BEPS MONITORING GROUP

Comments on BEPS Action 12:
Mandatory Disclosure Rules

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We welcome this opportunity to comment on the Discussion Draft (DD), and would also be willing to speak at the public consultation on the subject.

SUMMARY

Legal requirements for disclosure in advance of schemes for tax avoidance are a useful instrument for tax enforcement. However, in most countries where they have been introduced they affect mainly small and medium enterprises and wealthy individuals, and do not cover most avoidance by large multinational enterprises (MNEs). This is because they target standard schemes which are widely marketed by promoters, whereas MNEs generally use arrangements tailored to their specific needs, even if based on standard techniques. For example, it seems that the tax clearances arranged by PwC in Luxembourg over a period of eight years for 343 MNEs were not notified under the UK’s DOTAS requirements.

This DD mainly discusses standard schemes, but also includes some relevant proposals to adapt disclosure requirements to international corporate tax avoidance, which we support, with some suggested modifications. In our view, however, more needs to be done in this respect. Hence, we recommend extension of notification requirements to providers not only promoters, and put forward some hallmarks based on common international tax avoidance structures. In addition, we suggest that further specific hallmarks should be identified as part of the work on the other specific BEPS Action Plan points, to ensure that mandatory disclosure schemes can play a part in helping tax administration monitor compliance during the implementation phase of the BEPS project.

Like all methods of improving compliance, mandatory disclosure must balance deterrence with cooperation. However, there should be safeguards against the pitfalls experienced by some forms of ‘cooperative compliance’, which have led to public concerns about ‘sweetheart deals’. An important safeguard is greater transparency, and we recommend that the proposals should include (i) provisions for access to information derived from notification by a wide range of other tax authorities, and (ii) standards for reporting to the public of information and data from disclosure arrangements, to facilitate independent evaluation of the effects of such schemes.

1. GENERAL REMARKS

1. Mandatory disclosure regimes have been introduced by a number of tax authorities, to try to deal with aggressive tax planning of all kinds. They have not been aimed mainly at international tax avoidance techniques, nor indeed at corporate tax avoidance. Their main focus in most countries has been schemes which are marketed, the clients usually being small
or medium enterprises and individuals with substantial wealth. Hence, as the DD itself points out (para. 227) countries with such regimes have experienced comparatively few disclosures of international tax schemes. Tax avoidance structures used by multinational enterprises (MNEs) would not normally be considered notifiable under most existing mandatory disclosure schemes, because (i) such structures are usually designed for each firm specifically, even if based on common techniques, and (ii) they are usually based on legal interpretations which, although they may be challenged by the tax authorities (sometimes successfully), are considered to be within the scope of the law. Indeed, many such schemes have not been challenged by tax authorities, presumably because they consider that they have insufficient legal grounds to do so. However, this is also the case for marketed schemes, which tax authorities often have to counter through legislative action. Revision of the design of disclosure schemes to make them more applicable to cross-border tax avoidance, and hence more relevant to the BEPS project, is therefore an important issue.

2. For example, the so-called ‘LuxLeaks’ documents published by the International Consortium of Investigative Journalists in November 2014 revealed that Big 4 accounting firm PwC had secured tax clearances with the Luxembourg tax authorities for 343 multinational companies between 2002 and 2010, which involved questionable international financing structures. Questioned by the UK House of Commons Public Accounts Committee, PwC replied that these were ‘individual arrangements, each tailored to the needs of individual clients’, and implied that they did not need to be notified under the UK’s mandatory disclosure scheme (DOTAS), which it defined as being ‘all around secrecy, not wanting HMRC to know’. Although in evidence to that Committee PwC had asserted that ‘we do not mass-market tax products, we do not produce tax products, we do not promote tax products’, the Committee concluded that ‘The number of cases involved plainly demonstrates that PwC is effectively selling variations on a scheme to a large number of its clients’. Yet it seems that such activity, although involving routinized international tax avoidance, would not need to be notified under the type of mandatory disclosure scheme envisaged in this Discussion Draft (DD). Even less likely to be notified are the more specifically tailored arrangements which are widespread. The Luxembourg authorities of course treated these clearances (and as many more negotiated by other firms) as confidential. AP5 of the BEPS project on Harmful Tax Practices includes proposals for ‘compulsory spontaneous exchange of information’ of such tax rulings, but it seems that this will be an essentially voluntary procedure. Although the European Commission in March published proposals for mandatory exchange of information on such rulings, this will apply only between EU Member States. Hence, it seems that none of these arrangements would enable tax authorities of most countries to be notified about such tax avoidance structures, until perhaps at the audit stage, where some details may be required to be provided in transfer pricing documentation.

