers the prospect of a tangible payback at the bottom line as long as taxpayers can rely on revenue bodies’ behaviour.

63. But there are other less obvious but surely important non-financial benefits to taxpayers from early disclosures. For instance, issues, unwanted disclosures and audit time arising from shareholder reporting requirements or corporate governance issues for publicly traded companies can be greatly minimised when complex transactions involving potential tax disputes are resolved early on or in ‘real time’. In today’s corporate world, ‘clarity’ and ‘certainty’ are powerful ideas for executives making risk management decisions on behalf of their companies. Equally, early disclosure by revenue bodies on matters such as areas considered to be of concern will bring the further benefit to taxpayers of greater predictability as to a revenue body’s likely response to a transaction or tax position.

64. Also, early experience in the United States CAP programme indicates that the business units of corporate taxpayers will become involved early in the tax structuring of a deal when they know that it will be scrutinised by the revenue body on a current basis. This has had a significant impact on the structuring of corporate deals as the business people are now directly joined with the tax function as the actual transaction matures. This means that complex transactions will be driven by sound business economics with a commercially aligned tax minimisation plan wrapped around the deal, rather than the reverse.

65. These financial and operational benefits to taxpayers will not only be available to those who present low risk, although they should see the lowest compliance costs. It will also work, albeit more subtly, where taxpayers have some high-risk issues. Here, the focus will be on behaviour. A taxpayer who is transparent about a high-risk issue will expect the revenue body to use its resources to enquire into that issue (where the tax at risk is significant). But the discussions can be ring-fenced; the taxpayer's transparency will be a positive demonstration of his/her low-risk behaviour which will increase trust and maintain the low profile of risk more generally. By contrast, taxpayers who are not transparent about the issues that present risk should expect the revenue body to treat them as potentially concealing risks; so if an undisclosed high-risk issue comes to light, the profile of risk more generally will increase substantially.

The Importance of establishing trust

66. The enhanced relationship requires all three parties – taxpayer, tax intermediary and revenue body – to go beyond the bare minimum that they are obliged to do. They will do so only if they can see benefits to them from that new relationship. And fundamentally, they will not do so on a sustained basis unless trust is established **and** maintained.

67. Trust is not something any party can acquire or require; it has to be earned. Trust can be established, but it requires each party to behave in a way that is seen by the other parties as trustworthy, which means being credible (competent), reliable (following through on undertakings given), intimate (treating others as human, with needs, feelings and imperfections) and not self-oriented (not driven by our own agendas).⁴ It takes time for trust to emerge; and it will do so only through personal interactions and consistent deeds.

Implementation

68. Defining the content, parameters and requirements for the building of the enhanced relationship is merely the first step. The second – and equally critical – step is to develop the means by which the enhanced relationship can be implemented.

69. The study team recognises that the approach to implementation will necessarily be a matter for each jurisdiction. Existing relationships between revenue bodies, taxpayers and tax intermediaries differ widely between countries, so that the changes required to move towards the enhanced relationship will have to be adapted to fit the circumstances.

70. The study team has considered three paths to implementation of the enhanced relationship concept:

⁴ These basic components of trust in the professional context are derived from: David H. Maister, Charles H. Green and Robert M. Galford, *The Trusted Adviser*, Simon & Schuster, 2002.

