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A Framework for a Voluntary Code of Conduct
for Banks and Revenue Bodies



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Foreword

Improving tax compliance by banks is a shared concern of many tax commissioners. As a follow up to the OECD's Forum on Tax Administration (FTA) 2009 Report on Building Transparent Tax Compliance by Banks the FTA invited South Africa and the United Kingdom to examine whether there were ways in which countries could work together to build on and develop South Africa's Accord with its banking association and the United Kingdom's Code of Practice on Taxation for Banks.

An FTA project was subsequently commenced, involving nine other FTA countries (Australia, Canada, France, Ireland, Italy, Netherlands, Spain, Switzerland and the United States of America) aimed at exploring the potential relevance to other countries of the experiences of South Africa and the United Kingdom in developing Accords and Codes of Practice with their banks. The project benefited from discussions with the banking associations in a number of countries and from input by further FTA countries. In addition, there was detailed input from six banks on the emerging findings of the study.

The report from this study takes the form of a framework for a voluntary code of conduct for revenue bodies and banks. We think that the development of a relationship of mutual trust between revenue bodies and banks, characterised by transparency and openness, first described in the FTA 2008 Study into the Role of Tax Intermediaries, provides the opportunity for such a framework to be successful. Whether particular countries wish to use the framework will depend on the direction they want their tax administrations to take. It is hoped that the framework will prove useful for revenue bodies in countries that consider the negotiation of a code of conduct with banks could play a valuable role in their strategies to ensure compliance by banks and by their clients.

We would like to thank all of those who assisted the Study Team. We hope that the report will be shared widely within revenue bodies, as well as within banks and within their professional advisory firms.

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INTRODUCTION

1. Many countries are concerned about tax compliance by some banks despite the proposals set out in the OECD's Forum on Tax Administration (FTA) Report on *Building Transparent Tax Compliance by Banks* (the Banks Report).¹ In late 2009 the FTA commissioned a study to examine a way forward with banks, including the development of a framework for a voluntary code of conduct for revenue bodies and banks.

2. The Framework for a voluntary code is based upon the concepts developed, and proposals set out, in the Banks Report (2009) and the earlier report *Study into the Role of Tax Intermediaries* (2008) (Intermediaries Report).²

3. The Intermediaries Report described a relationship, the *enhanced relationship* between revenue bodies, large taxpayers and their advisers which is a collaborative relationship anchored more on mutual trust than on enforceable statutory obligations. The Banks Report examined whether there are benefits for revenue bodies and banks engaging in enhanced relationships given banks' dual role as taxpayers and promoters of financial products for their clients.

4. The two reports identified a number of principles that could guide the relationship between banks and revenue bodies:

- Transparency, openness and a high degree of trust are fundamental requirements of relationships between revenue bodies and banks in working towards a consensus approach to tax compliance.
- Effective relationships which can achieve this objective are built around practical commitments by both sides which are seen to be honoured.
- Revenue bodies need to understand the business of banking and banks need to understand the motivation for and the drivers of revenue body compliance intervention strategies.
- Lines of communication which can ensure timely and relevant responses to technical interpretation or other issues raised by either side need to be in place with responsibilities for responses clearly identified.
- Banks should not become involved in aggressive tax planning either on their own behalf or in their capacity as tax intermediaries, and should consult with revenue bodies where there is significant uncertainty.
- Banks and revenue bodies should work towards a common view of what constitutes acceptable or unacceptable tax planning.

¹ OECD 2009 *Building Transparent Tax Compliance by Banks*. OECD, Paris.

² OECD 2008 *Study into the Role of tax Intermediaries*, OECD Paris.

- Banks approach to tax compliance should be reflected in their governance and risk management processes.
- Revenue bodies should be impartial and proportionate in their approach to engagement with banks on tax compliance issues.

5. The study was led by the Commissioners of South Africa and the United Kingdom, assisted by a focus group consisting of 9 other FTA countries (Australia, Canada, France, Ireland, Italy, Netherlands, Spain, Switzerland and the United States of America). The banking associations in a number of the focus group countries were consulted on the form and content of the framework for a voluntary code of conduct.

6. Both South Africa and the United Kingdom have introduced measures aimed at improving the relationship with their banking sectors. On 29 January 2009, the South African Revenue Service (SARS) and the Banking Association of South Africa signed an accord that establishes a framework for cooperation between them to improve levels of tax compliance, discourage impermissible tax avoidance arrangements and enhance service.³ The UK introduced a Code of Practice on Taxation for Banks on 9 December 2009.⁴ The aim of the Code is to ensure that banking groups operating in the UK comply with the spirit, as well as the letter, of the law when it comes to tax matters. The UK Code's introduction should be seen in the context of HMRC's continuing drive to improve relations with large business. The experiences of both SARS and HM Revenue and Customs with the development of the Accord and the Code of Practice have informed the development of the Framework for a Voluntary Code of Conduct for Revenue Bodies and Banks.

7. Part 1 contains the Framework for a Voluntary Code of Conduct for Revenue Bodies and Banks (Framework). Part 2 contains a commentary on the Framework.

³ Banks Report Annex B6 page 116.

⁴ See: http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD1_030008

PART 1: A FRAMEWORK FOR A VOLUNTARY CODE OF CONDUCT FOR BANKS AND REVENUE BODIES

1. Introduction⁵

This document sets out a Framework for a Voluntary Code of Conduct for Banks and Revenue Bodies (Framework). This Framework assumes that Banks and Revenue Bodies want a relationship characterised by transparency, openness and trust and one which would provide for a constructive two way dialogue. Whether or not a country feels the need for a Voluntary Code of Conduct will depend upon the existing relationship between the banks and the revenue body and on that country's existing legislative and regulatory framework. The FTA felt, however, that it would be helpful for those countries which are considering introducing a code (a number of countries have already done this) to have a Framework which could guide them. This is the purpose of this document, which was discussed at the 2010 Istanbul FTA meeting.

2. Overview

This Framework for a Voluntary Code of Conduct provides a means through which banks and revenue bodies can work cooperatively to ensure the effective and efficient operation of the taxation system and to achieve the aims set out above. Under this Framework banks and revenue bodies are expected to behave as follows:

- 2.1 *Compliance*: Banks will comply fully with their tax obligations and promote tax compliance by their clients.
- 2.2 *Governance*: Banks will ensure they have adequate governance to control the types of transactions they enter into and the tax risks associated with those transactions.
- 2.3 *Tax planning*: Banks will not use or promote aggressive tax planning.
- 2.4 *Enhanced relationship*: Revenue bodies and banks will work to establish a relationship in which trust and co-operation can develop as set out in the Forum on Tax Administration study into the role of Tax Intermediaries (see footnote 1).

3. Details of commitments

3.1 Commitments by banks

3.1.1 *On compliance* banks:

- will comply fully with their tax obligations.
- will have, or will buy in, the skills necessary to deal with the tax issues that arise.

⁵ It is for each country to set out in the Introduction the reasons it has for introducing the Code.

