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Dear Achim,

BEPS Discussion Draft: Mandatory disclosure rules

PricewaterhouseCoopers LLP (PwC) welcomes the opportunity to comment on the OECD's *Public Discussion Draft on Action 12: Mandatory disclosure rules*.

We commend the Working Group for its efforts in identifying a modular approach to a mandatory disclosure regime (MDR), along with challenges associated with it. We think the OECD should make it clearer whether or not it recommends countries implement MDRs. In particular, we are uncertain at this time whether the OECD agrees that a thorough analysis is needed to ascertain any gap that remains to be filled if countries adopt all the other BEPS action items. To the extent that such an analysis can only be made after implementation of the BEPS package, it makes more sense to delay the policy recommendations of Action 12.

However, we also have concerns in a number of specific areas, notably with respect to the reporting of certain international tax arrangements, and believe further consideration is needed. In particular, we believe that reporting of such international tax arrangements should be restricted to mass marketed schemes.

The response in the pages that follow reflects the views of the PwC network of firms, and we offer our observations on several key aspects of the Discussion Draft, many of which relate to the options for including international tax arrangements.

1. Policy aims

The draft states that principles of clarity and ease of understanding, effectiveness and targeting, balancing additional compliance costs to taxpayers with the benefits obtained by the tax authority, as well as effective use of the information collected, are shared by existing disclosure regimes. Our experience suggests that this has not always been the case. Countries looking to introduce an MDR under the modular approach recommended might usefully consider their policy aims and review the experience of the existing regime most closely aligned with those aims.

The recommendations acknowledge that available data on the effectiveness of regimes is not comprehensive. But it concludes that there is sufficient evidence that they have met some of their key objectives. Our experience in the countries that have these regimes has been that the compliance burden on promoters (as broadly defined), companies and the taxing authority has been particularly noticeable, and great care is needed to ensure that none of those is burdened with disproportionate or inappropriate responsibilities. It has taken a number of iterations of the rules in order to make them effective and appropriate.

We recognise the need to identify mass marketed pre-packaged schemes or those which rely on limited or no disclosure and which aim to provide absolute tax benefits or cash flow advantages from delays in paying the tax due. Our experience in several countries with an MDR has been that the promotion and use of 'off-the-shelf' type products has been curtailed as a result of the introduction of the MDR. The MDR seems to work best on these types of scheme. This was particularly noted in Ireland and the UK, although there has been a suggestion, not in our view supported by the facts, that some of the promotion of schemes has been driven 'under the radar'. However, other countries have had positive experiences of using a range of other tools which deter promotion of schemes or ensure their detection. In some cases, this has resulted in the rejection of the need for an MDR, a decision which should be respected. In Australia, it has been sufficient to introduce a promoter penalty regime to prosecute advisors that market tax avoidance arrangements; the product rulings system under which mass marketed schemes are commercially unattractive without signoff by the revenue authority; and the tax return international dealings schedule. In China, a renewed focus on its General Anti-Avoidance Rule (GAAR) has coincided with an MDR article being dropped from the Chinese Tax Collection and Administration Law that is currently being amended, despite a more relaxed approach to the historically extensive questionnaires regularly used to seek information on hot topics.

The interaction of an MDR and a GAAR may give rise to practical problems. On the face of it, the MDR would need a dominant purpose/ main benefit threshold which would have to be similar to that in the GAAR, leading to taxpayers presumably either not entering into such arrangements or not disclosing them. South Africa has recently dropped the main benefit threshold from its MDR on the basis that where the offending elements of the GAAR are present the scheme will be reportable without regard to a main benefit test. This is particularly relevant in the context of the South Africa GAAR where the onus is on the taxpayer to show that the main purpose of a scheme is not tax avoidance – in effect, the MDR requires taxpayers to report cases where their sole defence against the GAAR is on the basis of main purpose.

Where other tools require the reporting of a list of transactions, the recommendations might go further so that an MDR would additionally support quantification of those transactions and related details of any tax effects or benefits obtained. However, countries are free to strengthen the requirements of those existing reporting regimes without including an MDR.

While there are numerous practical problems, the policy reasons for reporting certain international tax arrangements are also less obvious. Changes in international tax standards and other promised increases in cooperation between jurisdictions and alternative methods for addressing avoidance activity also suggest a serious review of the costs and potential benefits is needed before the recommendation of any new disclosure regime for international tax arrangements. Considering the overlap with other reporting measures, this could also be the small addition needed to tip the scales to the point where the compliance burden becomes too onerous for taxpayers and advisers (see also below). Further, countries with worldwide tax systems, like the US, retain residual taxing rights in respect of their taxpayers including multinational enterprises (MNEs) – these countries would not typically need to identify foreign tax planning that creates a cross-border mismatch.