- A 'Charter' that sets out the basic expectations of all the parties. This approach would have the advantage of bringing together the fundamental elements of the enhanced relationship in a single point of reference. The risk of this approach, however, is that the Charter will come to be viewed as merely one more regulatory document setting out the **minimum** requirements for 'compliant' behaviour – which is of course the very 'black and white' mentality that the enhanced relationship is intended to overcome. Care must be taken, therefore, both to ensure that the Charter is drafted with the full participation of *all* stakeholders, and that its terms are sufficiently high level – a 'principles-based' approach to the required conduct – that compliance will be a matter of adopting the spirit of the Charter rather than close analysis of its letter.
- A 'unilateral' declaration by the revenue body both that it intends to adopt the principles of the enhanced relationship, and that benefits will flow to taxpayers and tax intermediaries who follow suit. This approach would have the advantage of making the revenue body's intentions abundantly clear, thereby highlighting the benefits and detriments to the other parties of adopting or not adopting the principles of the new relationship. The risk, however, would be that the inherently unilateral nature of the approach would mean that it might be viewed with scepticism by taxpayers and tax intermediaries, and as an exercise of 'power' by the revenue body rather than as a step towards a new relationship.
- An 'informal agreement' between all the parties to the enhanced relationship. This approach would certainly have the advantage of flexibility. It would also place the new relationship on the proper footing from the outset – such agreements require mutual trust to be effective. This approach would be likely to be more suitable in those countries in which revenue bodies presently enjoy a closer relationship with taxpayers and tax intermediaries.

71. Whatever implementation method is chosen, it will be important to ensure that the chosen method deals with the consequences of a failure to meet commitments, both on the part of the taxpayer *and* the revenue body. In the absence of mechanisms to deal with such situations, the risk is that dissatisfaction on either side would lead to an inevitable reversion to the basic relationship, thereby undermining the whole process. Depending on the circumstances, this may be assisted by the creation of an oversight body – such as a joint taxpayer and revenue body committee – to monitor each party's compliance with the principles of the enhanced relationship. Whether such a body would be appropriate, and, if so, what enforcement powers that body would hold, will very much be a matter for each jurisdiction to determine.

Delivery

72. Successful implementation of the enhanced relationship will require significant behavioural change by revenue bodies, taxpayers and tax intermediaries. It will also necessitate from the revenue bodies a significant enhancement and redeployment of human and financial resources. These

changes carry with them the potential for internal disruption and added external political pressures.

73. Will the parties be able to deliver on their commitments to allow the foundation of trust to develop and the enhanced relationship to mature and, equally, will they be able to persuade the counter-party of their ability to deliver? One point is certain: Success can only come about if there is deep institutional commitment to the concepts and the program from all the participants.

OECD Tax Intermediaries Study
July 2007

APPENDIX ONE

The impartial approach

Introduction

1. As described in the working paper above, one key requirement of the enhanced relationship is for revenue bodies to bring an 'impartial approach' to the resolution of potential disputes. This appendix provides more detail on both the concept of the impartial approach and the manner in which the study team envisages it operating in practice.

2. At the conceptual level, the impartial approach refers to revenue bodies adopting and fostering an institutional attitude that approaches dispute resolution solely by reference to: (a) the merits of the case: and (b) reasonable legal positions that reflect what the tax law actually says, rather than what the revenue body would like it to say. 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 and it wishes to advance that position against that of the taxpayer because it reflects what the revenue body believes both to be sound tax policy and what the law-making body probably intended to say but didn't plainly articulate. This circumstance typically involves a result that was unforeseen or unintended by the parliament and produces bad tax policy or a significant tax revenue leakage.

3. The study group further believes that the development and implementation of the impartial approach may in some instances be facilitated by the use of 'alternative dispute resolution' ('ADR') processes that provide a framework and mechanism for independent issue resolution.

4. The impartial approach is part of the reciprocity for the openness expected from taxpayers under the enhanced relationship. Taxpayers that disclose relevant information in a timely manner and then carry on discussions with the revenue body in a fully transparent fashion have a reasonable expectation that, if a disagreement arises as a result of that disclosure and discussion, the revenue body will act objectively and fairly. It would seriously undermine the mutual trust and confidence that necessarily underlie the enhanced relationship for the revenue body to use voluntarily disclosed information in a manner that merely seeks to extract as much tax from the taxpayer as possible, assisted by whatever leverage, commercial or otherwise, can be brought to bear.¹

5. The principles of the impartial approach are already followed in many countries. Switzerland has a 'code of conduct for tax authorities, taxpayers and tax advisers' that requires the Swiss tax administration, amongst other things, to refrain from referring *"taxpayers or their advisers to judicial proceedings as long*

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.

as an efficient and timely solution can still be reached” and from “threaten[ing] to unduly delay the assessment procedure by taking legal action.” Moreover, the tax administration should ensure:

“[I]legality and equal treatment; equals should be treated equally, and unequals should be treated unequally; taxpayers’ cases will be treated differently only if the distinctive factual or legal features can be proven.”

