Background

1. In Working Paper 3: Overview – the emerging direction of the study, the study team summarised the approach the OECD Tax Intermediaries study is taking. The key issue was the recognition of the mutual benefits to all parties from revenue bodies’ using modern risk-management concepts. This Paper expands on these risk-management concepts.

Section 1: Why risk management is important

2. The fundamental function of a revenue body is to collect the tax that is due. Revenue bodies undertake this function in a world where there are many demands on them and their resources are scarce. Today, revenue bodies must manage the tax implications of growth in international trade, changes in employment patterns and demographics, international mobility of capital and labour, innovations in business structures and financial products, rapid changes in technology and information sharing techniques, and environmental and energy concerns.

3. It is often said that this more open economic environment is good for business and global growth. From the perspective of revenue bodies, however, the changing environment presents particular challenges, for example it can provide greater opportunities for the implementation of tax minimisation arrangements, including those which may lead to unintended and unexpected tax revenue consequences. The need to identify and challenge such arrangements (by way of audit, litigation, law reform and policy work) makes the task of revenue bodies both more difficult and more expensive. With a changing environment, it has therefore become more critical for revenue bodies to work together where beneficial and practical, and to allocate available resources in a targeted and effective manner.

4. The study team takes the view that risk management is essential if this goal is to be achieved. Risk management involves assessing the risk
profile of taxpayers (“risk assessment”) and then allocating resources to reflect the risk profiles (“risk-led resource allocation”).

- **Risk assessment** involves revenue bodies identifying, analysing and prioritising the risks presented by taxpayers (nationally and internationally) that might otherwise prevent them from achieving their function of collecting the right amount of tax. The result of risk assessment is a risk profile for each taxpayer. A risk profile might reflect the behaviour of taxpayers over a number of years. One step in generating a risk profile may be calculating an effective tax rate.

- **Risk-led resource allocation** involves a revenue body using the risk profiles to make informed, evidence-based, decisions about: which risks to treat; the best mix and sequencing of strategies (from help to enforcement); and how to allocate resources to the areas that are likely to benefit from more attention. For example, audits may be targeted toward businesses which exhibit characteristics judged to indicate that they may carry more tax risk than their peers.

5. More particularly, by considering risk and possible mitigation, the risk-management process will enable a revenue body to:

- provide context for decisions to allocate resources (including decisions to focus less on areas presenting low or negligible risk);
- identify, and bring to the relevant law-making body’s attention, areas where the law is not operating satisfactorily or is producing unacceptably high compliance costs; and
- where supported by specific risk profiles, gather evidence to make a case for additional resources or funding from government.

6. This study suggests risk management can be used as a vital tool to release and reallocate resources to the **two main areas of concern the study has identified**:

- **Tax planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences.**

Some countries suffer far less than others from tax planning that arises from interpretations of tax law that are not anticipated. Often this is due to the way their tax law is framed and the way their courts interpret it. The law cannot provide an answer to every transaction in any country; commercial life is far too diverse. Ultimately, if tax planning works within an interpretation of existing tax law that courts support, only governments and legislatures can change the wording of the law to alter that interpretation. Revenue bodies remain vigilant so that they can identify new areas of concern as early as possible.

---

¹ The somewhat difficult concept of the ‘right’ amount of tax is discussed in Working Paper 6 – the Enhanced Relationship.
and they can give their governments the opportunity to amend the law in good time. Risk management is a tool to aid that vigilance.

- **Taking a tax filing position that is favourable to the taxpayer without openly disclosing that uncertainty remains on whether it accords with the law**

The concern here lies in the level of disclosure that may accompany the transaction in question. Insufficient disclosure leaves the revenue body unable to make its risk-assessment with full information. Given the relatively low percentage of tax returns that are the subject of detailed examination in most countries, there is a danger that some taxpayers will minimise the disclosure they provide to reduce the risk of the return being identified for audit by the relevant revenue body. Accordingly, limited resources may mean the return, or the specific issue, is not considered in detail, so an uncertain filing position may be accepted without the legal arguments being tested. Hence, it is not the taking of the tax filing position in the tax return itself that is the concern – nothing should prevent a taxpayer from making a claim and pursuing it through debate with the revenue body and as far as the courts, however slim his/her chances of success may appear to be. The concern is that the taxpayer is not sufficiently open with the revenue body.

