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Change of Climate in Taxation: Are You Prepared for Extended Responsibilities?

Report from the 6th CFE Professional Affairs Conference in Milan on 22 November 2013.

Against the background of recent international and EU action against "harmful tax practices", the 6th Professional Affairs Conference of the CFE (*Confédération Fiscale Européenne*, the European federation of tax advisers) on 22 November 2013 in Milan shed light on changes to the responsibilities of tax advisers that these measures could entail. Risks arise from the – at times intended – loss of legal certainty and from changing interpretations of the law by tax authorities and may include civil liability to clients, exclusion from public sector work, disciplinary sanctions and even criminal penalties. The conference was co-hosted by the Italian tax professional organisation A.N.T.I. (*Associazione Nazionale Tributaristi Italiani*), a member of the CFE. The moderator was Dick Barmentlo, Chairman of the CFE Professional Affairs Committee.

The first speaker was Theo Poolen, Deputy Commissioner of the Netherlands' Tax and Customs Administration. He presented the relevant developments from the 2008 OECD Study on Tax Intermediaries[1] to the 2013 report on Co-operative Compliance,[2] seeking an answer to the question whether tax advisers are expected today to serve two masters, their client and the state.

Theo Poolen observed that since the OECD's Forum on Tax Administration in Seoul (2006), there has been a significant change in the perception of tax advisers by administrations. Initially, they had been viewed as being responsible for the erosion of the tax base – *see* the final declaration of the Forum's meeting in Seoul. The Forum's meeting in Cape Town (2008) indicated a different view on the role of tax intermediaries. The Cape Town declaration stated: "tax intermediaries play a vital role in all our tax systems by helping taxpayers understand and comply with their tax obligations in an increasingly complex world". Tax intermediaries can play a pivotal role by endorsing transparency and thus can become trustworthy stakeholders for tax authorities. Since 2008, tax authorities, tax intermediaries and taxpayers have developed enhanced relationships based on the principles of trust, mutual understanding and transparency. The 2013 follow-up report on Co-operative Compliance – a more appropriate name for the "enhanced relationship", observed that 24 of 26 surveyed countries had developed supervisory approaches based on trust, understanding and transparency.

In 2005, the Netherlands introduced their form of enhanced relationship, called "Horizontal Monitoring", a programme that endorses concluding compliance agreements between large taxpayers and the Netherlands Tax and Customs Administration. Companies commit themselves to introducing "tax control frameworks" (TCFs), in line with the trend of corporate governance reform in many countries, initiated by the United States' Sarbanes-Oxley Act of 2002.[3] A solid TCF shows that a company is in control. Tax advisers can play an important role in maintaining tax control frameworks. The Netherlands is the only country surveyed that offers cooperative compliance also to SMEs, with the particularity that these compliance agreements are concluded between the tax administration and tax advisers; thus, SMEs do not conclude individual compliance agreements.

An important element of co-operative compliance is that it provides an opportunity to discuss upfront tax issues that can raise doubt about their legal status, thus providing "certainty in advance" and avoiding ex-post supervisory investigations. Having a compliance agreement does not mean that the parties cannot have different opinions; there is always the right to "agree to disagree" and the agreement does not close the route to court. Neither is co-operative compliance aimed at creating a more favourable tax treatment for participating taxpayers. Increased legal certainty on the tax position may well be a positive effect for the company, but its tax liability is not affected. Theo Poolen concluded that co-operative compliance is not about *fair share* but about *fair play*.

Asked for his view on the dividing line between aggressive and regular tax planning, Theo Poolen said that if a taxpayer frequently and repeatedly changes his planning, with the apparent single aim of reducing his tax liability to zero, this would probably be seen by tax authorities as aggressive. A marketed scheme would not *per se* be aggressive, but a high price of a marketed scheme could well indicate that the user and promoter consider it risky. Governments should not be forced to spend their resources on giving aggressive planners certainty. He advised tax advis-

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1. OECD Forum on Tax Administration, *Study into the Role of Tax Intermediaries*, April 2008, available at http://www.oecd.org/tax/administration/studyintotheroleoftaxintermediaries.htm.
2. OECD Forum on Tax Administration, *Co-operative Compliance: A Framework. From Enhanced Relationship to Co-operative Compliance*, May 2013, available at http://www.oecd.org/ctp/administration/co-operative-compliance.htm.
3. US: Sarbanes-Oxley Act, 2002, 116 Stat. 745, enacted 30 July 2002.

ers to discuss with their clients their past tax arrangements, accepting that times have changed.