6. This paper details the reasons why an approach to dispute resolution in a manner akin to that set out in Switzerland’s code of conduct is indispensable to the enhanced relationship, the cultural changes that are necessary for such an impartial approach to be put into place, and ADR mechanisms that may be used to support it.

The need for an impartial approach

7. It is the universal responsibility of all revenue bodies to facilitate and administer the collection of the right amount of tax from taxpayers. The meaning of the ‘right’ amount of tax is often difficult to determine. This is particularly the case in the context of this study because here we have primarily looked to one of the main taxpayer segments in which the two areas of concern for the study² are most obviously important: global corporates and their complex commercial environment. It is here where we find business dealings and transactions which may give rise to disagreement about the ‘right’ amount of tax.

8. For our purposes, the path to finding the ‘right’ amount of tax can take one of four directions. Tax laws can:

- a) be clear and operate as intended by the law-making body and as foreseen by taxpayers;
- b) on a reasonable view of the law, operate in an unintended / unforeseen manner to the disadvantage of the taxpayer;
- c) on a reasonable view of the law, operate in an unintended / unforeseen manner to the advantage of the taxpayer; or
- d) be ambiguous. Ambiguity here can be uncertainty over the application of a pure legal principle or doubt over the application of a set of facts to a clear legal principle.

9. Laws falling within (a) shouldn’t give rise to any serious disagreement. By contrast, until the courts provide a definitive answer, laws falling within (d) will inevitably require the revenue body to exercise substantial discretion and judgment in determining the ‘right’ amount of tax, and therefore give rise to a much greater potential for disputes with taxpayers. Similarly for laws falling within (b) and (c), until they are changed by law-making bodies or interpreted by the courts, determining the ‘right’ amount of tax will again require the revenue body to exercise discretion and make judgments.

² The two areas of concern to revenue bodies relating to taxpayer behaviour are: (a) planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences, and (b) taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty in it.

10. 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, revenue bodies staking out positions that would require significant additional tax payments can produce unwanted (and, if not ultimately upheld, unnecessary) public disclosures by corporates. An example might be the requirement for a company 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 this discretion is always subject to administrative or judicial check, challenging a revenue body's decisions can be costly and time-consuming. In practice, conventional administrative or judicial 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.

11. It is for this reason that the impartial approach is a central element to creating and sustaining the enhanced relationship. If taxpayers are to conduct their affairs in an open and transparent manner, then revenue bodies must exercise their discretion in a considered, revenue-detached and proportionate manner. If not, it is the view of the study team that taxpayers simply will not commit to participate in building the enhanced relationship.

What is the impartial approach?

The dangers of 'advocacy'

12. It is already the stated aim of many revenue bodies to approach the application of tax laws in precisely such a balanced and detached manner. The Australian Tax Office assumes for itself a *"responsibility to apply tax law to the facts of individual cases in a fair, consistent and transparent manner"*.³ The overarching mission of the United States Internal Revenue Service is to *"provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all."*

13. The worth of these and other like goals expressed by revenue bodies is manifest. Nevertheless, some taxpayers perceive that many revenue officials approach the task of enforcement in a more revenue-focused manner.

14. An example might be a situation in which a revenue body concedes its position is unmeritorious and could not be sustained in court proceedings, and yet allows the dispute to go unresolved. The impartial approach views such behaviour as inappropriate, and requires a total concession by the revenue body.