3. The BEPS project aims to reform international tax rules so that, it is hoped, many or most existing international tax avoidance structures will become otiose. Nevertheless much room for interpretation is likely to remain, especially as there will be a diversity of new provisions around the world. The DD rightly points out the important role of mandatory disclosure together with other methods for early identification of compliance and tax policy issues. It is

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2 The report under BEPS AP13 in September 2014 would require the firm to include in the Transfer Pricing Master File ‘A list and brief description of the MNE group’s existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among countries’. While this seems intended to include rulings such as those of Luxembourg, the formulation may leave some room for doubt.
clearly important for tax authorities to be aware as early as possible of corporate arrangements and transactions which may raise issues of compliance with the spirit as well as the letter of international tax rules, especially in a period of rapid change. Knowledge of such schemes can be shared with other tax authorities, and discussions can be held in relevant forums on how they should be dealt with. Hence, in our view mandatory disclosure should be given wider scope as part of a more systematic follow-up to the BEPS project.

4. Therefore, greater attention is needed to ensure that disclosure schemes are redesigned to fit into the BEPS project. The DD makes a start on this in its chapter IV, which identifies some relevant proposals, including a broader definition of a reportable ‘arrangement’, withdrawal of the threshold requirement for cross-border arrangements, and development of new ‘hallmarks’ specifically targeted at international avoidance. In our view, however, more is needed to integrate these proposals into the BEPS project as a whole, and especially its follow-up. Thus, we recommend that a more systematic effort should be made, when finalising each of the Action Point proposals in the BEPS process, to identify issues which might raise issues of compliance. These should be fed back into this Action Point 12, to help in the formulation of suitable ‘hallmarks’ to include in disclosure regimes, which would be specifically targeted to international tax and BEPS issues. It is notable, as the DD points out, that few existing schemes include hallmarks specifically aimed at international avoidance arrangements. The DD itself includes three suggestions (para. 238) but these essentially deal only with hybrid mismatch arrangements. We suggest that much more could and should be done, through an international collaborative effort including especially non-OECD G20 countries and developing countries more generally, to develop a reporting template more directly geared to international tax avoidance issues.

2. SPECIFIC COMMENTS

Chapter II

1. Does Mandatory Disclosure have any other impacts on disclosure and taxpayer compliance not covered in this Chapter?

Tax authorities have been caught between adopting approaches based on deterrence or ‘cooperative compliance’, stick or carrot. While deterrence can be important, it is inappropriate where there is uncertainty about what actually constitutes ‘compliance’, i.e. where the rules themselves are indeterminate. This has been a factor in the problems experienced by programs for ‘cooperative compliance’, especially in the international tax sphere. Such programs have become discredited by public revelations of ad hoc settlements which have been criticized as ‘sweetheart deals’. They also have become unfortunately endemic in the international tax field, largely because of the trend towards rules relying on subjective and ad hoc judgments, notably in relation to transfer pricing.


4 The procedures followed by the head of the UK’s HMRC in concluding private settlements with large MNEs involving billions were heavily criticised by the House of Commons Public Accounts Committee (‘HM Revenue & Customs 2010–11 Accounts: tax disputes’, 61st Report of session 2010-12, December 2011); although they survived scrutiny by the National Audit Office, and a court challenge (see De Cogan, ‘UK Uncut Legal Action v HMRC: legal inaction and a return to Fleet Street’, British Tax Review 552-62 (2013)), newspaper coverage has been less charitable: see e.g. Syal, ‘Revealed: ’Sweetheart' tax deals each worth over £1bn’, The Guardian, 29 April 2013, and Malone ‘The Tax man with his nose in the trough’, Daily Mail 11 February 2015.
This does not mean, however, that there should be a switch towards a greater emphasis on deterrence. The best remedy, in our view, is to adopt rules which are based on clear criteria and which are therefore easy to administer, as we have advocated in our various submissions. The next best remedy is increased transparency, which we have also strongly urged. Although disclosure by taxpayers to tax authorities is clearly part of this, it is by no means sufficient to deal with the potential dangers. While it is important for tax authorities to maintain strict protection of confidential information received from taxpayers, there should be much greater emphasis on

(i) exchange of information between tax authorities, and

(ii) reporting to the public of information and data from disclosure arrangements.

