

WORKING GROUP DISCUSSION

TOPIC 3

Tackling international tax avoidance

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Working Group Final Report

1 The third SGATAR working group in 2010 considered the topic 'Tackling international tax avoidance'.

2 The working group commenced with an address by the group's Chairman, Australian delegate William Day. William first thanked the hosts, Japan, for their impressive organisation of the conference, then explained the rules under which the group would operate.

3 Delegates then presented summaries of their conference papers, and the Chairman led related discussions.

Defining international tax avoidance

4 A number of delegates defined international tax avoidance.

Use of legal means in unintended ways, to reduce tax

5 It seemed uncontested that use of provisions in tax legislation, in ways that were unintended by governments, to reduce a person's tax liability constituted avoidance.

Involving cross-border activities

6 International tax avoidance, of course, also requires a cross-border element.

Distinct from evasion

7 Avoidance was viewed as distinct from evasion. Delegates discussed this point in response to a question from the Indonesian delegate and it was referred to in a later presentation by the delegate from the Philippines. The

working party came to the conclusion that although there may not always be a clear line between the two concepts, avoidance is generally the result of legal actions that have unintended consequences. Evasion, in contrast, is the result of illegal actions.

8 In any case, measures designed to address avoidance are also likely to be useful for addressing evasion.

Examples – specific and general

9 Delegates provided examples, both specific and general, of international tax avoidance schemes and evasion. Mongolia, for example, discussed the shifting of income out of the Mongolian corporate tax base by means of deductible management fees paid to a foreign company.

Context

10 Many delegates referred to the context in which avoidance and policing of avoidance takes place.

Environmental factors – globalisation

11 Many delegates made the point that international tax avoidance has become more prevalent in recent years, as globalisation and technological advances have facilitated the cross-border movement of capital and individuals.

Motivation – attitudes

12 It was noted by Australia's delegate that tackling international tax avoidance involves, in part, addressing societal attitudes to taxation. Taxpayers must make the connection between taxation, provision of government services, and participation in society.

Consequences of avoidance

13 Several delegates referred to the reasons for concern about international tax avoidance. The obvious consequence is of course reduced tax revenue, but the fairness of the tax system is also called into question when there is avoidance. It was also noted by the delegate from Macao SAR that the existence of tax avoidance strategies can introduce distortions into economic decision-making.

All SGATAR members have been affected in some way

14 It was clear from the presentations of all the delegates that all SGATAR members have been affected by international tax avoidance, whether as members that have had their revenue reduced because of avoidance arrangements, as observers of capital flows through their location, or both.

Legislation

15 The tax legislation of SGATAR members was discussed.

Transfer pricing legislation (and other arm's-length rules)

16 A common feature in many cases was the existence of transfer pricing legislation. Transfer pricing legislation was the subject of more presentations than any other anti-avoidance measure.

17 Transfer pricing legislation allows the revenue authority to substitute an arm's-length price for the price actually charged in cases of transactions with related parties.

18 However, while some transfer pricing legislation was present in the legislation of many members, it varies widely in its effects. In some places, such as Papua New Guinea it has a relatively narrow scope. In others, the scope is wide. In Indonesia, for example, the legislation not only allows market

prices to be substituted but also permits the taxing authority to substitute equity for debt.

19 The People's Republic of China discussed the progress of new, comprehensive transfer pricing legislation it introduced in 2007 and followed up with supporting regulation in 2009.

20 Some other members are well advanced in plans to introduce explicit transfer pricing rules.

Specific anti-avoidance rules

21 Several members commented on specific anti-avoidance rules that they apply to prevent particular types of international tax avoidance. These are, by definition, limited in their effect.

General anti-avoidance rules

22 A number of delegates also commented on general anti-avoidance provisions that exist in their legislation or in common ("judge-made") law.

23 In addition to general anti-avoidance rules that are called by that name, the Chinese Taipei delegate discussed the use of a "substantive taxation" provision by its administration. This provision allows the economic substance of transactions to be taken into account for tax purposes.

24 Explicit provisions in legislation are not universal across SGATAR members, and common law cannot always fill the gaps.

25 The delegate from Thailand noted that it did not have a general anti-avoidance rule (GAAR). Although GAARs have benefits they also have costs, and research in Thailand had indicated that a GAAR may discourage FDI.

26 When GAARs are present, they may allow the tax authority to disregard an arrangement for tax purposes, or to reconstruct arrangements – that is, to

substitute some other commercially justifiable arrangement – to nullify the tax advantage, or even both such as in Hong Kong SAR.

27 The general anti-avoidance rules, in most cases, do not apply unless tax avoidance is the sole or main purpose of an arrangement.

28 In addition, the rules often do not apply unless there is evidence of contrivance, or commercially unreasonable practice, or an economic effect of the arrangement that differs substantially from what is purported for tax purposes.

29 It was common for tax administrations of members to require high-level approval before invoking general anti-avoidance provisions.

Thin capitalisation rules

30 Some delegates spoke about the existence of thin capitalisation rules in their legislation, designed to prevent excessive interest deductions being taken by multi-national groups.