**Section 2: Taxpayers**

7. So by being better at risk assessment, revenue bodies can more effectively distinguish areas that represent high risk from areas that represent low or negligible risk, and respond and influence accordingly. That is a benefit to the revenue body.

**Benefits for taxpayers**

8. However, risk management will also result in benefits to many taxpayers. For example, while taxpayers who demonstrate ‘high-risk’ characteristics can expect to attract greater scrutiny and enforcement attention, taxpayers who behave transparently and who do not have higher-risk tax issues can reasonably expect support and lower compliance costs.

9. It should therefore be for the benefit of the large majority of taxpayers whose activities and behaviours do not fall into a high-risk area to help revenue bodies to become better at risk assessment, better at recognising lower risk and, hence, better at minimising those taxpayers’ compliance costs.

10. In either case, the research and dialogue involved in the creation of a risk profile are likely to be beneficial for taxpayers. This is because, typically, large businesses attach considerable importance to revenue body staff having good knowledge about their industry and familiarity with their particular business.
Different dimensions to risk profile of each taxpayer

11. The study team has concluded that, in risk-assessing taxpayers, revenue bodies need to distinguish several different dimensions to risk that intersect with the two areas of concern identified above:

- **The taxpayer’s commercial structure, size and activities** – there are several reasons why any particular taxpayer might not pay the right amount of tax. For larger corporate taxpayers with extensive business activities – even those that are not especially complex – the range of tax issues that could arise is very large. Any one or more of these issues could represent a potential tax risk. Sometimes, a host of issues will be potentially high-risk. Sometimes, only one or two particular transactions or features of the taxpayer’s commercial structure may potentially be high-risk. For example, the taxpayer may operate in high-risk industries (e.g. those where significant research and development activities are undertaken, where valuable intangible property rights are created, and where cross-border transactions are very common). The bigger and more complex the taxpayer’s structure and affairs, the greater the potential for significant issues to arise. But size on its own isn’t sufficient. There is no reason why the profile of the largest corporate taxpayer cannot be low risk.

- **The quality of the taxpayer’s people, processes and accounting systems.** If taxpayers have internal governance, systems and processes that are not adequate for the task of gathering and handling the data needed to comply with tax obligations to the necessary standard, there will be problems.

- **The taxpayer’s behaviour** – this relates to the choices each taxpayer makes about what they share with revenue bodies and when. Taxpayers who do not disclose uncertainty about their tax issues when (or before) filing their tax returns, or who do not co-operate with revenue bodies’ reasonable enquiries, are likely to be seen as high-risk. The study team takes the view that the adoption of the principles of the enhanced relationship should lead to more taxpayers co-operating and behaving openly with revenue bodies.

- **The extent of agreement over interpretation of the law** – this relates to the extent of agreement or disagreement between taxpayers and revenue bodies about the interpretation of tax law. Where there is broad agreement about the interpretation of the law – and appraisal of the facts to which the law needs to be applied – there is unlikely to be significant tax risk, even where the commercial structure and activities indicate many tax issues which are potential risks. Accordingly, unless there is a significant chance that doing so will lead to a change in the tax computations (or to a change in the law where the interpretation is undisputed but the effect is undesirable to the revenue body) there is little benefit in allocating resource to the
case. This is not to say that taxpayers should accept the revenue body’s interpretation of the law even when they disagree with it. They are entitled to challenge revenue bodies and there is nothing wrong with a good-faith disagreement, even one that needs to be resolved through litigation. However, taxpayers will be aware that in an environment where revenue bodies engage in risk management, disagreement over interpretation of the law is likely to lead to an audit and possibly a dispute.