- where there is significant uncertainty, would be encouraged to enter into an early dialogue with Revenue Bodies as set out in 3.3.1 below.
- 3.1.2 *On governance* banks will have a documented strategy and governance process for taxation matters encompassed within a formal policy. Accountability for this policy will rest with the board of directors or, for foreign banks, with a senior accountable person.
- 3.1.2.1 This policy should include a commitment to comply with tax obligations and to maintain an open, professional and transparent relationship with revenue bodies.
- 3.1.2.2 Appropriate processes should be maintained, by use of product approval committees or other means, to ensure the tax policy is taken into account in business decision making. The banks' tax departments should play a critical role and their opinions should not be ignored by business units. There may be a documented appeals process to senior management for occasions when a tax department and a business unit disagree.
- 3.1.3 *On tax planning* banks will not use or promote aggressive tax planning:
- in their own tax affairs.
 - in products and services they offer to clients.
 - in their remuneration packages for employees including senior executives.
- 3.1.3.1 For the purpose of this Framework aggressive tax planning refers to the two areas of concern highlighted in the OECD *Study into the Role of Tax Intermediaries*:
- Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences.
 - Taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law.
- 3.1.3.2 Where a bank is unclear about whether a proposed transaction will be seen as aggressive tax planning it should ideally discuss this transaction in line with 3.3.1 below and the revenue body will assist in resolving the uncertainty.

3.2 Commitments by Revenue Bodies

- 3.2.1 *On understanding the business* revenue bodies will ensure they have an adequate understanding of:
- how large businesses operate.
 - the characteristics of, and developments in, the banking sector.
 - the unique characteristics of each bank, their business and the environment within which they operate.

To achieve this there will need to be a close dialogue between banks and revenue bodies with banks using their best endeavours to assist revenue bodies in this area.

3.2.2 *On impartiality* revenue bodies will bring a high level of consistency and objectivity in the identification and resolution of issues.

3.2.3 *On proportionality* revenue bodies will ensure that their decisions on (1) the tax risks to be addressed and (2) the allocation of resources to address those risks, are reasonable, balanced and proportionate.

3.2.4 *On openness and transparency* revenue bodies will:

- provide greater certainty through its systems, where appropriate in the provision for advance rulings.
- consider sharing their risk assessment with the banks.
- be open about why it has asked about particular issues, unless this would endanger an on-going investigation.

3.2.5 *On responsiveness* revenue bodies will:

- provide assistance to resolve uncertainty around complex or significant issues and commercial transactions.
- provide prompt, efficient and professional responses for the bank.
- provide, where necessary, access to senior-level management to discuss issues of mutual concern.

3.3 Relationship between bank and revenue authority

Banks and the revenue bodies jointly commit to building and maintaining a relationship which is transparent and constructive based on mutual trust and openness. In doing so banks and revenue bodies will:

- 3.3.1 Be open in disclosing and discussing significant uncertainties in relation to tax matters.
- 3.3.2 Discuss and resolve issues before returns are filed, whenever practicable.
- 3.3.3 Engage in a co-operative, supportive and professional manner.
- 3.3.4 Work collaboratively to achieve early resolution and hence certainty.

4. Implementation of the Framework

Banks and revenue bodies will discuss the implementation of the Framework, and continue to discuss its operation as part of the enhanced relationship.

PART 2: COMMENTARY ON THE FRAMEWORK FOR A VOLUNTARY CODE OF CONDUCT FOR REVENUE BODIES AND BANKS

1. The Framework for the Voluntary Code

1.1 This commentary explains the thinking behind the design and content of the Framework for the Voluntary Code (the Framework) and it is aimed at countries considering whether to use this approach. The Code assumes that Banks and Revenue Bodies want a relationship characterised by transparency, openness and trust and one which would provide for a constructive two-way dialogue. Whether or not a country feels the need for such a code will depend upon the existing relationship between the banks and the revenue body and on that country's existing legislative and regulatory framework.

1.2 The Framework is a code for banks. Countries will need to consider what the scope of the code should be if they were to introduce it:

- How should banks be defined?
- How tightly drawn should the definition be?

Countries will also want to consider whether to distinguish banks by size. In the UK, some of the detail (in part 3.1 of the Code) was found not apply to some smaller banks and it was decided that they need only adopt what is in the equivalent of the Summary section of the Code. The reason for this is that some of the more detailed aspects of the UK Code will not be relevant to small banks. For example, a small branch of an overseas bank may only have 20 or so employees and may not therefore have product approval committees, a tax department or separate business units. For smaller banks, the Summary may provide sufficient detail. It will be for countries to consider whether this sort of approach would be suitable for them and, if so, which banks should adopt the fuller version of the Code.

1.3 When considering whether to adopt the Framework, some banks may suggest that adoption would put them at a competitive disadvantage with banks that do not adopt. In the UK these concerns were addressed by:

- seeking to encourage all banks to adopt.
- seeking to work in real time with banks, whether or not they adopt, since transparency gives the Government the information it needs to amend the law where it is misfiring – creating a level playing field for all banks whether or not they adopt.

Countries will need to consider how they will respond to such issues of competition.

2. Status of the Framework for the Voluntary Code

2.1 The Framework addresses the choices banks make. It asks banks to refrain from undertaking transactions which they may be entitled to enter into but which would constitute aggressive tax planning (ATP). It also asks banks to be transparent where there may be doubt about whether a transaction would be considered to be ATP. Countries considering going forward with a code will need to be clear that it has developed from the enhanced relationship and it builds on the statutory relationship. Once a transaction has been entered into, it will be taxed in accordance with the law – nothing in the Framework will deprive banks of a judicial resolution when there is a difference of view on a tax issue. In addition the Framework is not intended to:

- promote or discourage a purposive method of legal interpretation.
- stop banks from being innovative.

3. Design of the Framework for the Voluntary Code

3.1 In designing the Framework the following key approaches were applied:

Reciprocal

3.2 The Framework follows the lead from and builds on previous FTA work advocating the enhanced relationship (*Study into the Role of Tax Intermediaries* and *Building Transparent Tax Compliance by Banks*). It also draws on the experience gained by HMRC and SARS introducing the UK Code and the South African Accord respectively. Feedback received during the FTA studies mentioned above stressed the importance of reciprocity and that banks may not go beyond their statutory obligations unless they could see an advantage to them doing so. The wording suggested in the Framework is explicit about this reciprocity providing commitments from revenue bodies as well as banks. Each country will need to consider whether to be explicit in setting out these reciprocal commitments or whether they are implicit, because their enhanced relationship already provides them.

3.3 Some feedback has suggested that the Framework's use of "will" when outlining the commitments of banks and revenue bodies indicates that there is very little margin for error should a bank adopt it and this will discourage adoption. The UK Code uses the word "should" in describing the standards that the bank is expected to adhere to but the study team considered that the reciprocal nature of the commitments in the Framework meant that "will" was more appropriate. The choice of "will" or "should" is at least partly driven by the formats used. The Framework sets out mutual commitments that both parties undertake to respect. The UK Code, by contrast, sets out behaviours banks should adopt. But whatever the format, the use of "will" could be seen to set a higher expectation, which needs some qualification such as "use best endeavours". As stated in the paragraph above it will be for countries to consider, where they wish to go forward with a code, what format to choose: the format will influence the language. Whatever format is adopted, the aim is to facilitate a transparent relationship and promote discussion, leading to open dialogue as envisaged in the enhanced relationship – a voluntary code cannot bind a bank to behave as the revenue body wants it to.