Information-seeking powers

31 It was common ground for nearly all members that the tax administration could compel the provision of information by taxpayers. In many cases, this could include compulsion of third parties.

32 Some members require particular information to be submitted with tax returns; concurrent documentation to document transfer pricing strategies, for example.

Information exchange

33 A number of delegates mentioned recent changes to their domestic legislation to allow for information to be collected from taxpayers by the tax authority, in response to requests from other tax agencies.

34 In general, these were designed to meet the requirements imposed by the latest OECD information exchange (EOI) article.

35 They pave the way for tax treaties to be negotiated or updated with the new EOI article, and for stand-alone tax information exchange agreements to be signed.

Penalties

36 Some delegates discussed the penalties they can impose if international tax avoidance is found to exist. These include penalties for tax shortfalls and promoter penalties. The latter impose penalties on promoters of avoidance schemes that would be similar to the penalties their clients would face.

37 Penalties may in some cases be reduced if there is a voluntary disclosure of avoidance by the taxpayer before any investigation. This can provide an incentive for non-compliant taxpayers to re-enter the tax system and become compliant.

38 Additional measures may also be used to encourage taxpayers back into the system. For example, views on the criminality of a transaction might be provided on an anonymous basis. If a person can be satisfied that only civil remedies are being considered in their case, they may be more willing to voluntarily disclose past avoidance.

Organisational structure and procedures

39 There was discussion of the organisational structure and procedures used by members to assist in their work to prevent international tax avoidance.

Specialist international avoidance units

40 Several members had established dedicated units within their agencies to deal with international tax avoidance. The Japanese delegate, for instance, noted several project teams and groups of international tax experts that had been set up over time to focus on international tax avoidance.

41 It is common for these units to collect and analyse information from multiple sources and to use this to determine priorities for further investigation or audit. In some cases, the units may go further and also carry out the investigation or audit.

42 In others, the information is passed on to a general investigation function within the organisation.

43 The use of experts in international tax matters in investigations, whether working with a centralised team or providing advice to a general investigation function, was found to encourage a more successful and speedier conclusion.

44 A number of members also had specialist units to deal with exchange of information.

Advisory panels

45 Other members used general information-gathering or investigation functions to deal with international tax avoidance, rather than a dedicated unit. In those cases, there was nevertheless recognition of the importance of dealing with international tax avoidance and co-ordinating measures to achieve this.

46 Advisory panels and steering groups were used in some cases to co-ordinate actions and ensure consistency in the application of anti-avoidance provisions.

47 Countries without specialist EOI units added EOI to the duties of general staff or of international tax specialists.

Other structural measures

48 Communications strategies play a role in discouraging international tax avoidance. Revenue authorities can publicly warn groups of taxpayers of the dangers or particular sorts of schemes. They can also publicise their increased access to tax information because of international co-operation. This may discourage taxpayers from ever entering into avoidance arrangements.

49 Communications could be provided, for example, by issuing public alerts, through other formal documents, by placing advertising in mainstream media. Informal channels may also be created if the media independently reports on successful enforcement activities.

50 Communication is one part of educating taxpayers about their responsibilities. Other avenues for education may be pursued too.

51 Related to communication, transparency of tax administration may assist in establishing the right incentives for taxpayers. Transparency can increase trust, reduce the potential that taxpayers will be surprised by enforcement actions, and promote voluntary compliance. There are some formal means that could be used to enhance transparency. For instance, the delegate from Malaysia mentioned tax audit and tax investigation frameworks that set out processes to be followed, and the rights and responsibilities of taxpayers and revenue authorities.

Information sources and analysis

52 Delegates discussed the information that they use to discover and counteract international tax avoidance.

53 Information is required to be submitted by taxpayers in some cases, either as part of tax returns, on remittance or receipt of payments, or in response to requests by the revenue authority. Ad-hoc questionnaires have been used to obtain specific information.

54 Information may also be obtained from other government agencies, private agencies, 'good citizen' reports (informants), publications such as annual reports and prospectuses, and the media.

55 Some delegates mentioned systems for tracking cross border financial transactions exceeding some threshold. Such systems may be run by the revenue authority itself or by some external agency that allows the revenue authority access.

56 Several delegates mentioned that they take a risk-based approach to selecting targets for further investigation. The information a tax agency collects needs to be analysed to be useful for this purpose. Computer technology increasingly provides the tools for effective analysis of the large amounts of data that are obtained.

57 Some delegates mentioned registers of tax avoidance promoters and high-net worth individuals. These are compiled from a variety of sources and are used to identify individuals that may have a high propensity to market or enter into international tax avoidance arrangements.

58 Vietnam explained that it planned to establish a comprehensive database to store information about business transactions, initially confined to related-party transactions, to combine information already held internally with information from third parties.

Information sharing

59 Sharing of information by revenue authorities – that is, from the revenue authority to others rather than the reverse – may be less common because of

confidentiality restrictions, but there is a desire on the part of some members to change this. The Australian delegate mentioned recent law changes that were made to permit cross-agency co-operation and information sharing, triggered by a project that dealt with tax evasion using offshore financial centres.