12. Conscious of this, the boards of an increasing number of corporate taxpayers are articulating a tax strategy that aligns with wider corporate governance and that has regard for the spirit of the law\(^2\). This signal from the most senior level means that these corporate taxpayers’ interpretation of the law is more likely to be aligned with the revenue bodies’ interpretation of the law. By virtue of this, such corporate taxpayers are less likely to enter into costly disputes with revenue authorities than their competitors who, by contrast, choose to place reliance on fine distinctions of black-letter law, especially those who couple this with a high determination to minimise tax liabilities through the use of creative transactions and structures, regardless of the commerciality of those transactions or structures.

13. Accordingly, regardless of the size and complexity of the group, the study team would expect corporate taxpayers with the following profile may find only those issues where there is disagreement over the interpretation of the law are likely to be audited. The profile, as confirmed by any necessary auditing by revenue bodies, is that of those corporate taxpayers that nationally and internationally:

- ensure their systems, people and processes are robust; and
- are transparent and co-operative with revenue bodies; and
- draw revenue bodies’ attention to those issues where there may be a disagreement over the interpretation of the law.

What does risk assessing a taxpayer involve?

14. Risk assessment is a more subtle art than a simple rating of “high” or “low”, or even allocating taxpayers a numerical score on a risk scale. Risk assessment implies a more complex form of taxpayer profiling in which the taxpayer’s behaviours and approach to interpreting the law are considered against the various types of potential risk in the taxpayer’s business\(^3\).

---


\(^3\) The study team is aware that tax risk profiles are already formalised at a national level in some countries – for example, New Zealand.
15. For example, take a taxpayer with many potentially high-risk issues arising from its commercial structure and activities, one or two specific tax issues where the taxpayer’s technical analysis differs significantly from the revenue body’s interpretation, and the taxpayer is co-operating fully and being open and transparent. A simple rating for this taxpayer cannot convey anything meaningful. The revenue body’s objective is likely to be to allocate resources to enquire into these one or two specific issues but not to spend resources on other aspects of the taxpayer’s affairs. Understanding the taxpayer’s profile is vital to enable the revenue body to respond appropriately.

16. To allow revenue bodies to take decisions on resource deployment, given that resources are finite, any measurement or assessment of risk must be comparative. This means it must allow the revenue body to prioritise issues, or respond to a taxpayer’s behaviour based on its risk profile relative to other possible users of those resources.

17. A risk profile for a taxpayer may, for example, consider factors such as:

- Effective tax rate;
- Size, structure and complexity of the business and its financing;
- Tax governance (existence of a tax strategy, accountability for tax decisions);
- Propensity to interpret the law in ways that differ from the revenue body’s interpretation
- Appetite for tax planning and risk;
- Strength of underlying processes and systems (integrity of accounting data);
- Complexity of legal arrangements;
- Openness and transparency;
- History of co-operation with revenue bodies.

Section 3: Tax intermediaries

**Tax intermediaries’ impact on their clients**

18. Tax intermediaries play a vital role in all tax systems. They provide taxpayers with expert advice on their tax obligations and with necessary financial services. They therefore have a significant influence on their clients’ risk profiles. Separately, all tax intermediaries have tax obligations in their own right: for example, to file tax returns, pay their own tax or disclose certain transactions they design or are otherwise involved in. Revenue bodies will want to use their normal risk management techniques in response to these obligations. But the study team will not consider these further here.

19. When considering the ways tax intermediaries influence their clients, the study team needs to distinguish between:
• tax advisers (i.e. accounting firms, law firms and other advisers in tax affairs\(^4\)); and
• financial institutions who often take a financial stake themselves (i.e. banks and other firms providing finance, derivatives, etc.)\(^5\).

**Tax advisers**

20. In many ways, the impact of tax advisers is to increase their clients’ compliance with their tax obligations and hence to reduce the risks the clients represent from revenue bodies’ perspective. For example, tax advisers help their clients to seek advance rulings/clearances, keep appropriate accounting records as required for tax purposes, ensure tax returns are thoroughly checked before submission, inform their clients about their tax obligations at home and abroad, assist in negotiations with revenue bodies where controversies arise, etc.

21. The study team believes that the impact tax advisers have is largely positive and is consequently one of the reasons why they are very important players in the tax system. By supporting and influencing one tax adviser, a revenue body can support and influence the behaviour of many taxpayers. Revenue bodies should actively support this positive contribution to the tax system.

