

Financial Services Tax News

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OECD study into the role of tax intermediaries

An Organisation for Economic Co-operation and Development (OECD) study into the role of tax intermediaries (such as accountants, lawyers and financial institutions) was released in mid January to coincide with the fourth meeting of the OECD Forum on Tax Administration in Cape Town.

The OECD study was initiated from the work program set out at an earlier meeting in Seoul, Korea in September 2006 and against the background of the increasing challenges facing revenue bodies from aggressive tax planning.

There is no definition as such of the term “aggressive tax planning” but the study does highlight two areas of special concern: (1) the use, for tax planning purposes, of unintended consequences from existing legislation; and (2) tax planning relying on less than full disclosure to the tax authorities.

The study, led by officials from the UK tax authority (HM Revenue & Customs) and the OECD Secretariat, has been under way for over fifteen months and has involved various tax authorities and consultations with the private sector.

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Main conclusions of the study

The main conclusions are:

- Tax intermediaries assist taxpayers to understand and comply with their tax obligations in an increasingly complex world, but some also design and implement aggressive tax planning.
- Revenue bodies are using various approaches (e.g., regulation of intermediaries, advance disclosure of tax schemes) to counter aggressive tax planning.
- Notwithstanding the *supply* of aggressive tax planning options from tax intermediaries, it is the “*demand*” (from taxpayers) which determines whether and to what extent such options are adopted. Crucially, there is significant scope to influence (i.e., deter) demand by taxpayers for aggressive tax planning.
- In this context, risk management strategies are an essential tool available to the tax authorities and should be applied to ensure that resources are applied to the highest priority areas and to ensure there is optimal use of the tax authorities’ resources.
- Revenue bodies can be more effective and efficient in their dealings with taxpayers and intermediaries if their actions are based on the following attributes:
 - understanding based on commercial awareness;
 - impartiality;
 - proportionality;
 - openness; and
 - responsiveness.
- If tax authorities can both demonstrate these five attributes and have effective risk management processes in place, taxpayers would be more likely to engage in an “enhanced relationship” with revenue bodies, i.e., one based on mutual co-operation and trust.
- The “enhanced relationship” offers benefits to tax authorities and taxpayers. This is because taxpayers that behave transparently (i.e., compliantly) can expect greater certainty and an earlier resolution of tax issues with less extensive audits and lower compliance costs. It is also stated that an enhanced relationship approach between revenue bodies and tax intermediaries would yield significant benefits.

The OECD study report acknowledges the diverse experiences of each jurisdiction and that its conclusions may be more relevant for some countries than others.

Strategy of the OECD

As is clear from the above conclusions, the overall approach of the study has evolved from simply looking at the role of intermediaries and has led on to the development of a wider strategy for approaching the tripartite relationship of taxpayer, tax authority and intermediary.

In essence, the approach of the OECD is to seek to shrink taxpayer demand for aggressive tax planning by a combination of offering benefits (giving taxpayers the ability to participate in an “enhanced engagement” with lowered compliance costs and greater efficiency) and offering a tougher stance (increased concentration of tax authority resources on identified risks of non-co-operating taxpayers).

For those in the banking and capital markets sector, the key question is how this approach is intended to apply to banking business. This is an area of special focus in the OECD study.

Comments on banks

In the section of the report on banks the focus is predominantly on investment banking activities. The report gives a number of examples of what it characterises as aggressive tax planning by banks.

It is noted that the study team has received many comments that some banks develop aggressive tax planning strategies for their own or their clients' use. However, the report recognises that banks do engage in a wide variety of activities so the provision of aggressive solutions involving tax planning forms only a small part of their activities. Nevertheless, it is noted the amounts involved can be very large, running into hundreds of millions of euros.

The role of banks is seen as somewhat different to that of other intermediaries because of their dual role. First, in providing aggressive tax planning for use by clients (often using financial products such as loans, repos and derivatives) and second, in the use of aggressive tax planning themselves (through the inter-bank finance market and in their own proprietary trading strategies). This dual role means they are both taxpayers and tax intermediaries.

As noted above, the study is premised on identifying ways to increase efficiency and effectiveness in revenue bodies' risk management and relationship with taxpayers. The approach adopted proceeds on the basis that shrinking taxpayer demand for aggressive tax planning will lead to a reduction in tax intermediary supply. It is noted that whilst this model may be helpful in addressing banks in their taxpayer role, it may not be so helpful (i.e., effective) in relation to their proprietary trading and inter-bank activities, particularly as the study notes that some banks may not see the enhanced co-operation model as sufficiently attractive for their inter-bank and proprietary structured finance operations.

Whilst the study notes some degree of engagement with banks has already taken place, it notes more work is required and it accordingly announces that the study team will undertake a follow-up study due by May 2009 that is focused on investment banking. This work will be led by the UK tax authorities. Pending that further work, it is noted that the study team does not have a clear view on the extent to which the general recommendations in the report can have the impact on banks' behaviour that revenue bodies wish to see.

The report identifies three objectives for this further study:

- to improve understanding of the role of banks in aggressive tax planning and how this relates to wider commercial activities;
- to assess the strategies used by different revenue bodies in dealing with banks; and
- to identify what benefits revenue bodies and banks could offer each other from which a mutually beneficial enhanced relationship could be constructed.

It is also noted that experience with efforts to respond to aggressive tax planning by other industries suggests that engagement at CFO or main board level will be required in the banking sector. However, it is an open question whether such main board level engagement in the banking sector will be effective from the perspective of the tax authorities. Nonetheless, the deferral of conclusions pending this further study is to be welcomed, particularly as it gives the tax authorities the opportunity to gauge a more accurate picture of the impact of tax in the banking sector.

In addition to the above, further work, led by Australia, will also be carried out on high net worth individuals.

A copy of the full report may be accessed via the OECD website (<http://www.oecd.org/dataoecd/28/34/39882938.pdf>).

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