

## TAXREP 3/09

### OECD PROJECT ON HIGH NET WORTH INDIVIDUALS

***Memorandum submitted in February 2009 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a discussion paper entitled 'The OECD's Project on High Net Worth Individuals' published on 30 October 2008 by the OECD Centre for Tax Policy and Administration.***

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# OECD PROJECT ON HIGH NET WORTH INDIVIDUALS

## INTRODUCTION

1. The OECD set up a Focus Group in March 2008 to prepare a report on High Net Worth Individuals (HNWIs) as a follow up to its report on tax intermediaries published in January 2008. That initial report had focused on the role of large corporate taxpayers, and their advisers, in tax systems.
2. The main thrust of the first report was the role that enhanced co-operation could play in tax systems, coupled with an appropriate risk assessment strategy.
3. The report also explicitly recognised the key role that tax intermediaries play in tax systems 'in helping taxpayers understand and comply with their tax obligations in an increasingly complex world'.
4. The current work of OECD considers how tax administrations can improve the way in which they deal with HNWIs.
5. A Discussion Paper 'The OECD's Project on High Net Worth Individuals' was published in October 2008.
6. The Discussion Paper notes the important contribution that HNWIs make to the public finances and seeks to explore how the resources of tax administrations can be used more effectively and what role a more co-operative relationship could play in this new environment.
7. The Discussion Paper also notes that there is a 'change in the international environment towards more transparency and improved international tax co-operation', so the Focus Group also wishes to identify ways in which those with undisclosed assets and income could be encouraged to disclose previous non compliance (this is covered in section B of the Discussion Paper and in particular Question 5).
8. The Discussion Paper asks for general comments from advisors, interested HNWIs and others and, in particular, for comments on how HNWIs interact, and might interact more effectively in the future, with tax administrations.
9. We set out in this document our comments on the Discussion Paper.
10. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex B.

## Some key issues

### *HNWIs are a very disparate group of taxpayers*

11. The Discussion Paper recognises (paragraph 20) that HNWIs are not an homogenous group which means that to deal appropriately with them requires great knowledge and expertise of this particular sector of the taxpaying 'market place'. If this particular part of that market place is to be well served this will require a considerable commitment on the part of tax administrations to putting in place trained and skilful employees.

### *How are HNWIs going to be defined?*

12. There needs to be more clarity as to what is meant by HNWI as far as tax administrations are concerned. We discuss below the potential number of HNWIs in Germany based on the figures in paragraph 8 of the Discussion Paper. OECD needs to be clearer as to whether it is aiming to delineate a policy for dealing with the super wealthy, or the merely wealthy. In the context of Germany for example is it aiming to define appropriate parameters, for that particular tax administration, in relation to the top 0.1% of the taxpayers or the top 5%.

### *Trust*

13. Any system of enhanced co-operation will depend on the confidence of the relevant taxpayers that their particular tax administration will behave in accordance with its laid down arrangements and will operate in an appropriate and proportionate way.

### *Confidentiality*

14. Confidentiality is vitally important for HNWIs for a number of reasons which are set out in the paper below. If more information is to be available to tax administrations and shared between them then there needs to be a clear commitment to ensure that this information is to be safe from disclosure in the public domain.

## General comments

15. HNWIs will generally deal with tax authorities through their advisers and we believe that they will not be particularly interested in establishing a close, personal, relationship with those administrations. They will in the main be more than content to let their advisers act as their go-betweens.
16. It is also often the case that very wealthy individuals will have a panel of advisers dealing with different aspects of their affairs. So there is a range of individuals dealing with their affairs and the taxpayer is not personally involved, whether it be with a tax administration or any other third party.
17. What is important is that the people within the tax administration who are dealing with the affairs of HNWIs are conversant with the issues which are involved and are capable of dealing appropriately with them.
18. There needs to be a recognition on the part of tax administrations that HNWIs will adopt a particular business structure or will arrange their investments for a variety of reasons. These could be affected by issues of personal and family safety, protection of assets from business collapse and family breakdown and

lack of confidence in a country's financial regulation. The impact of taxation on the chosen strategy will also be relevant but it will not necessarily be the major factor. Tax administrations need to be aware of the multiplicity of motives that drive the actions and decisions of HNWIs.