22. The actions of tax advisers can also influence their clients in ways that increase the risks revenue bodies perceive in their clients, especially in the study’s two areas of concern. Revenue bodies are particularly alert to these risks where tax advisers:

• design, identify or provide favourable opinions on tax planning options leading to unintended and unexpected tax revenue consequences; and/or
• act as advocates for their clients where there is disagreement over the interpretation of the law.

23. Qualified tax advisers are bound by professional standards set by the professional bodies of which they are members. In addition, most firms (and particularly the larger ones) have established their own ethical standards or ‘codes of conduct’. Additionally, umbrella bodies such as the Confédération Fiscale Européenne (CFE) also act to set and encourage shared values for the different professional bodies\(^6\).

---

\(^4\) Sometimes this can include banks (e.g. where they are involved in preparing and submitting tax filings).

\(^5\) Infrequently tax advisers will act in a similar capacity to financial institutions; but do not, typically, have the same direct access to the same deep pools of capital or the financial markets for risk.

\(^6\) In 1991 the CFE’s General Assembly in Zurich adopted the guidelines of “The development of the tax profession in Europe”. These came into force on 1 January 1992. These comprise the professional principles included in “European professional principles of tax advisers” (adopted in Rome in 1980) and revisions decided in April 2005 in Brussels. Supplemeting their own national codes of conduct, these guidelines bind the members of all professional organisations of the CFE.
24. The study team acknowledges the positive value of these professional standards. They mean that tax advisers provide negative opinions on aggressive tax planning, as well as positive ones; and they refuse to act for clients who do not accept these professional standards. They also mean that qualified tax advisers are unlikely to advise clients to avoid transparency or to provide less disclosure than the law and/or ethical guidelines would suggest.

25. Transparent behaviour may be even more common in relationships where the tax adviser is also bound by auditing standards (e.g. International Auditing Standards), or by the requirements of public listing authorities (e.g. those of the Financial Services Authority or of the Securities and Exchange Commission) that encourage further levels of public reporting.

Managing the impact tax advisers have on their clients’ risk profiles

26. Few countries systematically evaluate, much less manage, the impact tax advisers have on the risks their clients represent. Nevertheless, there is active dialogue between revenue bodies and tax advisers in many countries. For example, HM Revenue and Customs, the UK revenue body (“HMRC”), has been exploring ways of leveraging tax advisers’ positive impact using an approach it calls its ‘Agents Strategy’.

27. As part of HMRC’s plans to deliver a better service for business, HMRC intends to enhance services for agents, building and maintaining a positive relationship with the agent community based on professionalism, trust and the delivery of services, so that it can better support their clients and enable HMRC to target its activities more accurately on higher-risk areas.

28. In terms of risk management, HMRC intends to develop a better understanding of agents’ pre-return processes and how these might provide assurance about the return. The main objective is to enhance confidence that HMRC’s risk-profiling model will:

- help identify more accurately the higher-risk tax returns; and
- lead to the allocation of HMRC resource to those businesses where tax is more at risk and thereby reduce the likelihood of an audit or inspection for low-risk businesses.

29. Adopting an approach such as the Agents Strategy to manage the impact tax advisers have on their clients benefits the revenue body concerned by giving it a greater understanding of the behaviour of tax advisers in certain specific areas. Greater dialogue with tax advisers is not therefore about merely gathering specific pieces of information. Rather, it is also about adding to revenue bodies’ institutional knowledge of tax advisers and the role they play in the tax system, leading to better risk management and better

---

7 In the UK, the term ‘agent’ is used for professionals advising in tax affairs. In the context of this study, it should be read as a synonym for ‘tax advisers’.
compliance strategies that should lead to better-focused information requests and dialogue

30. Moreover, the study team envisages that tax advisers will also benefit from the greater interaction with revenue bodies that programmes such as the Agents Strategy bring about. Specifically, there may be the potential for a form of ‘enhanced relationship’ to develop in appropriate circumstances between tax advisers and revenue bodies. While different from the enhanced relationship between taxpayers and revenue bodies that the study team has explored in another working paper, it would be based on the same premise that greater openness and transparency can lead to better relationships. As this concept is separate from that of risk management, it is discussed in Working Paper 6 – The Enhanced Relationship.