Giuseppe van der Helm, CEO of the Dutch Association of Investors for Sustainable Development (VBDO) and President of Tax Justice Netherlands, advocated the benefits of sustainable tax planning.

Forward-looking planning that anticipates regulatory changes could not only help prevent reputation damage where public opinion expects a company to do more than the law requires, but could also help the company adjust to new rules before they are binding. Companies that realize that reporting on corporate social responsibility and tax payments will come in one form or another will have time to implement internal data collection processes so that this information is available when required by law.

Investors take a close look at companies and their ability to adapt to changing environments, with a special focus on risks, so tax advisers should ensure that a company does not defend risky tax positions. While in the past analysts often paid little regard to tax, considering it too technical, this has changed.

Tax advisers remain service providers who should not impose their thinking on a company. Decisions remain with the Board. However, tax advisers could help to raise awareness and ensure that the Board is in possession of the relevant facts. It is important to ask other stakeholders with regard to the well-being of a company, such as employees, investors, customers and suppliers about their expectations. The outcome could create a surprise for CEOs but could also take some of their worries away, as it may add legitimacy to their decisions.

Giuseppe van der Helm reminded participants that ethical standards for tax advisers going beyond the requirements of the law exist in many countries and are considered an integral part of the balance of rights and obligations of tax advisers, as expressed in the draft Model Taxpayer Charter.[4]

John P. Cullinane, Managing Partner Tax Quality and Risk at Deloitte UK, referred to the recent *Mehjoo* (2013) case[5] of the UK High Court in which an accountancy firm was held liable for not having made the client aware of an offshore tax planning opportunity that would have resulted in tax savings.

Depending on the terms of their contracts with their clients (including the implied terms they establish by their conduct), tax advisers may become duty bound to give ad hoc advice, even if not actively sought by the taxpayer, which includes referring them to specialists if necessary. However, whether there is an obligation to help minimize a client's tax bill and the extent of such advice required, ultimately depends on the individual engagement. To limit liability, tax advisers can put limitations on the engagement in contractual terms, reserving for themselves the discretion not to advise on certain schemes they consider inappropriate, for example, if they could bring the client or their own firm into disrepute.

John Cullinane emphasized the importance of understanding the individual client's interest when deciding whether or not to offer advice. This is determined by very different parameters, such as the resources and time a client would need to implement a certain arrangement, its expected commercial benefit and impact on reputation, the likelihood of non-acceptance by tax authorities and the taxpayer's readiness and ability to defend the arrangement and to bear the risk of legal uncertainty in the event of litigation.

Although morality is and should remain outside the reach of the law, it cannot be ignored and, indeed, due to public and media attention to tax avoidance, it often is associated with reputation risk.

As to the assumed "spirit of the law", John Cullinane remarked that it is hard to translate the purpose of tax provisions into practical guidance, as the purpose of most tax legislation is simply to collect money. The downside of the change of moral climate is that it suspends any incentive for the legislator to improve the quality of legislation.

The third panel discussed whether advice given to clients in the past could backfire on tax advisers, due to changes in the interpretation of the law by tax authorities.

Ivo Caraccioli, President of the Centre for Criminal Tax Law and partner of Valente Associati GEB Partners, analysed tax adviser liability under the Italian Criminal Tax System. Prof. Caraccioli started by outlining the particularities of the Italian criminal tax system vis-à-vis other Member States. The Italian criminal tax system not only punishes fraudulent behaviour and the use of false documentation, but, unlike the systems of other Member States, sets forth penalties (such as imprisonment) even for behaviour merely relating to inaccurate tax returns in terms of income and VAT exceeding given quantitative limits and omitted tax payments. Ivo Caraccioli then proceeded to explain that, in addition to the taxpayer's own criminal liability, it is often assumed that the tax adviser is liable as an accomplice.