As regards (i) the Introduction to the DD mentions that work under AP 12 will include proposals for enhanced forms of exchange of information about tax schemes. It is important that these should be as comprehensive as possible, in particular extending to developing countries. More could clearly be done to extend to tax officials from a wider group of countries the benefits of the work of Joint International Tax Shelter Information Centre (JITSIC), and of access to the Aggressive Tax Planning (ATP) Database. As regards (ii) we would like to see clear recommendations for standards of reporting to the public of information about the working of disclosure regimes. Such reporting should be sufficiently detailed to allow evaluation of the regimes by regulatory bodies such as government auditors, as well as analysis by academics and civil society organizations. It is notable that as the DD points out (para. 38) data on the effectiveness of such regimes have been collected only by the United Kingdom, and this has been in part due to public concerns and a scrutiny by the National Audit Office.\footnote{A study by the Oxford University Centre for Business Taxation, at the request of the National Audit Office, of the UK scheme reported that the published information was insufficient to allow an adequate assessment, and provided a list of questions to elicit further information: Devereux, Freedman Vella J., ‘The Disclosure of Tax Avoidance Schemes Regime’, OUCBT (2012).} Tax authorities are not best placed to evaluate the effectiveness of such regimes, not least because they are under-resourced, a much better solution is publication of data for others to evaluate.

2. Are there any practical issues that arise from the perspective of the promoter or taxpayer that are not covered in this Chapter? If so what are those issues and how could they be dealt with?

We suggest that, as part of the revision of disclosure regimes to address international avoidance, there should be a reorientation to a focus on ‘providers’ rather than ‘promoters’. As pointed out in section 1 above, the concept of promoters is directed primarily at off-the-peg schemes which are widely marketed. Disclosure is equally important for arrangements tailored to individual companies, which are often based on replicable techniques. For example, providers including lawyers, accountants, and investment banks often will recommend partially or fully tailored schemes to achieve a tax goal indirectly that cannot be achieved directly. The development of such schemes should be squarely within the disclosure requirements.

Chapter III

3. Are there any other considerations, not mentioned above that arise with option A or option B, if so what are they?

In our view, Option B is clearly preferable, i.e. notification by both providers (not only promoters) and users, and it should be recommended to countries for adoption. It has the
strong advantage of greatly improving compliance. The DD mentions only that it ‘reduces the risks of inadequate disclosure’, but these are substantial. The evaluation of the UK scheme by the National Audit Office revealed both substantial failure to report by taxpayer users of schemes, and non-reporting by promoters, sometimes due to avoidance of the reporting obligation by techniques such as obtaining a legal opinion. A dual reporting obligation is essential to help improve compliance.

4. Are there any other features common to promoted schemes that could be included in generic hallmarks?

In our view a different approach should be adopted to specifying the hallmarks for international tax avoidance schemes. Although such schemes may be very varied and complex, they depend at bottom on some basic techniques. It should be possible to capture these techniques by specifying hallmarks, in addition to the ones that have been mentioned in the DD (i.e. loss schemes, leasing arrangements, arrangements involving hybrid instruments). We suggest generic hallmarks along the following lines:

(a) inclusion in a multinational corporate group structure of an entity (i) not resident in the country where it is formed, or (ii) formed or resident in a jurisdiction designated as non-transparent, defined strictly based on compliance with the OECD’s Common Reporting Standard and including access to information on beneficial ownership;

(b) organising a multinational corporate group structure involving associated enterprises in different countries such that reportable profits and tax payable are significantly out of line with the real economic activities in the country concerned, especially by (i) transferring assets such as intellectual property rights to an entity to hold or manage without performing any substantive functions involving innovation or creativity; (ii) designating an entity as a provider of services for associated enterprises which generate an income to that entity significantly disproportionate to the real economic activities for which it is responsible; (iii) designating an entity to hold capital and make loans or other investments to associated enterprises while not performing any other economic activities; (iv) designating an entity as a principal in a contract manufacturing, contract distribution or contract research and development scheme; (v) restructuring of a global value chain so as to locate high value-adding functions in jurisdictions where they would benefit from low effective rates.

5. What is the best way of capturing those transactions where the promoter’s benefit is priced into the return on the transaction itself (rather than through a separate premium fee)

As stated in our reply to Question 2 above, we favour a wider approach covering providers, not only promoters. We therefore support a wider definition such as that in the Canadian scheme, outlined in Box 2 on p.28, which would not rely only on a premium or contingent fee, but extend also to any payment for an arrangement which the provider represents would result in a tax advantage.

6. Are there any other specific hallmarks which should be considered but are not covered in the documents?

See answer to Question 4 above, and to Question 18 below.

7. Have you encountered any practical and administrative difficulties in applying generic and specific hallmarks in practice? If so why have these arisen and how could they be overcome?

Countries which have specified as a hallmark the use of an associated enterprise located in a low-tax jurisdiction or tax haven have found it difficult to decide when a jurisdiction should be designated as such. Some, for example Argentina, replaced that concept with that of a
‘non-cooperating jurisdiction’, but at the time that this was defined in terms of signature of information exchange agreements many countries rushed to sign such agreements and this test became ineffective. We hope that a more rigorous process of evaluation of compliance with the Common Reporting Standard including access to beneficial ownership information, will make such a hallmark more effective.