³ Australian Taxation Office, *Law Sub-Plan 2006-07*, page 4

15. Similarly, some revenue bodies may 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.

16. Revenue bodies should also be aware that dispute resolution can be driven by extraneous factors not germane 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 examinations 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, corporate 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 obtain a premium settlement.

17. Tax officials work opposite tax advisers who are professionally required to act as zealous advocates for their client's interests. Such advisers should bring perspective to their client advice; taxpayers and advisers should have regard to the potential implications of pursuing a particular course of action (for example, more onerous legislation, withdrawal of administrative discretion or a poor relationship). Nevertheless, they can and do advance tactical and procedural arguments to win their case, arguments often not germane to the merits. It is understandable, then, that revenue body officials may be tempted to approach their task in a like manner. The difference is, however, that the revenue body can exercise formidable power and therefore must do so responsibly and mindful of the consequences for the broader development of tax law and for the generality of taxpayers, i.e. they need to have regard to the effect they may have on the entirety of the tax system. To build the enhanced relationship, therefore, it is revenue officials and not taxpayers and their advisers who must look to practice the impartial approach.

18. This is a point worth emphasising as tax intermediary behaviour was a primary focus of the Seoul Declaration. The study group acknowledges that tax advisers have a professional obligation to act solely in their client's interests; and that, in doing so, they play a necessary and meritorious role in the process of tax compliance. Certainly, change in the behaviour of tax intermediaries and their clients in other areas – notably an openly co-operative attitude manifested through the disclosure of information and transparency of discussions – will be necessary for the enhanced relationship to function. However, in the study group's discussion of the impartial approach specifically, it is the behaviour of revenue bodies and revenue officials that is under analysis.

Elements of the impartial approach

19. So the impartial approach is principally a matter of culture and attitude. No more or fewer powers of enforcement and tax collection are required for the

adoption of the impartial approach; rather, it is a matter of how existing powers are **exercised**.

20. Taking the three elements of the impartial approach identified in the Introduction in turn.

Merits of the case

21. The first is that the revenue body's approach to the resolution of disputes must be based on merit, and merit alone. In the first instance, this necessitates a dispassionate and responsible application of the right legal principles to the meaningful facts. But importantly, the idea of merit goes beyond strict legal positions and merges into other elements of the enhanced relationship, namely, proportionality and responsiveness. It envisages revenue bodies considering the nature of the transaction or tax position giving rise to the dispute, the conduct of the taxpayer, and the application of sound tax policy. Take, for instance, a taxpayer with a legal position that is likely to be sustainable who has made early and complete, voluntary disclosure of a transaction undertaken for a genuine commercial purpose. Focusing on the merits here would require the revenue body to process the issue quickly and efficiently, to avoid a 'heavy handed' approach to audit and to refrain from utilising highly procedural points as a basis for contesting the taxpayer's position. Given the taxpayer's openness and reasonable legal position, the revenue body should only be seeking to discover substantive and important potential points of difference.

22. A focus on the merits of the dispute further requires the revenue body to refrain from seeking to exert non-legal forms of leverage as a means of obtaining taxpayer concessions. We have noted some of these earlier; other examples include the prospect of further audit of tangential issues not central to the main dispute or information queries that are not designed to bring closure to issues.

What the law actually says

23. The second aspect of the impartial approach requires revenue bodies to approach disputes from the starting point that taxpayers are entitled to structure their affairs in accordance with reasonably arguable views of what the law actually says, as opposed to what revenue bodies would **like** the law to say as a matter of tax policy. This requires the revenue body to refrain from insisting on unmeritorious legal positions (point 2(c) earlier) in the hope that sufficient non-legal pressure can be brought to bear so as to achieve a favourable outcome regardless. This is simply a matter of revenue bodies recognising that the legislative process, rather than the taxpayer disputes process, is ordinarily the most appropriate means of addressing any undesirable revenue or tax policy consequences.