Voluntary

3.4 As noted above the Framework builds on the earlier FTA work advocating the creation of a relationship that goes beyond statutory obligations (both by corporate taxpayers and by revenue bodies). It might be possible to create statutory obligations to comply with various commitments

set out in the Framework but this would not be a code and would need to start from a very different place.

- 3.5 Without a statutory basis, adoption of a code by banks has to be voluntary. Banks would be free to choose whether to adopt a code proposed by a country, although a bank's attitude towards adoption will inform the revenue body's risk assessment of the bank.

Adaptable

- 3.6 The Framework's structure and content are based largely on the OECD studies and the experiences in the UK and South Africa during the development and implementation phases of their Code and Accord. It is a framework that can be used by countries but each country will need to carefully consider whether the Framework needs to be adapted to address unique issues it encounters in its relationships with banks. However it would be expected that the core features of the Framework would remain.

4. Introduction to the Framework for the Voluntary Code⁶

- 4.1 Each country should decide whether to add its own introduction setting out what its government seeks to achieve by asking banks to adopt the Framework. This has been deliberately left open to take account of the different situations and relationships that each country might have with its banks.

5. Overview⁷

- 5.1 The Overview sets out the main expectations of the Framework. The four areas concentrated on are those highlighted during the OECD studies.

- The *Study into the Role of Tax Intermediaries* looked at how revenue bodies can influence the demand for aggressive tax planning and recommended the establishment of an enhanced relationship with large corporates, going beyond their statutory obligations.
- The follow-up study *Building Transparent Tax Compliance by Banks* took this one stage *further*, asking how the enhanced relationship could operate in the specific case of the banks given that they, to an extent, use, promote and facilitate aggressive tax planning.

The commentary below looks in more detail at some of the conclusions and recommendations of these reports and Chapters 7 (Revenue body attributes) and 8 (The enhanced relationship) from the Intermediaries study are reproduced at Annexes 3 & 4 for reference.

⁶ This section relates to Part 1 of the Framework.

⁷ This section relates to Part 2 of the Framework.

6. Details of commitments

6.1 Banks⁸

On compliance

- 6.1.1 The suggested wording used in the Framework is that banks commit to fully complying with their tax obligations. Countries may want to consider what this will mean in practice for them. One suggestion is that this will mean that banks commit to having suitably skilled personnel to deal with issues that arise. Where the tax issues are more complicated and beyond the experience of the in-house personnel banks will be expected to seek professional advice to assist them in complying with their obligations. Finally where the issue remains uncertain countries will need to decide whether their code should (i) commit banks to engaging with the revenue body to resolve the uncertainty or (ii) whether banks are invited to do so, with less adverse inference if they choose not to.
- 6.1.2 The extent to which the engagement with revenue bodies can resolve the uncertainty and what should happen when there are disagreements is dealt with at 6.1.12-6.1.15 below.

On governance

- 6.1.3 The commitments suggested in this section of the Framework reflect the views expressed in the consultation undertaken during the OECD study *Building Transparent Tax Compliance by Banks*. Banks should have a documented strategy and governance process for taxation matters encompassed within a formal compliance policy. The policy should include a documented strategy to comply with tax obligations and to maintain an open, professional and transparent relationship with revenue bodies. The responsibility and accountability for the governance process will rest with the board of directors or equivalent senior officers in the bank.
- 6.1.4 Good governance requires the board of directors (or other senior leadership of the bank) to exercise strategic oversight of tax matters. They must take accountability for tax and ensure that there is a strategy describing the bank's approach to tax and the process for implementation. While the wording in the Framework does not determine what the strategy or governance process should be – these are matters for the bank to decide – it promotes a commitment to adopt a responsible approach to tax planning, as well as encouraging the development of an open, transparent and professional relationship with the revenue body.
- 6.1.5 In paragraph 3.1.2.2, the Framework focuses on processes. In the course of the OECD *Banks* study, banks explained how their internal processes operate. Banks regard product approval and other committees as standard practice enabling them to manage the risks they carry. Tax is one of these risks. Managing it should mean the tax analysis of any proposed transaction is signed off by the group tax function independently of the business units, with the tax function having the final say on the tax analysis. The only exception to this is that the major business decisions can be taken by the board despite tax risks. Revenue bodies will be aware that proper governance and risk management of the tax function by banks for particular transactions does not necessarily mean that these transactions will be low risk for tax from the revenue bodies' perspective.
- 6.1.6 ***On tax planning:*** An area of concern highlighted by the OECD *Intermediaries* and *Banks* studies was *aggressive tax planning* (ATP). This section asks the bank to commit to not using or

⁸ This section relates to Part 3.1 of the Framework.

promoting aggressive tax planning in its own tax affairs, in products and services it offers to clients and in its remuneration packages for employees including senior executives.

6.1.7 The *Intermediaries* study began following the Seoul Declaration when the FTA was concerned about “unacceptable tax minimisation arrangements”. The study team concluded that, because of the variations between the legal frameworks of the FTA countries, it would not be appropriate or feasible to reach a definition of “unacceptable tax minimisation arrangements”. Instead, recognising the need to provide clarity about FTA Commissioners’ concerns, it identified the two areas of concern detailed in the Framework.

6.1.8 The following is the meaning of ATP taken directly from the *Intermediaries* study:

- **Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences.** Revenue bodies’ concerns relate to the risk that tax legislation can be misused to achieve results which were not foreseen by the legislators. This is exacerbated by the often lengthy period between the time the schemes are created and sold and the time revenue bodies discover them and remedial legislation is enacted.
- **Taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law.** Revenue bodies’ concerns related to the risk that taxpayers will not disclose their view on the uncertainty or risk taken in relation to grey areas of the law (sometimes, revenue bodies would not even agree that the law is in doubt).

These two areas of concern are referred to as aggressive tax planning (ATP).

6.1.9 The first area of concern noted above talks about tax planning that involves the taxpayer taking a tenable position which has unintended or unexpected tax revenue consequences. In practice this will require banks to consider:

- Unintended – are the tax consequences consistent with/contrary to the legislator’s intention?
- Unexpected – are the tax consequences likely to be a surprise to the revenue body?

Revenue bodies accept that it can be difficult to discern the legislator’s intention and that ultimately that is a matter for the judicial process to determine. Because of this, the UK Code’s tax planning section asks banks to consider whether a transaction has “...a tax result...which is not contrary to the intentions of Parliament”. The UK Code deliberately casts this in the negative. Banks will be concerned that in some areas of tax law it can be easier to discern whether the tax result is clearly contrary to the intentions of Parliament than consistent with it. Countries will need to consider this point when they decide how a Code would operate.