2. Clarity and ease of understanding

Further work may need to be done to establish best practice in providing clarity and making the rules easy to understand. For those designing schemes, the reporting criteria should be sufficiently certain, unambiguous and based on objective criteria that there is a deterrent effect but they should also be wide enough to cover new and innovative schemes. For those implementing or merely advising on transactions, judgmental rules about whether there is avoidance which the tax administration wants to know about are more likely to avoid the disclosure of innocent planning.

Inherent vagueness, where disclosure is based on more subjective criteria, can lead to either over-reporting or under-reporting in our experience. Conservative taxpayers tend to over disclose, resulting in a greater burden on tax authorities, as happened with the US Reportable Transaction Regime in relation to loss transactions. It can also though allow positions to be adopted to the effect that arrangements are not reportable – prior to recent changes, South Africa's MDR had not worked particularly well in this regard and relatively few arrangements had been reported (the bulk of reported arrangements related to preference share financing arrangements that were specifically listed as reportable and which presented little risk to the fisc). Having to ascertain whether there are material economic consequences or material tax consequences as a result of an arrangement, in the manner proposed, appears to be largely subjective and the effect is uncertain.

Any generic and specific hallmarks need to be very clearly described in MDRs to avoid these uncertainties which have arisen in practice. This also impacts the need for either a threshold test or a monetary filter, but even with the best targeting one or other is likely to be vital to keeping the compliance burden in check, as noted further below.

The Discussion Draft recognises that a taxpayer may play only a minor part in an arrangement – for example, a small subsidiary that doesn't typically receive much information from its parent. However, there is an assumption that it will be sufficiently aware of the material tax consequences for any one of the parties to the transaction. In many instances it would have an obligation to find out more, but to a level which is rather unclear and that also affects the potential burden imposed.

3. Compliance burden

The challenge for an MDR is to target egregious schemes without creating an enormous compliance burden for the vast majority of companies whose commercial affairs happen to need advice, or in the case of MNEs, cross-border advice; and of course if there is excessive disclosure of benign transactions, the taxing authorities may also get swamped with unnecessary compliance costs.

The definition of a promoter who is required to make a disclosure should focus on design and sale of a reportable arrangement. Where it includes others only incidentally involved in the arrangement the level of knowledge and culpability may sometimes be relatively low, such as in South Africa where a promoter includes a person responsible for financing a reportable arrangement. Where the onus is put on intermediaries rather than the taxpayer (at least by default), those intermediaries have to put in place procedures and systems to ensure compliance at the time arrangements are made available. This could be when first discussed with the client, and staff who are involved have to be trained to ensure that is captured in relation to what is generally bespoke advice. In Mexico, the onus has been placed in relation to consulting situations more on taxpayers who can better control matters by reference to actual implementation of any arrangements carried out, whether based on the advice of one or more advisers or otherwise.

Where the burden is imposed partially on both the taxpayer and the adviser, the approach can itself lead to confusion as we found in South Africa. There needs to be absolute clarity as to when the reporting obligation falls on the taxpayer and when it falls on the adviser, without duplication.

An MDR can impose a significant burden on the tax administration to review and analyse all disclosures. This burden can be particularly onerous where the MDR is poorly targeted with scarce resources being directed to reviewing arrangements that are of little or no risk to the fisc.

The overall burden on taxpayers and advisers in relation to reporting transactions or satisfying compliance with a GAAR is already substantial in some countries. In Mexico, the MDR is duplicative in the most relevant areas, as taxpayers are already required to report transactions with non-residents, with related parties and certain other transactions. The US has both a codified economic substance rule and business purpose requirement which create significant uncertainty, and therefore consideration, on the part of taxpayers due to the subjectivity of the standards and the lack of guidance on how they may be implicated in normally accepted tax transactions. Korea has a substance-over-form rule that allows the tax authority to recharacterise transactions and requires taxpayers to report information on international transactions with related parties. Australia includes in its tax return an international dealings schedule. The Chinese tax authorities have regularly launched initiatives involving questionnaires or tax inspections on specific topics, such as intra-group cross-border payments and dividend repatriation. In Ireland, Australia and South Africa the MDR is fairly complementary to the GAAR as regards indicators such as the lack of commercial substance, but there is a degree of redundancy as a result of the overlap.

Virtually all our people in territories with existing MDRs recognised the significance, in keeping the compliance burden in check, of sufficiently high monetary limits on reportable transactions, particularly in relation to international tax arrangements. Most commented on the burden for both the taxpayer/ adviser and for the tax administration. In Mexico the taxpayer ombudsman (taxpayer protection body) was involved in establishing reasonable limits. South Africa's monetary threshold has just been increased, but the popular view is that it remains too low and the threshold should be set at a level that will capture only those arrangements that present a material threat to the tax base.