Interaction between risk profiles of tax advisers and of taxpayers

31. Should they wish to do so, revenue bodies could make use of national and international risk profiles of tax advisers (as firms or as individuals). This would involve use of the risk profiles (reflecting institutional knowledge – whether or not gained from the dialogue with tax advisers described above) to inform the assessments the revenue body’s staff make of taxpayers’ risks and hence their judgements on whether to audit or enquire into tax returns (and, if so, which aspects to focus on).

32. In generating a risk profile for a particular taxpayer, revenue bodies might take account of the risk profile of a tax adviser or advisers the taxpayer had engaged. Nationally and internationally, the adviser may have an influence on the taxpayer’s risk profile in each of the dimensions to risk mentioned above. For example:

- Advisers may give advice on the client’s commercial structure, transactions and activities, and on appropriate systems and processes.
- They may give advice on appropriate levels of disclosure, transparency and co-operation.
- They may give advice on the interpretation of the law.

33. Using the tax adviser’s risk profile to inform a judgement on whether or not to enquire into the taxpayer’s tax return already happens in practice; but in a far more unstructured and potentially very unreliable way. In risk assessing tax returns, revenue bodies’ staff often take account of their own and their immediate colleagues’ past experience of working with particular firms – or with particular individuals in those firms. Accordingly, the question may not be whether this approach should be adopted but whether it should be adopted in a more structured way.

---

**Tax advisers’ views**

34. Some tax advisers would find such a structured approach attractive as it would offer the prospect of lower overall compliance costs for their clients (on the basis that, at a cost, they would deliver a reputation with revenue bodies for straightforward dealing and for lower-risk behaviour by, and lower-risk issues in relation to, their clients).

35. Others would be concerned that the available data might not be robust or open to interpretation, that revenue bodies would need to make subjective judgements with which advisers would not necessarily agree, that the judgements would not be updated sufficiently fast to reflect new facts, and that unfairness would result.

36. Some advisers have even said that they would see such an approach as the exercise of inappropriate power by revenue bodies. The study team agrees that risk management involves an exercise of power in the sense that revenue bodies decide which tax returns to accept without enquiry and which to audit or enquire into. The study team also accepts that this has the potential to influence taxpayers’ behaviour; in fact, many revenue bodies explicitly seek to influence behaviour through the way they deploy their resources.

**A way forward**

37. Consequently, the study team takes the view that whilst such a structured approach is an appropriate use of revenue bodies’ power it is important that this power is exercised in a responsible and appropriate way.

38. In this respect, the study team notes that qualified tax advisers are usually regulated by professional bodies; and that individuals working within firms are regulated by their firms as well as the professional bodies and bound by strong codes of behaviour and ethics. Accordingly, the study team notes that an option to take this forward cautiously would be for revenue bodies to work with professional bodies to create generic risk profiles for tax advisers, based on the sectors of the market they serve. Revenue bodies and professional bodies and/or firms could subsequently use the generic profiles to agree profiles at a more detailed level by identifying exceptions and building separate profiles for those firms or individuals that did not fit the generic profile.

39. The study team notes that this sort of approach will best be supported by regular dialogue with the profiled firms and their professional bodies and that an enhanced relationship embodying a large amount of trust will be required if risk assessments are to be jointly developed.

40. In considering the creation of risk profiles for tax advisers, the study team’s view is that revenue bodies will need to be aware of the need for profiles to be frequently updated and also of the potential to affect competition
inadvertently – by, for example, forming or altering judgements at different times about firms, or individuals, that are in competition with each other.

41. If revenue bodies adopt this approach, they also need to consider how much to share with professional bodies, tax advisers or their clients. There would be various options:

   a) maintain full confidentiality around the processes and the risk profiles;
   b) publicise the methodology but keep the tax intermediary risk profiles internal to the revenue body’s staff;
   c) share the risk profile with the tax adviser (or group of tax advisers), and discuss the judgments made; or
   d) make the risk profiles more widely available so that they are transparent to clients.