8. *Does a hypothetical test effectively address one-off or tailored transactions? Are there any other ways in which such transactions could be captured by a mandatory disclosure regime?*

As already stated, we consider that disclosure should not be limited to off-the-peg or marketed schemes, but should use a wider definition covering providers of arrangements creating a tax advantage.

9. *Do any practical problems arise from an earlier reporting date and short timescale. If so what are those and how could such issues be dealt with?*

10. *What further information or detail is needed in respect of the concept of availability or is this clear?*

11. *Are there any other practical issues that arise from setting the reporting period, if so what are they and how can they be dealt with?*

In line with our recommendation that disclosure should not be limited to marketed schemes, we suggest reporting should be (i) by advisors triggered by the date on which the advisor becomes a ‘material advisor’, as in the US scheme outlined in para. 144, and (ii) by the taxpayer based on the date of the first transaction forming part of the scheme.

12. *Are there any other ways in which to identify scheme users other than scheme number or client lists?*

13. *What might prevent the automatic provision of client lists to the tax administration and how could this be dealt with?*

14. *Do you think that the proposed disclosure form (in Boxes 10 and 11) will be appropriate to provide tax administrations with the information necessary to understand the reportable transaction?*

15. *Are there any other information powers that would be necessary in the context of obtaining information from a promoter or advisor?*

The disclosure forms in Boxes 10 and 11 may be appropriate and feasible in countries in which the taxpayer that has paid for the scheme and the advisor relating to the scheme are located. In countries where affiliates or related parties are located which have not participated in the design of the scheme such disclosure forms could be equally relevant, but the tax authorities could encounter some problems in ensuring that foreign advisors comply with form B; and even that taxpayers comply with the ‘scheme details’ and ‘all parties to the transaction’ heads in form A. It is therefore essential that the proposals in this DD be complemented by appropriate proposals for enhanced models of information sharing which the DD explains (p.2) will be developed as a follow-up to these proposals.
16. Is there any additional information that should be reported to the tax administration?

17. Do any problems arise in practice in providing the information set out at Box 10 and 11. If so what are those and how could they be dealt with?

Chapter IV

18. Do you think that the Recommendations will be effective to capture international schemes, and, if not can you suggest alternative approaches?

In our view, as already outlined above, it is important to rethink disclosure schemes to adapt them more appropriately to international avoidance arrangements, and in particular to ensure that they can play a suitable role in the follow-up to the BEPS project. This chapter has made a start on such rethinking, but more needs to be done to ensure that this Action Point is more firmly integrated into the proposals from the other parts of the BEPS Action Plan.

To that end, we suggest that the working parties and groups engaged on the other substantive points of the BEPS Action Plan should be asked to specify structures or transactions which they consider might raise issues of compliance with both existing tax rules and the changes they recommend. Suitable hallmarks could be devised for inclusion in disclosure schemes to ensure that tax authorities have information in good time of arrangements or transactions that may raise problems of compliance.

19. Are the purpose and meaning of the terms used in the chapter clear, if not what further clarification is necessary?

We agree that the disclosure obligation on the taxpayer should be limited to persons resident or having a tax reporting obligation in the jurisdiction (as outlined in para. 233), and that this obligation should apply to any arrangement involving a cross-border outcome regardless of the country where such outcome arises (para. 236). We also agree that this should apply even if the taxpayer is not directly a party to the transactions creating the cross-border outcome (para. 241). However, we do not see the need for a materiality requirement as suggested in paras. 242ff, which would be complex and difficult to apply. It should be sufficient that the person is party to a transaction or series of transactions which involve a cross-border outcome, and is subject to a tax reporting obligation. States have now accepted the obligation to collect information from persons within their jurisdiction even if they have no tax interest, if it is foreseeably relevant to the enforcement of another country’s tax laws. The same principle should apply to these reporting obligations.

Also, since we support dual reporting, in our view the obligation on advisers should apply in relation to any arrangement involving an entity formed or resident in the country concerned, whether or not that entity is a taxpayer or has a reporting obligation there.

20. Are there any other examples of international tax schemes which should be disclosed under MDR?

We have already outlined in answer to Question 4 above some suggested generic criteria, and in answer to Question 18 the approach that should be adopted to identifying the types of arrangement which should be reportable.

21. Do you think that the Recommendations will impose an undue compliance burden on taxpayers? If so, why?

We have no doubt that this question will provoke the usual deluge of responses lamenting the compliance burden, many of them from tax advisers, nobly standing up for their clients. However, it should be borne in mind that disclosure obligations are required only for arrangements entered into by taxpayers which are complex and produce a tax advantage.
Such arrangements generally involve extensive documentation and hence very significant transaction costs to set up, and often to administer, as well as substantial fees to advisers or promoters. In view of this, it is hard to take seriously complaints about a compliance burden involved in reporting such arrangements.