

# BUILDING TRANSPARENT TAX COMPLIANCE BY BANKS

## HEADLINE MESSAGES

- It can be difficult for revenue bodies to understand the complex financial products and transactions used by banks, and to distinguish those which carry a tax risk.
- Banks develop complex structured finance transactions (CSFTs) both for their own use and to provide to clients. Revenue bodies are concerned about CSFTs which lack transparency and have tax as a primary driver. They need to develop the necessary skills to better understand CSFTs and differentiate those that should be regarded as aggressive from a tax perspective.
- Banks are highly regulated and are required to manage risk, including tax risk, through internal governance. Understanding how this governance works when developing products, including CSFTs, and testing its effectiveness provides important information to a revenue body about the risk of non-compliance by a bank.
- Revenue bodies should develop response strategies that improve transparency and compliance. This can be helped by co-operation with tax treaty partners.
- To promote an environment of greater trust, transparency and co-operation, revenue bodies should look for opportunities to:
  - share their assessment of risk with the banks;
  - invite early voluntary disclosure and discussion of issues where there is significant uncertainty; and
  - pursue an enhanced or co-operative relationship where the outcome in relation to products or services may be uncertain.

## COUNTRY PARTICIPATION

Fourteen countries participated in the working group: Australia, Canada, France, Germany, Ireland, Japan, Mexico, the Netherlands, Singapore, Spain, South Africa, Switzerland, the United Kingdom and the United States of America.

## PROCESS USED

The study was commissioned in January 2008 at the fourth meeting of the FTA in Cape Town as a follow up to the *Study into the Role of Tax Intermediaries*<sup>1</sup>. Terms of Reference were released on the OECD website in September 2008.

Research was carried out using a range of methods: participating countries were surveyed on their practices in relation to banks; questions were put to their national banking associations; and there was consultation with the European Banking Federation, the Securities Industry and Financial Markets Association (SIFMA) and the London Investment Banking Association. Members of the study team also spoke with senior members of the tax departments of a small number of major global banks; joint meetings were held involving a number of Commissioners from participating FTA countries and senior representatives from several major global banks; and the team was joined by a number of secondees from the major global banks and SIFMA who assisted with the preparation of the report by providing an industry perspective.

A draft of the report was provided first to representatives of tax intermediaries and the FTA for initial comment. A second draft was formally circulated to the CFA and approved on 15 April 2009.

## MAIN RECOMMENDATIONS

### 1 Recommendations for revenue bodies

To improve staff capabilities and their commercial understanding of financial markets and banking, including CFSTs, revenue bodies should:

- seek the assistance of their national banking association in providing training programmes for their staff;
- develop initiatives with banks to enable revenue staff to build understanding of banking operations, particularly governance structures and product development processes concerning CSFTs;
- recruit banking experts; and/or
- embark on exchange initiatives with other revenue bodies where less-skilled revenue staff can be given opportunities to work with administrations that have greater experience with banks.

To provide earlier certainty revenue bodies should:

- work with banks as part of an enhanced relationship through guidance, rulings and real time discussion of issues; and
- encourage banks to be more transparent so as to better understand the commercial context and complex details of CSFTs.

<sup>1</sup> Fourth Meeting Of The OECD Forum On Tax Administration, *Cape Town Communiqué 11 January 2008*

To improve risk assessment revenue bodies should:

- ensure they have necessary strategies in place to prevent, detect and respond to aggressive tax planning including working closely with banks and developing close working relationships with other domestic regulators and overseas authorities;
- seek to understand the legal context of CSFTs in their own jurisdiction to identify those transactions which pose a significant tax risk;
- learn about control functions within banks to understand if they provide revenue bodies with assurance of tax compliance. This would include developing an understanding of:
  - banks' internal governance processes and the authority of a bank's tax department;
  - the adequacy of corporate governance and risk management systems for managing tax risk to inform the revenue body's risk assessment of the bank, its major transactions and products; and
- where banks are unwilling to voluntarily offer an appropriate level of disclosure their risk assessment is likely to be high.

To improve transparent tax compliance revenue bodies should:

- engage with financial regulators to improve tax compliance as part of an overall corporate governance framework;
- work co-operatively with overseas tax authorities and other relevant agencies in accordance with exchange of information provisions available in bilateral and multilateral treaties;
- consider pursuing multilateral efforts to quickly identify, distinguish and respond to complex transactions; and
- work more closely with enforcement agencies and regulatory bodies in dealing with offshore promoters and offshore tax evasion.

To improve international cooperation revenue bodies should:

- jointly examine and remove the barriers to a more effective exchange of information on banking activities to take full advantage of the recent significant progress on implementing Article 26 of the OECD Model Tax Convention on Income and Capital (Article 26 standard);
- further exploit the potential of some multilateral instruments such as the joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters;
- continue the dialogue amongst FTA Commissioners and senior officers on enhanced relationships and the effectiveness and inconsistencies of measures taken to limit aggressive tax planning;
- encourage the development of the OECD Aggressive Tax Planning Directory and in particular to use this initiative to share experiences on measures taken to counter schemes; and
- explore whether the FTA could provide a forum for dialogue between Commissioners and bank executives.

## 2 Recommendations for banks

In the course of the Study, the Team also identified a number of 'good practice' recommendations for banks:

- the bank's internal tax department's decision not to proceed with a transaction should not be overridden without escalation of a decision to the CEO or board;
- banks' internal tax departments are encouraged to provide a greater degree of transparency in the governance of CSFTs implemented both for clients and on the bank's own account;
- all banks should ensure that they have appropriately skilled and trained staff to review CSFTs for clients;
- in setting their business strategy, banks should consider the benefits of an enhanced relationship with revenue bodies including early certainty, reduced compliance costs, and reduced reputational risk; and
- as part of this relationship, banks should share their views with revenue bodies on tax risk assessment for products or services where there is potential for uncertainty around the tax treatment. Banks as with other large corporates should take tax risks into account as part of their governance framework.

## POSSIBLE NEXT STEPS

Following the May 2009 FTA meeting, this report will be published by the OECD. Developments by revenue bodies from these recommendations will be discussed at the next FTA meeting.