42. The study team strongly favours option (c) which is best suited to maximise the value that revenue bodies can gain from factoring tax advisers into the risk profiles of their clients since it gives most opportunity to refine and improve the judgments that need to be made. It is also consistent with the conclusion about the value of dialogue between revenue bodies and tax advisers. Hence, option (c) should provide more common ground with tax advisers compared to the other options which would be perceived by tax advisers to be ‘unfair’ due to the lack of transparency and the excess of transparency respectively.

Financial institutions

43. We now turn to whether, and how, revenue bodies should take account of another major group of tax intermediaries, financial institutions, in risk assessing taxpayers. Although the starting point (i.e. that these tax intermediaries influence their clients) is the same, the context and options here are different.

Context

44. Financial institutions’ direct access to capital, and to financial markets familiar with risk, allows their involvement in designing and facilitating structured tax products to be more direct than tax advisers. Nevertheless, the fact that a financial institution has designed and facilitated such a product does not lead to a conclusion that all its clients are high-risk; it is likely to have many other clients for many other financial products or services. Equally, the client may obtain financial products and services from several sources that are not known to the revenue body. Accordingly, the relationship between a taxpayer and a financial institution can appear less transparent than between the taxpayer and the tax adviser.

9 The largest corporate groups can have relationships with more than one tax adviser. However, at least for taxpayers below this very top level, from revenue bodies’ perspective there is usually a much more visible and transparent relationship between the taxpayer and its tax adviser than between the taxpayer and financial institutions.
**Options**

45. The objective of risk management is to help revenue bodies manage tax risk and allocate resources efficiently with a view to supporting a fair and efficient tax system.

46. With respect to situations where a taxpayer is known to have used tax planning provided by a financial institution that generates considerable revenues from selling aggressive tax products, that taxpayer is likely to be seen by the revenue body as higher-risk. However, the linkage is with the use of tax planning, not just with the financial institution. In particular, for practical purposes, it may be difficult to make a link to a financial institution that has provided a tax product on a “one-off” basis and does not sustain an ongoing relationship with the taxpayer. This means that it is less likely that revenue bodies will be able to identify and link a particular financial institution with a particular taxpayer and draw any inference in risk assessing the taxpayer. Accordingly, although their character and activities in the market may at times be similar, the options available with respect to risk profiling financial institutions are, generally, considerably more limited than for tax advisers.

47. Nevertheless, revenue bodies will want to take account of a taxpayer’s use of tax planning products (whether devised and sold by financial institutions or by other tax intermediaries) in risk profiling the taxpayer. Moreover, the study team’s proposals in relation to the demand side – see the separate paper on the ‘enhanced relationship’ – should have as much impact on financial institutions as on tax advisers.

**Section 4: Information needs**

*The challenge to obtain information on areas of risk*

48. We now turn to why current and reliable information is critical to effective risk management, the form that such information may take, and the tensions that exist in the tripartite relationship with respect to allowing full access to that information.

49. Taxpayers may be unwilling to provide revenue bodies with the information needed for an appropriately informed risk assessment. One of the causes is taxpayers’ wish to keep their financial affairs private. This is despite revenue bodies in most countries being under an obligation to keep secret all information provided to them by taxpayers.

50. Privacy aside, there can be other reasons that would feature in taxpayers’ thinking:

- A taxpayer who has taken the benefit of the doubt in filing a tax return may prefer not to disclose that there is uncertainty over whether the return accords with the revenue body’s interpretation of the law. By not being fully transparent, the taxpayer may hope not to get into
discussions with the revenue body, saving time and effort and also reducing the risk of being asked to pay extra tax (and possibly other amounts such as interest or penalties).

- The taxpayer may know about defects in tax law that are not known to the revenue body and which allow the taxpayer to legitimately pay less tax. The taxpayer may expect the defects to be removed by changes in the law once the revenue body becomes aware of them. By not sharing this knowledge with the revenue body, the taxpayer may hope to delay these law changes and thereby benefit for longer.

- The taxpayer may fear that being open and transparent with the revenue body will trigger additional attention from the revenue body and that this will involve significant distraction and additional cost – at least in the short run.