24. In cases of outright ambiguity, either factual or legal (point 2(d) earlier), it is of course impossible to insist upon the revenue body taking a position that accords with what the law 'actually says' as, absent a consensual resolution, it will be for the courts to say. Here, the impartial approach only requires that the revenue body adopt a legal position that, after careful consideration, it considers

both to be reasonably arguable and in accordance with good tax policy. Beyond that, it must not exploit the ambiguity as a means of attempting to extract concessions from the taxpayer.

Dispute resolution as a strategic tool

25. There are circumstances in which, although a taxpayer's legal position appears to be relatively strong, a revenue body may nevertheless wish to assert a contrary position in the interests of seeking to maintain its view of the law-making body's intention behind a particular tax law. Such instances are likely to arise in respect of tax planning that seeks to exploit laws that have an unintended or unforeseen tax consequence. In such cases, it is not inconsistent with the impartial approach to seek to use the dispute resolution process – and litigation in particular – as a tool to seek to clarify the law, prevent the particular scheme in question from succeeding, and send a general message to taxpayers that planning of such a nature will be challenged. In these circumstances, using dispute resolution as a means to these broader ends is a natural and desirable stance for revenue bodies to take.

26. But the impartial approach *does* require two things of revenue bodies in this situation. The first is the recognition that the revenue body's position must be justified by reference to a tenable legal construction of the relevant tax law. What constitutes a sufficiently tenable construction will vary with the circumstances; the more egregious the planning, the more likely a revenue body can and should proceed to litigation on a weaker case. But in all circumstances, the revenue body's legal position must be reasonably arguable. As already stated, revenue bodies must start from what the law actually says rather than what it would like it to say. The second requirement is that the decision that a scheme is sufficiently egregious to be subject to challenge must be subject to proper consideration at an appropriate level within the revenue body and communicated to collection officials in an effective manner. In any case, such decisions cannot be made unilaterally by collection officials as a convenient means of justifying their position in any given case.

Alternative dispute resolution mechanisms

27. The development of a detached, objective approach to revenue enforcement – manifested through the three attitudes described above – should bring consensus rather than conflict to the forefront as the principal basis for the resolution of revenue disputes. Consent-based outcomes can, of course, be reached simply by a process of negotiation between the revenue body and the taxpayer – assisted by the tax adviser. However, recent developments in the dispute resolution field have demonstrated that 'getting to yes' is often greatly assisted by the use of more structured forms of 'alternative dispute resolution', or 'ADR'. The study group is of the view that the increased use of consent-based ADR mechanisms in the revenue field may assist the process of cultural and attitudinal change that underlies the impartial approach. It is, moreover, hoped that the increased use of ADR would have further, more immediate and meaningful benefits to taxpayers and revenue bodies.

28. This is because ‘consent-based’ ADR, a concept which is discussed further in the following paragraphs, has been said by ADR professionals⁴ to be of particular utility when the parties expect to continue in a relationship following the resolution of the dispute. Litigation is often a hostile and adversarial process in which, by its very nature, there can be only 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.

29. Of course, the study group recognises that 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. 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. But these points do not mean that ADR will not be of use in the more general cases that comprise the majority of revenue disputes.

30. 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 group does not consider ADR of this nature, being close in style to the formalism and adversarial style of litigation, to be well-suited 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.

31. 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

⁴ See generally: Julie Macfarlane (ed.), *Rethinking disputes: the mediation alternative*, Cavendish, 1997.

parties' respective cases as a means of creating a basis for negotiations and avoiding unnecessary escalation in the early stages of a dispute.

32. It will be apparent that such ADR mechanisms depend for their efficacy on, and thereby tend to foster, participants' bringing a detached and objective approach to the process. For this reason, the study group believes that they are an ideal complement to, and vehicle for, the impartial approach to revenue disputes.

33. Increased use of ADR tools is well under way in some jurisdictions. In 2001, for example, the US Internal Revenue Service launched a 'Fast Track Settlement' (FTS) scheme for large corporates. 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.