19. We are not convinced that providing better services to HNWIs and engaging with them in a more positive way will necessarily produce more tax revenue. On the other hand it may give the tax administration assurance that HNWIs are complying with their fiscal obligations. It may also lead to better relationships between the tax administration and the HNWIs, or rather their advisers, which could reduce costs for both parties.
20. A co-operative compliance regime will require a considerable commitment from tax administrations. This will require significant initial investment, improved staffing levels, appropriate specialists, initial and ongoing training plus a commitment for this to continue.
21. It may be difficult in the current economic climate for tax administrations to produce a system which works well for all HNWIs.
22. Tax administrations could alternatively focus on identifying those who have avoided disclosing any of their assets or income to the relevant taxing authorities. This would benefit all. Indeed, arguably using resources to target those who do not comply at all may be a better application of resources than improving relationships with those HNWIs who are already engaging with the tax administration.
23. There should be acceptance by the tax authority that tax practitioners assist their clients to comply fully with the client's reporting and taxpaying obligations. Any compliance checks should start on the premise that nothing is being deliberately hidden or mis-represented unless there is clear evidence that that is not the case.
24. The definition of HNWI needs further consideration and it also needs to take account of differing income levels around the world.
25. There is a discussion of the criterion for selecting HNWIs in paragraph 12 of the discussion draft and this needs further elaboration.
26. In paragraph 8 it is noted that 0.1% of German taxpayers pay about 8% of total income tax and those taxpayers probably represent about 30 or 40,000 taxpayers in total. It is then stated that 5% of German taxpayers pay 40% of total income tax but this latter percentage probably represents well over one million taxpayers. It would in our view be unlikely for tax administrations to want to establish a special approach to such a large group of taxpayers.
27. In the UK the existing Complex Personal Returns unit which currently deals with about 45,000 of the wealthiest individuals is to be restructured. The number of taxpayers to be dealt with by the newly named High Net Worth unit will be reduced to about 5,000 of the very wealthiest individuals, defined by reference to wealth as well as income.

28. We believe there could be merit in identifying the very highest tranche of income tax payers, taking into account also their wealth, and considering what special approach is relevant in relation to that particular group of taxpayers.
29. But it is of paramount importance that any tax system, and the way it is administered is, and is seen to be, fair to all. So there should be no suggestion that individuals outside the remit of the HNWI approach are not being treated fairly.

**Set out below are our responses to the specific questions raised in the Discussion Paper: the Discussion Paper divides the issues into Organisational Aspects (Section A of the Discussion Paper) and Possible elements of a co-operative compliance approach (Section B of the Discussion Paper).**

### **Organisational Aspects – Section A of the Discussion Paper**

***Question 1:** What are the important features of tax administration that may facilitate the compliance approach? Please build on positive and negative experiences in dealing with your tax administration.*

30. We draw your attention to our Ten Tenets for a Better Tax System in Annex B. We have applied these tenets over the past ten years to identify the beneficial aspects of tax systems and we believe they apply equally well to the current investigation of how to improve the relationship between tax administrations and HNWIs.
31. Above all, the tax rules should be easy for all to understand and comply with.
32. The onus should therefore be on the tax administration to set out clearly and unambiguously the nature of the tax system, how it is to operate and for the rules to be applied consistently.
33. The tax treatment of a transaction should be certain at the time it is undertaken and should not change subsequently. Equally, the individual should have certainty in the case of cross-border transactions that all tax regimes will treat the transaction in the same way or, if tax law varies, that it is clear in each jurisdiction how the transaction will be dealt with.
34. Tax administration staff should be well trained and understand the practical and business issues which individuals face as well as the associated tax technical issues. It should not be necessary for either of these to have to be explained to them by the HNWI's advisers.
35. The persons administering the tax regime should be wholly impartial and have nothing to gain financially or otherwise by collecting more tax or investigating more individuals. Administrators of the tax system should not be open to bribery or corruption.
36. The tax administration should demonstrate an underlying trust in those dealing with it, so that individuals are deemed to be honest unless proven otherwise.