6.1.10 This commentary does not go into detail setting out examples of what constitutes ATP but there are some useful examples of ATP involving Complex Structured Financial Transactions (CSFTs) in the *Banks* study. In clarification of the UK Code HMRC suggested that, as a practical test which experienced tax advisers could answer without legal advice, banks should consider whether the tax consequences of a proposed transaction are “too good to be true”. Another frequently used test for the presence of ATP is whether or not there is an underlying commercial purpose for a transaction or whether the transaction would be undertaken in the absence of a tax advantage.

- 6.1.11 This question will inevitably leave some room for doubt on some occasions. Paragraph 3.1.3.2 suggests that, where banks are unclear about whether a proposed transaction will be seen as ATP they should discuss this with revenue bodies. Here the Framework seeks to further encourage banks, as recommended in the OECD studies, to provide a degree of transparency above the minimum legal requirement.
- 6.1.12 Where banks seek clarity in this way, they should do so sufficiently in advance of undertaking the transaction to allow revenue bodies time to review the available information and comment on it. How far in advance will be a matter for the banks to judge and revenue bodies will need to recognise that commercial pressures sometimes dictate that transactions are carried out very quickly - there will sometimes be little opportunity to disclose or discuss the transaction in advance.
- 6.1.13 Revenue bodies will need to decide what they will want to see to enable them to understand the transaction. There are different ways to achieve this and the possibilities include:
- Setting out rules for the information needed – this can prove too bureaucratic in some cases and insufficient in others.
 - More detail could be provided but might add complexity while still not solving this problem.
 - Being more principled, not rule-based, about what is required – e.g. specifying that the information should enable the revenue body to understand the transaction.
 - Face-to-face explanations may offer dialogue and better outcomes than correspondence.
 - Supporting documentation may be needed – but it may be easy, if banks are so minded, to hide the important information among voluminous irrelevant detail.
- 6.1.14 Where banks seek clarity, revenue bodies will need to be prepared to work with banks within a reasonable timeframe that recognises the commercial pressures. Where appropriate, revenue bodies should tell banks whether they consider the transaction falls within what they consider to be ATP. It may not be possible for revenue bodies to provide the clarity sought within the timeframe required. Countries that are considering going forward with a code will need to consider what happens in these circumstances. In the UK, the bank decides whether to proceed with the transaction without receiving the revenue body's views. Alternatives would be that the bank cannot proceed, or must wait for a set period before proceeding. These would potentially offer revenue bodies more protection when banks have adopted a code. However, such an approach would risk adverse impacts on commercial transactions and hence reduce the likelihood of the bank adopting.
- 6.1.15 Where there is a disagreement over whether the transaction should be considered to be ATP and banks proceed with the transaction, revenue bodies will be able to use their statutory powers to review and challenge the transaction, as appropriate.

6.2 Revenue bodies⁹

- 6.2.1 The suggested commitments set out in the Framework for revenue bodies are taken from Chapter 7 of the *Intermediaries* study (see Annex 3). The Study Team found that large corporate taxpayers

⁹ This section relates to Part 3.2 of the Framework.

want early certainty and a problem-solving attitude. It then set out the five attributes that revenue bodies should show to significantly contribute to early certainty – understanding through commercial awareness, impartiality, proportionality, openness through disclosure and transparency and responsiveness.

- 6.2.2 Revenue bodies should understand the recommendations in the *Intermediaries* study and critically review how far they have gone in meeting these. The reciprocal and voluntary nature of the Framework means that it is likely to be more difficult to persuade banks to adopt the Framework if the revenue body does not display the attributes outlined here; this could have significant resource implications.
- 6.2.3 Some banks have mentioned that the true potential of the enhanced relationship may not be achieved unless it includes engagement with those responsible for proposing and crafting legislation because existing law will not always permit a satisfactory solution. One option would be to include a process through which those responsible for tax policy could be consulted. This commentary does not examine this issue but it was felt appropriate to highlight it here for revenue bodies' consideration.
- 6.2.4 The Framework contains a reciprocal commitment from the banks under *On understanding business* to help revenue bodies understand banking. During the *Intermediaries* study, large corporates were clear that revenue bodies needed to have adequate understanding of their businesses based on commercial awareness. The Study Team recommended that revenue bodies explore opportunities to work in partnership with large corporate taxpayers and tax intermediaries to deliver training on relevant issues. The Framework seeks to commit banks to assisting revenue bodies in this area.

6.3 Relationship between banks and revenue bodies¹⁰

- 6.3.1 Chapter 8 of the *Intermediaries* study (see Annex 4) discusses the enhanced relationship. The behaviours envisaged in the enhanced relationship are set out in the commitments from banks and revenue bodies in the Framework. This section's wording assumes that banks and revenue bodies want to jointly commit to building and maintaining the relationship which should be transparent and constructive – based on mutual trust wherever possible.

6.4 Implementation of the Voluntary Code¹¹

- 6.4.1 The Framework provides a text that countries can use if they decide to implement a voluntary Code of Conduct for Banks and Revenue Bodies and could form the basis of a discussion between the two parties. The Framework is intended to be endorsed by a Bank and the Revenue Body where it operates and may be adapted as appropriate to the particular circumstances in a country. Nonetheless, it would be expected that the core features of the Framework would remain.
- 6.4.2 The consultation process during the introduction of the UK's code led HMRC to suggest that the adoption of the Framework should be a corporate decision by the bank, following its own governance, and this decision should be communicated to the revenue body through the existing informal dialogue they have as part of the enhanced relationship. The recommendation of this study is that a similar view is taken by countries wishing to go forward with the Framework and

¹⁰ This section relates to Part 3.3 of the Framework.

¹¹ This section relates to Part 4 of the Framework.

revenue bodies should be aware that the process banks will have to go through to get approval may be quite lengthy. Alternative options would be:

- A requirement that banks formally sign the Framework.
- A lesser expectation that the bank would follow the country's code unless it decided not to do so.

ANNEX 1 THE SOUTH AFRICAN EXPERIENCE WITH THE BANKING ACCORD

Background

In January 2009, SARS signed an Accord with the Banking Association of South Africa, which is the main representative body for South African banks. The origin of the Accord can be found in the late 90's when SARS expressed its concern with regard to the low effective tax rate prevailing in the financial services industry. The SA banking industry, since the mid-1990s, paid very little income tax, despite the fact the industry was a very profitable one.

The aim of the Accord, in essence, was to seek recognition by the banks that, in a developing country such as South Africa, it was important that sufficient tax revenue should be raised to provide fiscal flexibility and stability. By doing that, on a macro-economic level, it would assist in sustaining economic growth and development, increase employment opportunities, and provide social support with regards to the basic and other needs of South Africa's people to achieve a greater level of social justice.

The Accord, therefore, from a SARS perspective, had a higher purpose aimed at ultimately enhancing tax compliance to bring about the fiscal ability and space to achieve the aims in par 2.2. SARS, therefore, pushed for an Accord that, at the very least, would require from the SA banks a high level of commitment towards:

- Promoting good governance to ensure that tax compliance and the effective rates of tax paid were dealt with by the banking industry as a corporate governance issue at board level;
- Discouraging harmful and unacceptable tax practices;
- Promoting tax compliance and timely disclosures;
- Cooperating in identifying and resolving areas of mutual concern; and
- Tax should not be seen by the banks as a tool to reduce the cost of capital by lowering interest rates, as the determination of macro-economic policy is the function of Government and not the banking industry.