60 Sharing of information across jurisdictions is discussed in more detail below.

International co-operation

61 The working group discussed the role of international co-operation in reducing international tax avoidance.

62 It was heartening to note that there was general agreement about the importance of international co-operation in combating international tax avoidance, and to observe that many members expressed a commitment to further advances in this area.

Knowledge sharing and assistance

63 Comments were made by several delegates about the sharing of knowledge and experiences with international tax avoidance. This sharing, which does not involve specific taxpayer information, may take the form of staff exchanges, training, advice on audit approaches, or directories of tax avoidance schemes. The delegate from the Republic of Korea referred to the OECD's aggressive tax practices directory, which it monitors for information about schemes identified in other places and uses to inform its own activities.

Counteracting information asymmetries

64 The point was made that taxpayers are no longer constrained by borders, because of the freer movement of global capital and advances in communications technology. In contrast, revenue authorities are often constrained by borders.

65 There was general agreement that increased international co-operation could at least reduce the information asymmetries caused by this unequal situation. That is, it would make it more difficult for taxpayers to “fly under the radar” of their revenue authority by undertaking parts of arrangements in the jurisdiction of another tax agency.

66 Delegates expressed a view that they were committed to making information sharing provisions work well. As mentioned elsewhere in this report, a number of members have already altered their domestic legislation to remove impediments to the exchange of information under appropriate arrangements.

67 Tax agencies of course have no jurisdiction outside their territories, but a number of bilateral and multilateral legislative instruments and administrative measures have been used to allow tax information to flow more freely across borders.

Formal instruments (DTAs, TIEAs)

68 All members had established double tax agreement (DTA) networks, often quite large ones, and included exchange of information (EOI) provisions in their tax agreements.

69 Agreements without effective EOI provisions were rare, although a significant number of older treaties do contain EOI provisions that pre-date the OECD’s latest model provision. Recent changes to domestic law by a number of members will permit EOI provisions to be updated to the latest model using protocols or new treaties, and in some cases members reported they have already started to update these provisions.

70 It may be straightforward to update existing DTAs, and even where there is no existing DTA members may prefer to negotiate full DTAs rather than just EOI provisions. However, in cases where it is only EOI provisions that are

wanted, tax information exchange agreements (TIEAs) provide a low-cost alternative.

71 SGATAR members have now negotiated TIEAs in significant numbers, and these follow the OECD guidelines for information exchange. Significantly, many of the TIEAs are with low-tax jurisdictions that may once have had secrecy provisions that prevented information exchange. TIEAs significantly alter the landscape by making it more difficult for taxpayers to hide their international tax avoidance or evasion activity.

Administration of DTAs, TIEAs

72 Several members referred to the administration of DTAs and TIEAs. The three types of information exchange: exchange on request, spontaneous exchange and automatic exchange were all mentioned.

73 In respect of automatic exchange, it was noted that the information received will be less useful unless there is co-ordination to ensure it is straightforward to match taxpayer details held by one tax administration to those held by another.

74 It was noted by New Zealand that spontaneous exchange can be very successful in practice, if staff members at the coal-face are encouraged to identify information to be exchanged when they come across suspicious transactions or transactions that they suspect would be of interest to another tax authority. Spontaneous exchange in this way can ensure that information is received at an earlier stage than if the recipient has to first commence an audit and make a request. It can also bring to a member's attention issues it was not even aware of.

75 There was a general discussion about the difficulties that may be encountered with EOI provisions in practice. A number of members noted that information requests must be specific and detailed to be valid, raising questions from other members about the level of detail required. This appears to be an

area in which there is some uncertainty between some members, and the group concluded that it may be useful for this issue to be considered further outside this SGATAR meeting. Singapore indicated that it has a legislated list of requirements that need to be fulfilled by requesting authorities. Such an approach would seem to be useful in providing clarity.

76 Some members mentioned advanced pricing agreements (APAs), which provide taxpayers with certainty about the future treatment of arrangements under transfer pricing rules. APAs can be unilateral or multilateral. The latter are more likely to foster links between tax agencies, although it was noted mutual agreement procedures to finalise these may create conflict as well.

Other international co-operation measures

77 The Joint International Tax Shelter Information Centre (JITSIC) was mentioned. JITSIC members send staff to JITSIC offices to collaborate on tackling international tax avoidance.

78 Other similar (but less formal) cross-agency networks of specialists were also mentioned as a possibility for the future.

79 These networks can make it less burdensome to bring tax avoidance arrangements to light and to understand them. They can also provide a means for sharing best practices for addressing such arrangements.

Conclusion of working group session

80 Following the presentations the Chairman thanked the presenters for their hard work, candour and insight.

81 He noted that there seemed to be a common understanding of the “mischief” of international tax avoidance. There was also a lot of common ground in the means used to combat such avoidance.

82 At the same time, individual members had presented some novel suggestions that had provoked thinking and discussion.

83 Following discussions, and after extending an invitation to address any further issues, the Chairman proposed that the meeting of the group be brought to a close. This proposal was accepted.