Conclusion

34. The impartial approach may be seen by revenue bodies as a radical transformational change in the way they go about doing business and resolving tax disputes. The main *quid pro quo* being asked of taxpayers and their advisers – openness through full disclosure and transparency – is likely to be viewed by them as equally radical. That is why the enhanced relationship presents both enormous challenges and profound opportunities for meaningfully changing the tripartite relationship.

APPENDIX TWO

Proportionality

1. The concept of proportionality requires revenue bodies to approach the examination of tax returns in a contextual manner, taking into account considerations such as the risk profile of the taxpayer in question, the revenue consequences of pursuing a particular line of enquiry and the like.
2. Approaching the matter from a detailed level, proportionality could mean that revenue bodies:
 - only initiate audits or inquiries in relation to significant issues, and only where there are sufficient reasons for doing so;
 - only ask appropriately focused questions that seek information that will lead to a conclusion of the audit/enquiry;
 - close audits/enquiries quickly once the significant issues have been satisfactorily explored and it is clear that no significant differences or issues remain;
 - have an appreciation of materiality in the context of the taxpayer's business, meaning that the 'big picture' must be kept in view – materiality for tax is not the same as for accounting purposes, but it will differ between taxpayers so that what is a significant issue should take account of the impact the issue may have on arriving at the "right" amount of tax;
 - understand that the taxpayer's systems will not be 100% accurate and be prepared to discuss with the taxpayer what level of inaccuracy is within acceptable tolerances;
 - when the taxpayer's or the tax intermediary's processes break down, discuss the reasons and the remedial action the taxpayer/intermediary proposes to take before concluding that tax offences have been committed;
 - address their efforts towards encouraging long-term compliance, which in appropriate cases will mean helping taxpayers learn from errors and reduce the risk of recurrence, and only penalising such errors where this is necessary to improve long-term compliance;
 - discuss the implications of decisions before taking them; and
 - behave in a way that is human – by, for example, maintaining the relationship with the taxpayer and tax intermediary by forewarning, where appropriate, the issue of letters that might otherwise be unexpected and damage the relationship.

APPENDIX THREE

Disclosure and transparency

Introduction

1. The concepts of 'disclosure' and 'transparency' are aspects of the enhanced relationship. They are distinct from each other, and, depending on the context in which they are used, can require different things of the various parties to that relationship.
2. The purpose of this appendix is to examine disclosure and transparency in greater detail and provide an overview of how the study team envisages that disclosure and transparency will actually impact upon the interactions between revenue bodies, taxpayers and tax intermediaries.

Describing 'transparency'

3. 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). A transparent relationship, for a taxpayer, means that the cultural and institutional status quo must be that such issues need to be the subject of disclosure and discussion with the revenue body. In turn, a transparent relationship for a revenue body means that it must be up-front about what tax issues it considers to be of concern, and willing to engage in dialogue (and, if appropriate, give guidance) when it is approached by a taxpayer wishing to disclose such an issue. A transparent relationship is, therefore, possible only if a minimum degree of trust exists between the parties to it. It must also be supported by sufficient inter-organisational communication protocols and processes.
4. Breaking down this general description, it can be seen that transparency has a number of aspects: individual, cultural and structural. Taking them in turn:
 - The *individual* aspect of transparency refers to the individual relationships by which taxpayer personnel (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. An example on the revenue body side might be the creation of dedicated teams to deal with a particular taxpayer or group of taxpayers. Such relationships are important because continuity can lead to a familiarity and ease of communication, upon which mutual trust and respect can be built.
 - The *cultural* aspect of transparency refers to the collective manner in which taxpayers and revenue bodies, at the institutional level, view the other party to the relationship. Clearly, a culture in which the other party is viewed in a

suspicious or adversarial manner is a significant barrier to transparency, regardless of the relationships at the individual level.