One of the main causes for the low effective tax rate of the banking industry identified by SARS was the structured finance market, which in several cases amounted to aggressive tax avoidance structures eroding particularly the corporate income tax base. SARS identified tax deferrals and permanent tax saving techniques as the main tools used to affect the structures.

SARS and National Treasury have met with the South African Banking Council (the predecessor of the South African Banking Association) and the Chief Executive Officers ("CEO's") of the bigger SA banks to discuss the above-mentioned issues on an industry-wide basis since late 2000. During the discussions, some of the initial concerns and statements made by the Council and the banks included:

- Uncertainty regarding the tax treatment of tax structures, the banks role as intermediaries between their clients and the revenue and their involvement in the structured finance market by utilising their tax base for the benefit of their clients;

- The banks' unwillingness to acknowledge that they had been involved in aggressive tax planning (which went beyond the simple use of tax incentives) that resulted in the low effective tax rate as they only acted as arbitrageurs of tax incentives granted by Parliament, thereby reducing the cost of capital for investors;
- Bank secrecy – the banks maintained that, under common law, they were obliged to ensure the secrecy of their client's affairs and this restrained them from freely furnishing information to SARS.

The unacceptable low effective tax rates of banks in 2001 also triggered the intervention by the then Minister of Finance, Trevor Manuel, who, inter alia, stated in his 2001 Budget speech that "Government is concerned about the low effective tax rate on banks. Banks are able to defer and avoid tax by using derivative financial products and structured, asset-based finance techniques, amongst other devices". He further warned that SA may follow the example of a number of countries that limited the scope for banks to avoid tax by introducing alternative minimum taxes or presumptive taxes on easily identifiable and audited tax bases, for example, on gross assets.

To a great degree the Minister's reference to an alternative minimum tax, alternatively, a presumptive tax was the stimulus that actually got the ball rolling towards better co-operation and transparency on the part of the SA banking sector. A paradigm shift occurred and this enabled SARS to make significant progress during the years that immediately followed in raising the low effective tax rates of banks.

The discussions for purposes of the establishment of constructive relationships between SARS and banks followed a two pronged approach i.e. top-down interactions between the then Commissioner of SARS, Pravin Gordhan, and the Banking Association and the CEO's of the major banks and bottom-up technical discussions between technical representatives from both sides.

The improved enforcement of current law since 2001 by SARS based on its increased expertise in the investigation of aggressive structures and better co-operation by banks regarding provision of client information, enabled SARS to challenge many tax avoidance schemes.

Initially, in 2003, the Banking Association representatives tried to focus the project plan and deliverables of the Accord Task Group ("the ATG") only on operational issues such as compliance and reporting, inquiries, audits and investigations, and collections in a manner that actually limited the ambit of SARS' powers. The discussion of these issues, therefore, resulted in protracted legal debates and unnecessary complicating side issues.

For this reason SARS required from the SA banks a high level of commitment towards:

- Ensuring that taxation issues were dealt with as a corporate governance issue at board level;
- Promoting the introduction of appropriate risk management measures to encourage the highest standard of tax compliance;
- Discouraging harmful and unacceptable tax practices;
- Promoting tax compliance and timely disclosures; and
- Co-operating in identifying and resolving areas of mutual concern.

It was also during these discussions that the Commissioner mooted the concept of “no go zones”. The counter from the banks was that there was simply too little certainty to have a bright-line test regarding transactions that were acceptable and those that were offensive to SARS. These concerns were, however, largely addressed through legislative measures, tax rulings in respect of *bona fide* transactions, reportable arrangements measures and a new GAAR, which defined terms such “impermissible tax avoidance” and “lack of commercial substance” to assist in identifying anti-avoidance structures. This enabled the banks to obtain greater clarity regarding the tax consequences of anticipated transactions.

Although the Accord was only signed in January 2009, the relationship between SARS and the banking industry evolved fundamentally since the commencement of the discussions and a move towards a new way of interacting had clearly been embarked upon.

In order for the Accord to retain its impact and to maintain the enhanced relationship with the banks, however, it is recognised that regular Forum meetings and implementation feedback from the banks would be necessary.

The early reactions of the banks to the introduction of the Accord and the Code in practice

Although the Accord was only signed in early 2009, the concept was introduced in the early 2000’s with a first draft based on principle issues circulated in February 2004.

Following the 2001 budget statement, a paradigm shift occurred and this enabled SARS to make significant progress during the years that immediately followed through the implementation of the following measures:

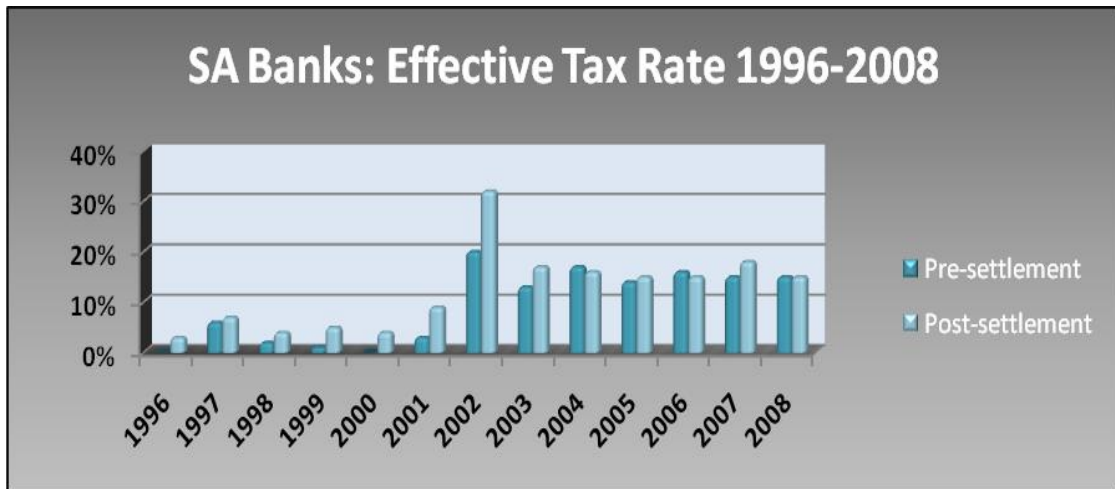
- Focusing resources on raising the low effective tax rate prevailing in the Financial Services Industry and more specifically the banking sector;
- Establishing a reliable operational approach and methodology in order to deal with problem issues and the unwinding of structures; and
- Establishing constructive relationships between SARS and the major players in the banking sector.

The disclosure of information regarding bank clients or other third parties was one of the main obstacles in the investigation, understanding and counteracting of tax aggressive structure structures involving banks by SARS. However, as the Accord discussions progressed, some banks started to co-operate with the investigations enabling SARS to settle several matters even before the Accord was signed.