- Related to the first point, the taxpayer may fear that the “roadmap”, provided to the revenue body from full disclosure of all transactions and matters that present tax uncertainty, might lead the revenue body to exercise “heavy-handed” and disruptive discretion in evaluating the information received.

51. The same factors may influence the thinking of tax advisers. But tax advisers are also subject to legal, professional and ethical obligations to their clients. This means that tax advisers are likely to defer to statutory obligations limiting disclosure of information to revenue bodies, not provide disclosures beyond the statutory requirement except with their client’s permission, and advise their client not to provide disclosure except where it is in their client’s own interest.

52. Their ability to share information with each other under tax treaties aside, the consequence is that revenue bodies have two possible ways of obtaining the information they need. One is through statutory obligations on taxpayers or tax intermediaries that require the disclosure of the information they need. All tax systems impose such obligations to a greater or lesser extent, as the next paragraph notes. The alternative is to persuade taxpayers and tax intermediaries that disclosure and transparency beyond the statutory requirement are in the taxpayer’s own interests. The study team takes the view that there is considerable merit to this alternative and it has developed the concepts in the separate paper on the ‘enhanced relationship’.

Sources of information

Primary source

53. The primary source of information for revenue bodies on taxpayer activity is the tax return. This information can be supplemented with intelligence gathered through a variety of other sources, including third-party information and historical data. However, reliance on the tax return as the
primary source of information from the taxpayer presents a number of difficulties, including:

- Waiting for a return to be filed means that there is often a significant delay in receiving information (i.e. between the transaction being implemented and the return being filed);

- Since it takes time to assess and analyse a return, any tax technical challenge from a revenue body on a particular transaction is also delayed; creating further delay (and therefore uncertainty for the taxpayer) before the issue can, where appropriate, be taken through the courts;

- Since concluding on the technical position can take time, any legislative response to the discovery of defects in existing law is also delayed, creating uncertainty for taxpayers and additional revenue loss for governments; and

- The above aside, a lack of transparency in the return can mean there are often gaps in the revenue body’s understanding of a particular transaction or arrangement.

Enhanced sources

54. One of the biggest challenges facing revenue bodies is how to increase the quality and quantity of real-time information that is received on the activities of taxpayers and tax intermediaries.

55. Several countries have responded to this challenge by introducing rules to enhance transparency by requiring the disclosure of tax planning to the revenue body in advance of the return process. The adoption of the enhanced relationship should also help to accelerate the flow of information from taxpayers.

56. Depending on the design, advance disclosure rules can provide revenue bodies with valuable information prior to lodgement of the tax return – for example: the types of tax planning occurring; the identity of the designers; the identity of the intermediaries (if any) who advise on its legality; and the identity of the taxpayers who implement it. However, taking into account the key considerations for any revenue body designing an advance disclosure regime, revenue bodies generally need to:

- be clear about the objective of the advance disclosure regime and the risk the regime is intended to address;
- consult with taxpayers and tax intermediaries in developing the legislation – particularly its scope of reportable transactions – in order to ensure it will achieve these objectives without creating unnecessary compliance burdens; and
• ensure the operational implications of the regime have been fully considered so that adequate support and administration systems are in place to respond to the information received.

57. Balancing specific advanced disclosure rules, an advanced clearance or ruling process can significantly enhance the delivery of certainty for taxpayers, and therefore allow uncertain tax positions to be settled quickly and efficiently\textsuperscript{10}. Indeed, it has been argued that each complements the other to deliver effective tax risk management, and the benefits of greater efficiency and certainty, for revenue bodies and for taxpayers.

58. Those countries that have a track record in delivering advance clearances or rulings have noted it can benefit taxpayers and revenue bodies in equal measure. The fact that revenue bodies see transactions at the earliest possible stages allows them to benefit from considering addressing policy issues (and introducing any necessary new law) at an earlier stage than would otherwise be possible. Taxpayers benefit from being able to proceed with proposed transactions with certainty of tax treatment under existing law.