37. Bona fide commercial transactions should never be subject to anti avoidance legislation or treated less favourably simply because the transaction involves an entity which the home authority regards as 'favoured'.
38. Tax authorities need to have an awareness of different cultural backgrounds and approaches to tax compliance, Some tax authorities are open and publish all tax returns whereas others fiercely protect the confidentiality of individuals.
39. Conversely lack of any of the above features may make it less likely that individuals will engage with the tax authority.
40. There are, in addition, other issues which concern individuals and may lead them to consider becoming less compliant or non compliant in some respects.
41. Many HNWI's have considerable and well-founded concerns about the care taken of confidential information provided by them to tax authorities because although assurances are given about exchange of information and the safety thereof, in the real world mistakes can happen. Concerns about confidential information become greater when such information may be shared with other tax authorities, with or without the individual's knowledge because these other tax authorities may allow greater access to data by others and / or exercise less care with the data.
42. For example, there have been a number of losses of data in the UK by HMRC and other organisations. Leaks of personal information have a much bigger impact for some than others and personal safety may be at risk where financial data becomes public.
43. It should be remembered that the more personal information is passed from person to person and authority to authority, the more chance there is of its loss or unauthorised disclosure. As tax authorities do not always need information relating to an individual's worldwide affairs in order to tax that person correctly in their own country, they should only have access to the information that they need. Providing more than is required puts the individual to extra unnecessary expense and increases the risks associated with loss of data which are highlighted above.
44. Once disclosed, information will always be in the public domain and the act cannot be undone or the knowledge forgotten.
45. A self assessment system, such as in the UK, requires a taxpayer to provide a return of income and gains and compute their tax liability. The tax administration may then enquire into and potentially challenge the return. This can create a somewhat confrontational environment which may not be conducive to co-operative compliance.
46. However, advance agreement of items in a return is possible in only certain well-defined circumstances and HM Revenue & Customs (HMRC) does not comment before a return is submitted whether or not the proposed treatment of an item in the return is either correct or acceptable. This can result in a confrontational approach to tax compliance. It would be less confrontational if, where doubt exists, the individual could agree the treatment with HMRC prior to submission of the return so that both the return and tax paid are correct.

47. If individuals are not able to deal with the tax without obtaining professional advice, then it is arguable that the system may have become too complex. In the UK parts of the tax regime are extremely complicated and the legislation is not always well drafted or clear. HMRC and taxpayers then have to resort either to the judicial system for interpretation or follow guidance notes which have no statutory underpinning. Following one recent case, *Langham v Veltema*, the operation of law is such that a taxpayer can never be truly certain that their tax affairs are in order. Issues such as this need addressing urgently if individuals are to have confidence in the tax system.
48. Furthermore we do not consider that taxpayers should need to rely on guidance as to how a law should operate especially as such guidance may not be issued on a timely basis.
49. When advisers deal with HMRC it costs their clients money. Poor staff training and needing to provide unnecessary information and explanations mean that these costs can be higher than necessary. This means that advisers are increasingly likely not to wish to discuss issues with HMRC.

**Question 2:** *Do you think that having a dedicated unit (or units) as part of your tax administration (either at national or at regional level) with particular responsibilities for HNWI is a good idea? If you are generally supportive of such an idea, what roles and responsibilities do you think such a unit should assume?*

50. Overall we believe that HMRC already has sufficient information available to it to deal with HNWI and does not need a separate unit. However, and this is very important, this is on the basis that all HMRC staff are trained to a sufficiently high standard to be able to deal with issues which arise and if unable to do so, have access to appropriate resources including sufficient experienced staff.
51. Although it is likely, it is not inevitable, that HNWI will have more complex tax affairs than others and therefore the tax administration may find it more efficient to group staff who have suitable training and experience in separate units. This would be an operating issue rather than a requirement.

*In particular do you have any views on the following points?*

*a. How should a tax administration best gain insights into the behavioural drivers and the general context within which HNWI and their advisors operate? For instance, by employing staff with relevant private sector experience perhaps on secondment, on short term contracts, at the end of successful careers, or on permanent contracts. Should there be some form of advisory board involving advisors and other relevant market participants (e.g. private banks) or some other structured form of providing relevant background and context to the tax administration.*

52. We believe there is merit in secondment of staff from and to the private sector so that there can be a better understanding of the issues that face HNWI.

*b. What role and responsibility should the unit assume with respect to the affairs of the taxpayer (e.g. research and risk assessment or full responsibility for the file including potential audit)?*

53. We believe there is merit in keeping decisions about risk separate from the duties of dealing with the particular HNWI.

*c. What taxes relating to the HNWI and their affairs should such a unit deal with and why? instance, should it be limited to income taxes or also cover inheritance and estate taxes, VAT/GST etc.?*

54. There is merit in having all the affairs of the particular HNWI dealt with by a single part of the tax administration. But in practice that may be more of a co-ordinating role rather than a fully operational one. A HNWI is likely to have business activities, perhaps via an extended family, and trust, investment etc structures and there may well be professionals co-ordinating all these activities.