After the signing of the Accord in 2009, several banks have informed SARS that they are adhering or implementing the Accord, for example by enhanced internal governance measures such as the escalation of all tax related issues or transactions to the bank’s audit committee presided over by the Chief Financial Officer, keeping the Board of Directors informed of any major tax issues, as well as introducing other risk management measures to ensure compliance with the Accord.

Since the intervention by SARS and the then Minister of Finance, the targeted investigations by SARS into aggressive tax structures, better co-operation by the banks, the use of better internal governance measures in the banks and the introduction of the first draft of the Accord based on issues of principle, a marked increase in the effective tax rates could be observed, as reflected below.

Graph 1: Effective Tax Rate of Banks – 1996 to 2008



ANNEX 2 THE UNITED KINGDOM EXPERIENCE WITH THE VOLUNTARY CODE OF PRACTICE ON TAXATION FOR BANKS

Background

The UK introduced a Code of Practice on Taxation for Banks (Code) on 9 December 2009. The aim of the Code is to ensure that banking groups operating in the UK comply with the spirit, as well as the letter, of the law when it comes to tax matters. The Code's introduction should be seen in the context of HMRC's continuing drive to improve relations with large business.

For several years the Large Business Service in HMRC (and its predecessors) has been structured on a sector basis. The effect of this was to create offices with considerable expertise and knowledge of the way banks operated. It also allowed HMRC to build up good relations with banks collectively, through the various banking associations, and individually, through the appointment of Customer Relationship Managers.

Through HMRC's links with the Association for Financial Markets in Europe (AFME), the British Bankers' Association (BBA) and the Association of Foreign Banks (AFB) HMRC has been able to discuss issues of importance to the banking sector. For example issues such as the operation of the EU "Savings Tax" directive, the Disclosure of Tax Avoidance Schemes (DOTAS) regime and specific anti avoidance measures affecting the financial services industry were issues where consultation with the representative bodies was welcomed and resulted in modifications to the proposed measures.

In addition the UK has sought to encourage businesses to adopt good governance practices on matters of taxation for a number of years. HMRC's *Tax in the Boardroom – HMRC view*¹² from 2006 set out HMRC's views on tax governance suggesting that businesses should put in place a formal tax policy, approved by the board of directors, that sets out:

- Their high level tax strategy
- Operating principles and guidelines

Tax in the Boardroom went on to outline what HMRC would regard as good practice. HMRC suggested that the clear tax policy should be aligned with business strategy and operations and should be supported by operational procedures that have been reviewed by the business internally. Relationships between business and HMRC were also highlighted with business being encouraged to openly share relevant and appropriate information.

Following on closely from *Tax in the Boardroom* the 2006 *Review of Links with Large Business* (RoLLB) identified 4 main outcomes that business and HMRC wanted to see:

- Greater certainty through advance rulings and an extension of the existing clearance system.

¹² www.hmrc.gov.uk/lbo/tax-in-the-boardroom.htm

- Efficient risk-based approach to dealing with tax matters.
- Speedy resolution of issues with the aim to reach a decision on issues within 18 months.
- Clarity through effective consultation and dialogue.

HMRC continues to deepen its implementation of RoLLB and this process has been well received by business.

At the same time as HMRC was conducting its RoLLB and implementing the recommendations the OECD's Forum on Tax Administration (FTA) was carrying out its own studies in this area.

The Study into the Role of Tax Intermediaries (2008) looked at the way tax advisers and banks provide avoidance. It recommended that revenue bodies (RBs) build what it termed an "enhanced relationship" with large corporates, going beyond their statutory obligations.

Building Transparent Tax Compliance by Banks (2009) took this one stage further, asking how the enhanced relationship could operate in the case of the banks. It made a series of recommendations both for RBs and for banks, including:

- a) RBs should improve their commercial understanding of banks, especially their risk management and governance functions;
- b) Banks and RBs should work collaboratively to provide earlier certainty and develop an "enhanced relationship".

The Banks study also saw that the extent to which banks use, facilitate and promote aggressive tax planning schemes posed a significant risk to tax systems and made several recommendations to mitigate the risk posed. There are references in the recommendations to building open and transparent relationships between the RBs and the banks mirroring many of the recommendations coming out of RoLLB. Recommendation (v) also talks about the mutual benefits for banks and revenue bodies in providing certainty, cost savings and fewer disputes.

The Code

The reports and initiatives described above provided the context in which, on 16 March 2009, the Chancellor announced that he had asked HMRC to start consultation on the possible introduction of a code of practice designed to ensure banks complied with the spirit, and not just the letter, of the law. The consultation document was published on 29 June 2009 together with the proposed Code.

The consultation document states that the Code "*...draws on two themes in the Government's approach to encourage large businesses to develop their relationships with HMRC. These are:*

- *The benefits of transparency; and*
- *The importance of good governance and senior-level accountability for tax matters."*

And the Code itself sets out "*...the principles and behaviours which the Government expects banks to adopt with regard to all taxes...*"

The Code states that “*The Government expects that banking groups, their subsidiaries, and their branches operating in the UK, will comply with the spirit, as well as the letter, of tax law, discerning and following the intentions of Parliament.*” The Code focuses on 3 areas:

- Governance
- Tax planning
- Relationship between the bank and HMRC

Governance – To comply with the Code each bank should have a documented strategy and governance process for taxation matters encompassed within a formal policy and this policy should be taken into account in business decision making. The policy should include a commitment to comply with tax obligations and maintain good relations with HMRC.

The guidance on governance included in the Code is consistent with the findings of the OECD study *Building Transparent Tax Compliance by Banks* and also repeats some of the guidance from *Tax in the Boardroom – HMRC view*.

Tax planning – This section of the Code is intended to assist boards in determining where to draw the line on tax planning. The Government recognised that tax is an important factor in many business decisions and that tax planning in support of commercial transactions is normal and appropriate. However banks should not engage in tax planning that goes beyond support for genuine commercial activities (for example exploiting loopholes in the legislation etc). The section specifies three areas for banks to consider:

- Firstly the Code looks at transactions that give a tax advantage for the bank that is inconsistent with the underlying economic consequences of the transactions. There are some situations where UK tax law deliberately departs from the underlying economics: where the law does not tax a profit (or relieve a loss), where certain expenses are disallowed or where the mechanism for relieving expenditure departs from the economics in its timing. The Code sets up a 2 step test:
 - Is the tax result consistent with the underlying economic consequences? If so then it is not a transaction that the Code is concerned with. However if the tax result is not consistent with the underlying economic consequences then the second step must be considered.
 - Where the tax result is inconsistent with the underlying economic consequences of the transaction does the bank reasonably believe that the tax result is not contrary to the intentions of Parliament?
- The second area considered is where a bank provides services which create a tax advantage for its customers. Here the Code says a bank should not promote arrangements to other parties unless it reasonably believes that the tax result of those arrangements for the other parties is not contrary to the intentions of Parliament. The focus here is on promotion of arrangements rather than facilitation of arrangements for the very practical reason that it would be difficult for banks, when they are involved in someone else’s transaction, to identify whether the tax results are, or may be, contrary to the intentions of Parliament.
- Finally the Code seeks to ensure that banks use remuneration packages that result in the proper amounts of tax and National Insurance Contributions (NICs) being paid on the rewards of employment. There have been many examples, often involving payment by assets, where

employees received rewards in ways which were intended to escape tax and NICs. The test for the bank to apply is whether it reasonably believes the “proper amounts” have been paid and in practice this will involve asking whether the result of any proposed arrangement is contrary to the intentions of Parliament.