The absence of a dominant purpose/ main benefit threshold would be of concern in some territories. In Australia, for example, there is a clearly established GAAR rule (in the law since 1981, with a history of prior rules going back 100 years) that distinguishes between what is tax avoidance and what is not through the dominant purpose test. Absence of a main benefit test in relation to international tax arrangements might be more supportable in countries where there is a clear listing of arrangements that are reportable within the BEPS space, such as hybrid debts and foreign cell captives.

Significant work may sometimes be needed to confirm whether a disclosure has to be made following the introduction or extension of a specific regime as put forward in this Discussion Draft. In many cases, the outcome will be that no disclosure is needed.

4. Timing

Early identification of new schemes is not as relevant in cross-border situations as it is in relation to domestic situations when the law can more easily and quickly be changed. Instances of legislative change being made at an early stage in relation to disclosures seem far more prevalent in the UK than elsewhere. It may be arguable that the 5 day deadline in the UK facilitates such early change but also that the timing issue may not be as critically regarded by tax authorities in many cases as might otherwise seem likely.

In relation to international tax arrangements, much more time may be necessary in order to establish reportable information. As previously noted, neither taxpayers nor advisers will not always be in a position to have first-hand access to more than a small piece of the big picture. Any request for additional information takes time. There is an additional question as to whether any validation of a response would be necessary, if not strictly by the law then by an entity's own control framework. The reporting of the details of a person from whom additional information could be sought by tax administrations, as mentioned in the Discussion Draft, may be all that is feasible.

In particular, it should be questioned whether early reporting under an MDR is necessary in the context of treaty related matters and whether these should be reportable only at the time of the filing of a return.

5. Multiple taxpayers and advisers in different countries

There seems to be an expectation that promoters will be aware of the full consequences of tax planning within multinational groups. It is very unlikely to be the case in the common and mainstream situation of international tax advice where several advisers have been involved in bespoke tax planning for a group on its commercial affairs. Frequently there will be a mixture of firms of accountants, lawyers and other intermediaries involved, each responsible for only part of the transaction. Even where separate firms within the same network are involved, the ease of cross-border communication and the specificity of the information supplied cannot be assumed.

In limiting the burden on taxpayers/ advisers and tax administrations, it would be preferable to require one disclosure in one territory for an arrangement, rather than multiple reporting to multiple tax authorities. However, it may not be feasible to constitute such rules. Consider, for example, a tax advisor in Country A engaged by the headquarters in Country A to work on tax planning for a subsidiary in Country B to achieve a tax benefit in Country B. In this case, who should report and to which tax authority should it report? It is unclear whether rules could be formulated in such a way that there would be certainty about reporting and enforcement.

The terminology of legal professional privilege suggests a strong underlying UK influence. It is similar to the attorney-client privilege in US common law but may not be present in all jurisdictions. It is important to ensure a level playing field between promoters who can claim such privilege and those that cannot do so in relation to particular arrangements.

6. Behaviour and focus on outcomes

Generic hallmarks tend to be framed by reference to the behaviour of promoters. These have in some cases been described in a subjective manner that has made it difficult for advisers to show that even bespoke commercially driven advice is not within scope. An absence of a dominant purpose/ main benefit test would make this doubly difficult. Hypothetical tests (such as premium fee) are in general considered to be too subjective and place an undue burden on taxpayers and promoters.

The Discussion Document states that reporting will be required of "key provisions of foreign law relevant to the elements of the disclosed transaction". However, in making this disclosure, advisers (or taxpayers) will be wholly reliant on information given from advisers in those overseas territories – they will not, even in the largest organisations, have the expertise to verify whether that analysis is complete or accurate.

Advisers and other intermediaries falling within the definition of promoters would be expected to provide information within their knowledge, possession or control. The Discussion Draft suggests that

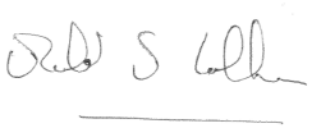
regimes might often identify an intermediary as the primary reporter or having an equal obligation with the taxpayer. This would seem to raise particular difficulties in relation to international tax arrangements where the description of a reportable arrangement is outcome focused – intermediaries may in practice often have difficulty ascertaining a description of the outcome from the taxpayer (or another adviser).

The description of hallmarks for cross-border arrangements which would be reportable transactions, and the examples used in the Discussion Draft, suggest that many of the outcomes would be addressed by other BEPS actions. Is it reasonable to assume in Figure 4 on page 63 of the Discussion Draft that the mismatch is not dealt with under post-BEPS rules?

7. Consequences

The Discussion Document recognises that disclosure does not necessarily imply aggressive avoidance, but in practice there are negative consequences of transactions being reported. In the UK, for example, reputational, taxation and commercial consequences include Advance Payment Notices, issues for companies seeking Government contracts and the High Risk Promoter regime. Those consequences ought to be carefully examined – it is clearly vital that the regime should only apply to its intended targets, and that taxpayers do not face negative consequences as a result of badly targeted hallmarks.

Yours sincerely



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