55. It would seem to us to be inappropriate for any tax administration to seek to mirror the role of the professionals who are organising all the disparate affairs of the particular HNWI. But there would seem to be merit in having some knowledge of the inter connections so that a rounded view can be taken of the affairs of any particular HNWI.

*d. Should the unit be responsible also for the affairs of all/certain entities controlled by a HNWI (e.g. only the personal affairs of the taxpayer, all operating entities and non-trading entities only non-trading entities)?*

56. Having a single unit responsible for all aspects of the tax affairs of a HNWI may not be appropriate especially where there are non resident businesses or where the business interests are shared with others.

57. Different entities have legal standing in their own right and should be treated in the same way as are other such entities where a HNWI is not involved.

58. A special unit should only be concerned with non resident entities to the extent that they are taxed in the home country.

*e. Should HNWIs and their advisors be assigned a designated contact point within the unit?*

59. We believe there is much merit in having a single designated contact point if an HNWI unit is established. Each HNWI will be a significant contributor to the public finances and is likely to have complex personal and commercial affairs with complex tax issues arising. Some individual should be responsible, on the tax administration side, to ensure that all the relevant issues are handled in an appropriate way.

*f. Should the unit be tasked with preparing an annual or periodic report about the overall environment and key developments, including the most pressing issues identified by HNWI and their advisors for use by the heads of tax administrations and finance ministries?*

60. If tax administrations are going to set up systems such that they are well informed about the issues facing HNWIs then it seems appropriate that the detailed knowledge that is gathered together should be shared. If there is going to be a genuine commitment to openness and transparency then sharing details

about the more general environment in which HNWI's are operating should be part of that commitment.

*g. Should additional safeguards and security procedures apply to the information held by the unit?*

61. All individuals, not just HNWI's, are entitled to have their personal information kept confidential and there should be rigorous procedures in place to ensure this.
62. However, it should be recognised that HNWI's, their families and businesses may be at more personal risk as a result of inappropriate use and disclosure of information. It is therefore imperative that those with access to that information, including those who have received it from another jurisdiction, should be aware of the possible effects on the HNWI of unauthorised disclosure or loss of the information.

**Question 3:** *If you are from a country that currently has a dedicated unit dealing with HNWI's what advantages or disadvantages have you seen in having such a unit and do you have any comments on the way it was set-up and is operated? What are the features that you find the most useful?*

63. In the UK we currently have dedicated tax offices called Complex Personal Returns Units (CPRUs) which deal with the income tax and capital gains tax affairs of 45,000 of the highest income individuals in the UK. These teams will shortly be reorganised, and their name changed to High Net Worth (HNW) units, and the taxpayers being dealt with by them will be reduced to 5,000 of the very wealthiest individuals. See our comments at paragraph 27 above.
64. The existing CPRUs are not considered a good model for what tax advisers would like from the units. The staff are not always suitably trained or experienced and enquiries into taxpayers' affairs seem to take much longer than they should, often due to staff lacking understanding of business and financial matters and having the erroneous view that HNWI's do not disclose all taxable income.
65. The new High Net Worth units aim is to be a 'one stop shop' with appropriate links to other tax specialists. At present it is not clear whether this will improve the situation.

### **Possible elements of a co-operative compliance approach – Section B of the Discussion Paper**

**Question 4:** *If the tax administration offered this or a similar approach, what would encourage HNWI's and their advisors to opt into it? In your answer please consider the points discussed below and indicate which points may be more important and which may be less important. Please also describe any other elements or concerns that you think would be relevant for HNWI's and their advisors (e.g. privacy concerns), and how these may be addressed.*

66. We consider that HNWI's would be encouraged to join a cooperative compliance regime if that regime:

- was able to give binding rulings on the tax treatment of transactions and in reaching its ruling focussed on the issue being addressed; and did not demand a knowledge of worldwide financial affairs;
- had the facility to agree an individual's residence position which would be binding on all jurisdictions concerned, because uncertainty over country of residence is a major worry for many HMWIs;
- fully addressed concerns about privacy and data transfer including situations where different jurisdictions apply differing levels of care and disclosure
- was more forthcoming as to how openness between other tax administrations is being applied;

**Question 5:** *The Focus Group seeks input from HNWIs and their advisors about the framework for voluntary disclosures and what particular elements would encourage taxpayers to come forward, e.g. solutions to issues such as lack of back-year records, inability to calculate final tax liability, concerns regarding privacy.*