The tax planning section of the Code asks banks to consider whether a transaction has “...a tax result...which is not contrary to the intentions of Parliament”. The phrase is deliberately cast in the negative rather than asking banks to only undertake transactions where the tax result was consistent with the intentions of Parliament. This recognised the banks’ concerns that in some areas of tax law it can be difficult to discern the policy intent. Paragraph 22 below comments on defining the intentions of Parliament.

The OECD *Study into the Role of Tax Intermediaries* outlined in Chapter 9 the part that some banks play in developing and implementing aggressive tax planning. The study identified aggressive tax planning in two ways:

- Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences; and
- Taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law.

The Code seeks to address the first of these by asking the banks to consider the intentions of Parliament and comply with the spirit and not just the letter of the law. The second part is addressed through building an open and transparent relationship between HMRC and the bank.

Relationship between the Bank and HMRC – The Code states “*Relationships with HMRC should be transparent and constructive, based on mutual trust wherever possible.*” The Code goes on to outline the features of the relationship it wants to see:

- Disclosure of uncertainties on tax matters
- Focus on significant issues
- Resolution of issues before returns are filed
- Engaging in a co-operative, supportive and professional manner
- Working together to resolve issues and provide certainty

The Code also asks banks to discuss with HMRC, in advance, proposed transactions which they consider may be contrary to the intentions of Parliament. If a transaction that falls in that category has already taken place then banks should disclose this to HMRC as soon as possible and not wait for the submission of the relevant tax return. The behaviours set out draw on those described in RoLLB, the LBS Operating Model and the OECD *Study into the Role of Tax Intermediaries*.

Consultation and the final version

On 9 December 2009 the Code was formally introduced following the consultation period.¹³ The paragraphs below deal with two of the main points arising during the consultation period in more detail but the following is a link to the Consultation Response Document which:

- summarises the general comments received in respect of the Code;
- summarises the responses to the specific questions in the consultation document; and
- includes the final version of the Code.

As originally framed the Code required banks either:

- not to undertake certain transactions or,
- to discuss them in advance with HMRC.

This would have forced banks to be transparent if they were in doubt. Banks suggested this forced disclosure was inconsistent with the more co-operative relationships HMRC was seeking to build. Ministers decided to change the wording so it now encourages, but does not force, disclosure in advance.

A major discussion point during the consultation was the question of how to define the “intentions of parliament”. The Code asks banks not to enter into transactions or promote transactions which it reasonably believes are contrary to the intentions of parliament. HMRC provided guidance following the consultation that the question of whether the tax results are contrary to the intentions of Parliament can be answered in practice by asking whether the tax consequences of a proposed transaction are too good to be true (in the sense that they are unexpected and unintended). Banks are able to apply this in practice.

Adoption of the Code

As at 30 June 2010 over 100 banks had adopted the Code and many more, including most of the largest banks, were actively working towards adoption.

Banks were expected to take time before deciding whether to adopt the Code. For banks, adoption needs to be a business decision taken at the most senior level, not just by the tax department, if it is to have the intended impact on transactions the bank undertakes. This means the bank needs to understand the practical impact adopting the Code will have on its operations. Obtaining board-level agreement therefore takes time, especially where the board is based outside the UK (where the culture can be very different).

¹³ http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD1_030008

ANNEX 3 EXTRACT FROM THE STUDY INTO THE ROLE OF TAX INTERMEDIARIES - REVENUE BODY ATTRIBUTES¹⁴

Key points:

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

BACKGROUND

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

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

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

In working paper 6,¹⁵ these attributes were linked with what was described as an ‘enhanced relationship’. Responses pointed out that they should not only be offered to a select group of taxpayers on the basis of a revenue body’s subjective judgment as all taxpayers should be treated equitably and consistently. They should therefore be seen as fundamental attributes that underpin all the revenue body’s actions.¹⁶ The Study Team accepts this point, although it believes revenue bodies will be able to apply at least some if not all of these attributes more comprehensively when dealing with a taxpayer who provides a high level of disclosure and transparency. This is because in some circumstances the extent to which a revenue body can apply some if not all of these five attributes will be dependent on the information it has available. The application of these five attributes is developed in Chapter 8.

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

¹⁴ Intermediaries Report Chapter 7 page 33

¹⁵ http://www.oecd.org/document/27/0,3343,en_2649_33749_39006683_1_1_1_1,00.html.

¹⁶ For the avoidance of doubt, this includes dealings with tax intermediaries as well as taxpayers and others.

UNDERSTANDING BASED ON COMMERCIAL AWARENESS

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

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

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

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

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

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

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

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

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

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

IMPARTIALITY

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

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

PROPORTIONALITY

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

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

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

Examples of what proportionality could mean for revenue bodies are:

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

OPENNESS AND TRANSPARENCY

Taxpayers will want to see openness and transparency from revenue bodies. The extent of this is a matter for each country to decide at both a conceptual level and on a case-by-case basis. While the Study Team does not recommend detailed solutions, there are some considerations that are of general application. First, consultations with stakeholders suggest that rulings play a key role in providing taxpayers and their advisers with greater disclosure and transparency on particular transactions or issues.

These mechanisms provide taxpayers and those advising them with the opportunity to seek early certainty on the tax consequences of a particular set of circumstances. As set out in Chapter 6, the majority of FTA countries have some form of advance ruling mechanism¹⁷ and countries need to consider how these can be developed, if appropriate, to encourage additional levels of openness and transparency.

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

- The broadest is the risk-management strategy. The Study Team recommends that revenue bodies should consider providing greater transparency on their broad approach to risk management, including the types of behaviours or transactions the revenue body sees as risks and how it will respond to them.¹⁸
- The mechanisms by which taxpayers or issues are selected for audit, including the algorithms used in computerised risk engines. The Study Team **recommends** that revenue bodies should **not** publish full details of these since to do so could invite inappropriate behaviour by some taxpayers.
- The revenue body's risk assessment of a particular taxpayer. Some revenue bodies are already open with particular taxpayers about their overall assessment of risk and have seen benefits from discussing how the assessment has been reached and how it translates into particular responses.¹⁹ The Study Team therefore sees greater openness as an important element in building mutual trust under the enhanced relationship described in Chapter 8 and **recommends** that individual countries decide whether and how to pursue this.

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

RESPONSIVENESS

What taxpayers, particularly large corporate taxpayers, most want in relation to tax is early certainty. And they want it quickly. Revenue bodies therefore need to be responsive. Taxpayers should receive prompt, efficient and professional responses when they make requests of revenue bodies. They can also expect a

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

¹⁸ For example, the ATO already publishes taxpayer alerts as well as details of their 'compliance program', which sets out the areas of risk to compliance and how they intend to respond, including a wide range of measures to help those people trying to comply. Further details can be found at: <http://atogovau/corporate/content.asp?doc=/content/88713.htm>.