- The *structural* aspect of transparency refers to the protocols by which taxpayers and revenue bodies communicate. These can be tailored to fit the circumstances of a particular relationship. Some parties may wish to discuss issues of concern with each other on a regular, pre-scheduled basis. Others may prefer a more *ad hoc*, as-necessary approach. In any case, the relationship structure must be such that there is a readily accessible and mutually accepted means by which information can be passed from one organisation to the other.

5. 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 have not been 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 therefore requires that attention be paid to all of its three aspects.

Describing ‘disclosure’

6. Acts of disclosure, and a willingness to undertake acts of disclosure, are what a relationship based on transparency is intended to foster. They are the end towards which the means of a relationship based on transparency is oriented.

7. The issues that need to be the subject of disclosure all relate to tax positions that give rise to a material risk; or, alternatively, will or may give rise to such a risk or uncertainty as the circumstances progress. As already noted, however, the content of disclosure varies both as between taxpayers and revenue bodies, and as between different forms of risk and uncertainty. Additionally, as many taxpayers conduct the whole or part of their tax affairs through tax advisers, disclosure must on occasion be made by an adviser on behalf of the taxpayer.

8. The remainder of this appendix deals with these different forms of disclosure.

Disclosure by taxpayers

9. The working paper reaches the conclusion that a taxpayer fully participating in the enhanced relationship must disclose anything that the taxpayer reasonably believes is of interest, or necessary for the revenue body to undertake a fully informed risk assessment.

10. Practical examples of what information might be of interest to a revenue body include:

- the general appetite within the taxpayer for tax risk, and the processes by which decisions are made to assume or not to assume such risk;
- tax positions or potential tax positions adopted by the taxpayer that present risk due to factual uncertainty;

- tax positions or potential tax positions adopted by the taxpayer that present risk due to tax planning, particularly when the planning is designed to exploit an unintended or unexpected tax consequence;
- detail concerning specific transactions whose tax treatment or potential tax treatment presents risk (either due to factual uncertainty or tax planning), including:
 - the identity of the parties to the transaction (or, where it is not possible for the taxpayer to reveal the identity of its counterparty, the identity of the parties to the transaction that are under the taxpayer's control);
 - the purpose of the transaction, including whether it was initiated for a genuine commercial purpose or a pure tax-planning purpose;
 - any international aspects to the transaction that have a tax impact; and
 - any other relevant surrounding factual circumstances; and
 - changes in tax positions or transactions that result in the relevant tax risk increasing or decreasing.

11. Discussion of the disclosure of information regarding positions or transactions that give rise to tax risk inevitably leads on to considerations of confidentiality and, more importantly, information privileges such as legal professional privilege (LPP).

12. The study group envisages that taxpayers participating in the enhanced relationship should be prepared to disclose to revenue bodies information that is commercial-in-confidence. In any event, revenue bodies ordinarily possess statutory powers to compel the disclosure of confidential information at the tax return stage. Equally, revenue bodies are ordinarily themselves under strict obligations of confidence with respect to information disclosed to them by taxpayers (whether that disclosure was voluntary or compelled).

13. However, the study group does *not* believe that participation in the enhanced relationship would require taxpayers to disclose information subject to privileges such as LPP. While the doctrine varies between countries, it is a general feature of LPP that it provides a degree of information protection that is significantly stronger than mere confidentiality. In many countries, for instance, revenue bodies cannot compel the disclosure of information subject to LPP. The study group wishes to be clear in saying that the enhanced relationship as it relates to LPP is not about revenue bodies seeking to obtain on a voluntary basis information that it cannot obtain on a compulsory basis. This is because revenue bodies will not need to see legal opinions and other related documents provided to taxpayers by legal advisers in order to undertake the risk assessment. Assessing risk requires the disclosure of facts – areas of uncertainty, transactions undertaken and the like – rather than the legal conclusions drawn from those facts by legal advisers.

