

New OECD report on building transparent tax compliance by banks

A new report has been released by the OECD Forum on Tax Administration. The Report, entitled “Building transparent tax compliance by banks” examines the role of banks in aggressive tax planning. The report also examines the relationships between banks and revenue bodies and considers whether there are benefits in engaging in an “enhanced relationship”.

The report was commissioned by the OECD Forum on Tax Administration (FTA) at the fourth meeting of the FTA in Cape Town, South Africa, in January 2008 as a follow up to the “Study into the role of tax intermediaries” published by the OECD in 2008.

Study approach

The study was led by the tax administrations of the UK and Australia and the OECD Secretariat assisted by a focus group consisting of 12 other FTA countries: Canada, Ireland, France, Germany, Japan, Mexico, the Netherlands, Singapore, Spain, South Africa, Switzerland and the US.

Representatives of some of the major banks met, and have had continued dialogue with the study team.

The report is broken down into six chapters. Chapter one describes the role banks play in the economy and tax systems, and issues for tax compliance following the financial crisis. Chapter two describes aspects of tax and banking that concern revenue bodies. Chapter three considers governance and risk management strategies employed by revenue bodies when responding to tax risk posed by banks and their clients. Chapter four addresses tax authority risk management and response strategies. Chapter five deals with recent examples of tax evasion activities of clients of some banks. Chapter six contains the report’s conclusions.

The report puts much emphasis on an “enhanced relationship” between revenue bodies and taxpayers. The key feature of this is stated to be transparency in relation to all tax related activities.

Whilst the focus of the study is on aggressive tax planning, it is noted that there have recently been some highly publicised cases of banks or their employees actively

assisting their clients to evade taxes. It is noted, following the April 2009 G20 meeting and the agreed actions against non-co-operative jurisdictions including tax havens, that revenue bodies will want to look at ways of encouraging taxpayers who shield their assets and income in offshore jurisdictions to regularise their tax affairs at home. Further, it is stated that banks may have a role in assisting taxpayers to come forward.

Aggressive tax planning

In Chapter two of the report the same definition of “aggressive tax planning” (ATP) is adopted as in the original Intermediaries Study. The definition of ATP is expressed to cover arrangements broadly involving two areas of concern to revenue bodies: (1) *planning involving a tax position that is arguable but has, in terms of legislative intent, unintended and unexpected tax revenue consequences, and (2) taking a tax position that is favourable to the taxpayer without openly disclosing that there is significant uncertainty as to whether it accords with the law.*

This very broad and inevitably subjective definition of ATP would seem to need further clarification. In this context, eight “features” are listed which, it is stated, may indicate aggressive tax planning. The first seven features relate to the determination of whether a transaction has economic substance apart from the tax considerations (e.g. use of off-market terms, circular flow of funds, etc). The eighth feature refers to transactions “which in substance produce unintended multiplication of tax benefits in different jurisdictions.”

Conclusions

The key conclusions from the report are:-

- It is noted that bank governance and risk management frameworks for new complex financial products are not

specifically designed to manage tax risk from a tax authority perspective. However, tax authorities can, by understanding particular processes for approval of new products, improve their selection of issues for intervention or audit, and better target questions and information requests.

- There are a range of examples of what is considered by tax authorities to be aggressive tax planning that have been used or marketed, after having passed through approvals processes within banks. In the report it is noted that bank governance and risk management frameworks are not sufficient without the appropriate exercise of good judgement, a statement which could be read as suggesting that such “good judgement” is required to prevent the use of these structures.
- It is noted that there are a number of pressures on risk control functions including: increasing complexity; lack of transparency; offshore elements of a transaction; conflict between front office functions and risk managers; and remuneration incentives in a high risk/reward culture. Tax authorities need to understand how these conflicts are managed to assess the level of assurance they can take from a bank’s internal controls.
- Good working relationships that allow open dialogue between banks and tax authorities have had a positive impact on overall compliance behaviour and a reduction in compliance costs. Also, it is stated that a number of mutual benefits for banks and tax authorities were identified from open and transparent relationships and that these relationships work best when their scope and the commitments of both parties are made clear and appropriately skilled staff are in place. The success of the relationship will be improved where it is voluntary and there are clearly understood rules of engagement and planned outcomes, with commitments by both parties, supported at senior levels.

Notwithstanding these comments, the report recognises that not all banks will be willing to engage in an enhanced cooperative

relationship programme. It is also likely that some banks will continue to engage in aggressive tax planning and to promote aggressive tax planning to their clients. Not surprisingly, the study notes that in these circumstances this may lead to significantly more resources being used in auditing, investigating and pursuing exploratory issues with these taxpayers than would be used in dealing with more transparent taxpayers.

The report makes a variety of recommendations for tax authorities and for banks.

Tax authorities

For tax authorities, the recommendations are grouped under five main headings:

- To improve staff capabilities and their commercial understanding of financial markets and banking, including complex structured finance transactions.
- To provide earlier certainty to bank taxpayers.
- To improve risk assessment of banks and complex structured finance transactions.
- To improve transparent tax compliance by banks.
- To improve international co-operation among revenue bodies.

Banks

For banks, a number of “good practice” recommendations which should be considered are made as follows:

- To ensure that appropriate governance for the management of tax risk is in place, the bank’s internal tax department should have the final say on complex structured finance transactions entered into for the bank’s own account.
- Bank internal tax departments are encouraged to provide a greater degree of transparency in the governance of complex structured finance transactions implemented for clients and for the bank’s own account to the bank’s lead tax authorities.

- All banks should ensure that they have appropriately skilled and trained staff to perform duties in relation to the review of complex structured finance transactions for clients.
- Banks should consider the benefits of an enhanced relationship (particularly greater and more timely levels of certainty, reduced compliance costs, and reduced reputational risk) in setting their business strategy.
- As part of an enhanced relationship, banks should share their views with revenue bodies where there is potential for uncertainty around the tax treatment.

Input by the Singapore tax authorities

Although Singapore is not a member of the OECD, the Inland Revenue Authority of Singapore (IRAS) participated in the tax intermediary project that led to the publication of this report.

The knowledge acquired by the IRAS from this forum would have further enhanced its understanding of the banking industry and the products it offers. In turn, this has led to a more risk-based focus to its approach to tax administration, as evidenced by the fact that the IRAS has begun to engage the industry on tax risk management issues, as well as the adoption of a strategic compliance framework.

Under the strategic compliance framework (summarised in an appendix to the OECD report), the IRAS would adopt a risk-based approach in tax administration, with the goal of encouraging compliance by businesses. To this end, it will strive to provide clarity and certainty of the tax rules, facilitate large businesses to adopt the relevant controls in their tax management process, and detect and deter non-compliance by focusing on high risk areas.

How can PwC help?

- PwC has an international network of tax specialists who have been closely following the work of the OECD in this area in general and the bank study in particular. We would be pleased to help with the development of tax risk management processes or similar matters in line with the recommendations of the OECD report.

Contacts

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