¹⁹ For example, the countries that have developed business models designed to produce greater co-operation (see Appendix 9.1) see higher levels of revenue body openness about taxpayer risk assessment as an integral part of the programme.

fair and efficient decision-making process and definitive resolution of issues (although some issues will need to be discussed at length and even litigated before they can be resolved).

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

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

ANNEX 4 EXTRACT FROM THE STUDY INTO THE ROLE OF TAX INTERMEDIARIES - THE ENHANCED RELATIONSHIP²⁰

Key points:

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

BACKGROUND

The three previous chapters described risk management, information needs and revenue body attributes. This chapter brings these together and explains how a more collaborative, trust-based relationship can develop between revenue bodies and large corporate taxpayers who abide by the law and go beyond statutory obligations to work together co-operatively. This is the enhanced relationship. It is a relationship that favours collaboration over confrontation, and is anchored more on mutual trust than on enforceable obligations

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

THE BASIC RELATIONSHIP

There is a basic relationship in any country between the revenue body and the taxpayer. This basic relationship varies between countries but broadly it is characterised by the parties interacting solely by reference to what each is legally required to do. While the principal parties are taxpayers and revenue bodies, tax advisers also play an important role.²¹ They provide advice to clients as to the legal boundaries of the relationship and, acting on behalf of their clients, often interact directly with revenue bodies.

As set out in Chapter 6, the basic relationship typically means taxpayers file a tax return that discloses a limited amount of information as required under the law, including their taxable income – and, in self-assessment systems, the tax payable – and pay that amount on time. It may not oblige the taxpayer to set out how those amounts were arrived at, nor whether there are matters of uncertainty or unpredictability.

²⁰ Intermediaries Report Chapter 8 page 39.

²¹ In some circumstances, in some countries, tax advisers can also be a party to the basic relationship where they act under a valid power of attorney. For example, in the USA this is common practice for large businesses and HNWIs.

Revenue bodies typically have administrative tools to: (i) query the taxpayer about the tax declaration; (ii) obtain additional information; (iii) correct the calculation of the tax payable; and (iv) collect the tax. Some countries require more of taxpayers than others, so the precise scope of this legal standard and hence of the basic relationship varies from country to country.

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

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

THE ENHANCED RELATIONSHIP

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

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

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

BENEFITS FOR REVENUE BODIES FROM AN ENHANCED RELATIONSHIP

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

BENEFITS FOR TAXPAYERS FROM AN ENHANCED RELATIONSHIP

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

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

Additionally, we believe in the longer term there will be a noticeable financial advantage for taxpayers through reduced compliance costs. If revenue bodies are able to succeed in directing more of their

resources into high-risk issues and high-risk behaviour by taxpayers, there will be a long-term gain for lower-risk taxpayers.

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

DISCLOSURE AND TRANSPARENCY BY TAXPAYERS

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

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

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

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

Transparency has three levels: individual, cultural and structural.

- The *individual* aspect refers to the individual relationships by which taxpayers (and their external advisers) and revenue officials interact. Ensuring that, so far as possible, relationships at this level are built and maintained is a key task, both for revenue bodies and for taxpayers. Continuity can lead to a familiarity and ease of communication upon which mutual trust and respect can be built.
- The *cultural* aspect refers to the collective manner in which taxpayers and revenue bodies, at the institutional level, view the other party to the relationship. A culture in which trust is developed between the parties is a significant facilitator of transparency.
- The *structural* aspect refers to the protocols by which taxpayers and revenue bodies communicate. There needs to be a readily accessible and mutually accepted means by which information can be passed from one organisation to the other. This can be tailored to fit the circumstances of a particular relationship – there may be regular meetings or discussions only as necessary.

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

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

- volunteer information where they see potential for a significant difference of interpretation between them and the revenue body that may lead to a significantly different tax result; and

- provide comprehensive responses so that the revenue body can understand the significance of issues, deploy appropriate resources and reach the right tax conclusions.

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

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

BUILDING THE ENHANCED RELATIONSHIP

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

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

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

- A unilateral statement or declaration by the revenue body, setting out how it intends to work.²² This would include what the revenue body asks of taxpayers and tax advisers and the consequences for them if they do or do not provide what is asked for. It would then be for taxpayers to decide whether and how to respond.
- A charter adopted jointly by or on behalf of all stakeholders setting out how all participants intend to work together.²³ This would include what all the participants – revenue body, taxpayers and tax advisers – are expected to do and the consequences for each of them if they do not.
- A formal or informal agreement between the revenue body and a specific taxpayer.²⁴ These could be tailored to suit the specific needs of different taxpayers. They could include how they intend to work together and how the agreement could be terminated.

²² For example, this is broadly the approach used by Ireland in their ‘Co-operative Approach to Tax Compliance’ - see appendix 8.1.

²³ For example, Switzerland has a ‘Code of Conduct for Tax Authorities, Taxpayers and Tax Advisers’. This code of conduct provides a very basic list of ‘dos’ and ‘don’ts’ which apply not only with respect to communications between tax advisers and the tax administration, but ultimately with respect to any citizen approaching an administrative authority. The Code of Conduct is supported by the Federal Tax Administration, by cantonal tax administrations and by the ‘Schweizerische Treuhandkammer’. A copy of the code of conduct can be found at: www.amcham.ch/switzerland/content/code_of_conduct_complete_sep06.pdf. In addition the Study Team also noted the 2006 draft code of conduct developed by KPMG’s Tax Business School which sets out to develop “a voluntary code of conduct focused around behaviours [to] help set the environment for trust. The [code] could regulate the behaviour of taxpayers, tax collectors and tax advisers and could be devised and regulated by that group.” David F Williams for KPMG’s Tax Business School, A Code of Conduct for Tax, October 2006, 4.

²⁴ For example, this is broadly the approach used by the Netherlands in ‘Horizontal monitoring’ and the USA in their ‘Compliance assurance program’ (CAP) – see appendix 8.1.

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

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

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

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

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

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

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

AN ENHANCED RELATIONSHIP WITH TAX ADVISERS

What about the relationship between revenue bodies and tax advisers?

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

In many countries, this relationship already exists. A strategy of positive engagement with tax advisers offers potentially significant benefits to all parties in the tax system. In particular, it can add to revenue bodies' understanding of tax advisers and the role they play in the tax system, as well as understanding of their clients and broader developments in the economy. This, in turn, should result in improved risk and

compliance strategies and better-focused information requests and dialogue with taxpayers, resulting in reduced compliance costs for all. For taxpayers and advisers, such a dialogue can lead to the development of advance rulings, public guidance, standards for evaluation of administrative programmes and other steps to increase certainty and responsiveness.

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

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

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

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

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

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

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

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

DEALING WITH THOSE UNWILLING TO OFFER DISCLOSURE AND TRANSPARENCY

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

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

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

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

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