14. Beyond this general discussion and the examples provided above, it is not possible for the study team to be more specific about the information that taxpayers participating in the enhanced relationship should disclose, or the manner in which such disclosure should take place. The former is a matter for

taxpayer judgment and discussion with the revenue body; and the latter is a matter for taxpayers and revenue bodies establishing a relationship based on transparency along the lines of the discussion in the preceding section.

Disclosure by revenue bodies

15. As already noted, disclosure by taxpayers is concerned with providing revenue bodies with sufficient information to undertake meaningfully the process of risk assessment. Disclosure by revenue bodies, on the other hand, is designed to achieve two things. The first is to assist taxpayers to make sensible judgments as to the information they need to disclose to the revenue body. The second is to provide sufficient information to taxpayers, in response to taxpayer disclosures, to give them the early certainty that they will expect to obtain from participating in the enhanced relationship.

16. Accordingly, the disclosure expected of revenue bodies can roughly be divided between (i) 'general' disclosure – that which the revenue body must make to all taxpayers as a matter of course – and (ii) 'specific' disclosure – that which the revenue body must make in response to a prior act of disclosure by a taxpayer. What these different types of disclosure might actually entail for revenue bodies will be considered in turn.

17. General disclosure, as noted, is concerned with keeping taxpayers informed about the types of risk that revenue bodies perceive as being of particular importance. This necessarily entails keeping taxpayers informed about the revenue body's risk-assessment strategies. Specifically, taxpayers who participate in the enhanced relationship have a legitimate expectation that revenue bodies will disclose to *all* taxpayers information including the following (in addition to those disclosures identified in the working paper above):

- types of behaviours or transactions that the revenue body will consider to be high-risk and likely to be subject to challenge, and why it has reached that conclusion;
- details of how the revenue body will respond to such behaviours or transactions;
- information regarding the manner in which they risk-assess taxpayers or groups of taxpayers, including the criteria which are used to determine 'high-risk' versus 'low-risk' behaviours and transactions;
- information regarding the steps that taxpayers profiled as engaging in 'high-risk' transactions or behaviours can take to change that profile to 'low-risk'; and
- detail as to the risk profile which the revenue body has determined applies to a particular taxpayer.

18. Specific disclosure, as noted, is about revenue bodies responding to voluntary disclosures made by taxpayers so as to give taxpayers the maximum possible degree of certainty as to the revenue body's view on a particular tax uncertainty or risk. Depending on the circumstances of the disclosure and the content of the information disclosure, this could entail a revenue body approving a taxpayer's proposed tax treatment of a transaction that is disclosed in real time by

a taxpayer or otherwise responding, with reasons, to the taxpayer's proposed treatment. Alternatively, it could involve providing formal or informal guidance to taxpayers in respect of non-transactional tax risks.

19. Clearly, what revenue bodies should disclose will be a matter for judgment in the circumstances. But the goal in all cases should be to reciprocate, to the greatest possible extent, the openness shown by the taxpayer in making the voluntary disclosure in question. This is part of the reciprocity that will build trust and encourage taxpayers to participate in the enhanced relationship as a whole.

Disclosure by tax advisers

20. Disclosure to revenue authorities by tax advisers is a difficult subject. The study team recognises that tax advisers owe stringent ethical and legal obligations of confidence to their client. In the case of legal advisers, depending on the country in question, they may also have an obligation to assert on behalf of their client LPP in respect of all information to which it applies. The study team therefore envisages that if disclosure to a revenue body is made directly from a tax adviser, it can only be (i) on the taxpayer's instructions, e.g. in accordance with a general enhanced relationship existing between the taxpayer and the revenue body, or (ii) under a statutory obligation that requires direct disclosure from the adviser.

This is not to say, however, that tax advisers have no role to play in fostering relationships based on transparency and openness. For the reasons stated in the working paper above, the study team envisages that participation in the enhanced relationship will bring real benefits to taxpayers. As such, tax advisers, acting in their clients' best interests, should advise their clients of these benefits and assist them in formulating a relationship with the revenue based on transparency and in making the necessary disclosures as part of this relationship.