67. In the UK under our professional ethics rules, tax practitioners do not condone evasion and do not act for evaders. HNWIs represented by qualified tax practitioners in the UK should therefore be compliant. Where an individual has not been complying with their obligations tax practitioners will assist in disclosure and negotiating a settlement.
68. It is therefore difficult for ICAEW to comment on the behaviour of non compliant individuals. We recommend that further work is undertaken to ascertain why certain individuals choose not to comply and what are appropriate incentives to draw such individuals back into the (compliant) system.
69. It should be noted that HNWIs are not the only group who may wish to make voluntary disclosures. However, HNWI are more likely inadvertently to transgress tax legislation in different tax administrations simply because their financial affairs can affect many countries and it can be difficult to keep up to date with changing rules in several tax regimes. As a result they may need to make disclosures when an error has been identified.
70. Amnesties (where tax and penalties are waived) for those who have not paid their taxes are unfair to those who have met their obligations and who may have lost competitive advantage as a result. However, we do recognise that there is a need to encourage individuals to disclose where they have not previously done so.
71. Interest charges should generally not be waived as this merely represents commercial restitution. Nevertheless, there are arguments for reducing, but not eliminating, other penalties so honest taxpayers can see justice to have been done and those taking advantage of the amnesty obtain some benefit (reduction in possible penalties) by doing so.
72. We consider that innocent non disclosure (mistakes) and culpable non disclosure (fraud) should be differentiated with the former attracting no penalties.

**Question 6:** *Please express your views on the merits of a product ruling regime in connection with HNWIs. In addressing this question please take a broad view of the term “product ruling” to include any form of advance certainty (whether formal ruling or not) and also consider which segment of HNWIs you think would be the users of the types of products for which product rulings could be made available (i.e., certain HNWIs might be more likely to enter into tailor made arrangements that do not lend themselves to product rulings).*

73. In the UK, as noted above, transaction rulings are generally not available for individuals although they are for businesses in certain circumstances.
74. An advance ruling system has attractions to taxpayers especially where it provides certainty of taxation treatment in the regime in which the transaction is being undertaken. Such rulings can be especially useful where mass marketed products (eg discounted gift schemes, loan trusts) are concerned.
75. We are, however, concerned that where one-off rulings are sought, the tax administration might use this as an opportunity to carry out what we refer to as a ‘fishing expedition’ to obtain more information about unrelated and irrelevant transactions, involving clients in unnecessary costs, both in terms of time and money.
76. One area in which advance rulings are likely to prove very helpful is tax residence. This is fundamental to how an individual is taxed but often unclear. Sometimes different tax administrations interpret the same double tax treaty in different ways; having a ruling which is binding on both treaty tax administrations would be desirable.

**Question 7:** *Do you have any other comments which you wish to make?*

77. There seems to be an underlying theme to the paper that building trust and having closer relationships with HNWIs will improve compliance. We would like to see this premise examined in more detail. For example, what information is available to indicate that HNWIs are not compliant, or are less compliant, than other sectors of the population? Just because their financial affairs may involve more than one country and the arrangements appear complicated does not, in itself, indicate that the individual will not comply with their fiscal obligations. In these cases the individual almost certainly has a number of advisers who help them to be compliant.
78. Similarly, the report suggests that exchange of information and greater transparency would be desirable. Information which is not relevant is not necessary and has an associated cost to both the tax administration and the individual. Too much information can be as bad as too little.
79. The Focus group should also consider what it is hoping for as an outcome to the discussions and whether co-operative compliance is what tax administrations should be striving to achieve. If the aim is to extract more tax from the same taxpayer population, targeting the wholly non compliant (whether or not HNWI) may be a better focus of the resources of the tax administration.
80. The non compliant and evaders, whether HNWI or not, often do not engage with the tax administration at all. We consider that tax administration resources

should be targeted on those that warrant it including those who do not comply as well as those who do.

81. It has been suggested that some taxpayers may be willing to pay a fee to have their return reviewed immediately after submission and obtain earlier certainty that no enquiries will be necessary. That would produce a two tier system according to ability to pay which we consider to be unacceptable.
82. In our experience most individuals do not wish to subvert the system but wish to comply with their obligations.
83. The authorities alone should be responsible for identifying both evaders and the non compliant and should risk assess their own systems.

## ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at [taxfac@icaew.com](mailto:taxfac@icaew.com) or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

## THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see <http://www.icaew.co.uk/index.cfm?route=128518>.