59. Additional post-transaction information from other sources can also help revenue bodies in their risk assessments. On the one hand, using externally-sourced data (e.g. press releases, website material, public accounts, etc.) to audit taxpayer files allows a revenue body to verify returns and statements lodged by taxpayers under tax law, and identify omissions.

60. For example, the international bodies that set rules for financial accounting standards are actively considering forcing disclosure of uncertainties with respect to tax liabilities. With due respect to materiality, the USA’s FIN48 accounting standard has already gone some way in this direction. Such standards affect what appears in the public accounts of those enterprises that adopt them. Many countries, for example France and the UK, require disclosure, in publicly available accounts, of a reconciliation of differences between the current year tax liability from a tax return (or the liability estimated at the time the accounts were audited) and the tax figure stated in the profit and loss account. In some countries, revenue bodies may have sufficient legal powers to gain access to documents such as the accrual working papers supporting the judgements surrounding numbers in such reconciliations. These may also include documents amending an estimate of a tax liability for a previous year to reflect facts that were not available at the time the previous year’s figure was audited.

61. Last but not least, information can be obtained from treaty partners under existing tax treaties and, within the EU, under the Mutual Assistance Directive. In this respect, cross-border organisations such as the Joint International Tax Shelter Information Centre (“JITSIC”) can facilitate and focus information exchange. The current members of JITSIC are Japan, Canada, Australia, the United States and the United Kingdom.

---

\textsuperscript{10} A majority of OECD member countries have a public advance clearance or ruling system of some description.
Benefits of utilising enhanced sources

62. The imposition of well-targeted information requirements, and utilisation of other enhanced sources, can have further benefits beyond the provision of the information itself. They can change behaviour both of taxpayers (who can be referred to as the ‘demand side’ because there is a demand by taxpayers for tax advice) and of tax intermediaries (who consequently can be referred to as the ‘supply side’ since tax intermediaries are the suppliers for tax advice demanded by taxpayers).

63. This seems to be because they change perceptions – increasing the expectation that a legislative loophole will be closed quickly (so the incentive to design or implement a way to exploit it is considerably reduced) or increasing the expectation that a position of doubt will be raised for discussion with a revenue body (so there is greater chance of gaining a tax advantage only by resolving doubts in open discussion as to the effect of the tax law – whether or not that law favours one side or the other).

64. However, the converse is that where information requirements are poorly designed or not comprehensive, there will be inefficiency for revenue bodies, taxpayers and tax intermediaries; and this will lead to the opposite perceptions.

Section 5: Revenue bodies’ capability needs

65. To manage risk effectively, revenue bodies need a range of capabilities. The study team’s consultations indicate that tax intermediaries and large corporate taxpayers identify one such capability in particular: they want revenue bodies’ staff to understand them, which requires a high level of ‘commercial awareness’ and international co-operation, a subject more fully explored in Working paper 6: The Enhanced Relationship.

66. In addition, there are other capabilities required for effective risk management. Revenue bodies need well-trained staff who are able to draw the right conclusions from the information gathered and presented to them; and revenue bodies’ staff need to have appropriate values and behaviours that engender trust.

67. This subject is more fully explored in Working paper 6: The Enhanced Relationship where the study team records the reciprocity taxpayers are seeking in return for offering greater disclosure and transparency. Behaving in the ways described there should lead to better risk management because it should yield better information. But this is not just about encouraging different behaviour by taxpayers and tax intermediaries; in order to get the best value out of risk-management techniques, revenue bodies need certain attributes even without the enhanced relationship.

68. In particular, revenue bodies’ staff should show a degree of trust in information provided by taxpayers and tax intermediaries; not all information
will be reliable, but risk management requires judgements to be made about where the information may be unreliable.

69. Areas of risk identified should be significant; revenue bodies’ limited resources mean that optimal risk management and resource deployment do not allow insignificant issues to be pursued. Revenue bodies should share with taxpayers and tax intermediaries, and each other, their perceptions of risk; doing so enables revenue bodies to add to their understanding of the taxpayer’s risks, as well as making the process less threatening for the taxpayer. Where relevant, it may also enable taxpayers to better articulate their tax-risk profile to internal and external auditors and to other relevant stakeholders.

OECD Tax Intermediaries Study
July 2007