In his opinion, international taxation is an area of increasing criminal risks due to the complexity of transactions and tax in general, which usually requires technical advice from highly specialized professionals. These topics include fictitious foreign residence (which can involve the offence

4. M. Cadesky, I. Hayes & D. Russell, *Towards greater fairness in taxation – A Model Taxpayer Charter*, published in May 2013 by the Asia-Oceania Tax Consultants' Association, the *Confédération Fiscale Européenne* and the Society of Trust and Estate Practitioners. The draft Model is available at http://www.cfe-eutax.org/sites/default/files/Model%20Taxpayer%20Charter,%20preliminary%20report,%20text.pdf.
5. UK: HC, 5 June 2013, *Mehjoo*, [2013] EWHC 1500 (QB); 25 Mar. 2014, [2014] EWCA Civ 358. Since the conference, the earlier UK Court decision in the *Mehjoo* case was overturned. The UK Court of Appeal concluded that Mr Mehjoo's "chartered accountants" were *not* obliged to advise him of specialist areas outside their knowledge as general tax advisers, beyond the terms of their contract and in the absence of stronger indications of accepting a wider remit by their conduct than existed in the facts of that case. It is not clear if there will be a further appeal to the UK's Supreme Court. In any event, the new decision strengthens the importance of the written engagement letter or other contract between the adviser and the client.

of "omitted tax return"),[6] hidden or multiple permanent establishments (which can involve the offences of "omitted tax return" or of "discrepant tax return"),[7] and transfer pricing challenges with regard to the determination of transfer prices among various countries, with consequent tax savings deemed illegal.[8]

In addition, Prof. Caraccioli emphasized that, more and more, tax must be in the boardroom. Company CFOs nowadays wish and need to be informed by CEOs with reference to general corporate policies; tax issues are no longer seen by CFOs as marginal matters.

Tax advisers advising companies risk being incriminated for tax crimes as accomplices in collusion with the company's in-house parties (who might have signed tax returns), although they might have limited their services to the provision of advice and to eventually proposing possible solutions. Only when the company has withheld facts from the tax adviser, or when the adviser has been misled as to the true nature of certain financial transactions, will the good faith of the tax professional be fully corroborated.

In light of the above, Ivo Caraccioli explored possibilities for tax advisers to avoid incurring any criminal risks. One solution was the issuance by top management executives of some kind of "statement of comprehensiveness" specifically stating that tax advisers have had access to all factual elements that are necessary to reach a particular decision.

Finally, the implications of the EU Anti-Money Laundering Directive (2005/60)[9] and the expected amendments to the Italian anti-money laundering provision (article 648ter of the Criminal Code) for tax advisers were discussed.

Andrew Cole, Director Specialist Investigations from the UK tax administration HMRC, explained HMRC's policies towards users, advisers and promoters of high-risk schemes, as well as tax compliance as a prerequisite with regard to public procurement.

Recognizing that tax advisers are vital to the functioning of the tax system, HMRC expects them to be transparent and cooperative.

High-risk schemes cause damage to the taxpayer not only by reducing the amount of tax but by binding the tax administration's resources.

When deciding on the opening of criminal investigations, a particularly severe circumstance for HMRC is the inducement of others to submit claims based on fraudulent arrangements. Key elements in this can be an individual's position of trust or responsibility, as often held by tax advisers, and the use of materially false statements or documents to enhance the credibility of a scheme. There have been cases where the promoters of fraudulent schemes have been sentenced to several years of imprisonment.

A very different form of sanctioning non-compliant tax behaviour is the exclusion of taxpayers from public procurement procedures. Under the UK's Public Contractions Regulations, a supplier can be disqualified from participating in a procurement process if it has not fulfilled its tax obligations. This includes tax compliance in other jurisdictions where the operator is established. The tenderer must state whether or not there have been any criminal convictions or civil fraud or evasion penalties in the past six years, returns submitted (after 1 October 2012) have been challenged under the new UK General Anti-Abuse Rule (GAAR)[10] or the *Halifax* principle,[11] or a failed avoidance scheme was, or should have been, notified under the Disclosure of Tax Avoidance Schemes rules (DOTAS). Occasions of non-compliance have to be self-certified and the tenderer has to demonstrate that measures have been put in place to avoid repetition.

The UK government recently announced proposals aimed at the behaviour of high-risk avoidance promoters. This is an adaption of HMRC's existing practice of "naming and shaming" serious defaulters who have committed civil or criminal offences. The proposals will extend to promoters and intermediaries such as tax advisers. They will include new information powers enabling HMRC to get early knowledge of new schemes and potential penalties for non-compliance.

In 2013, there was an initiative by HMRC to contact users of schemes directly, cutting out advisers and promoters. The experience was that users, especially first-time users, were often unaware that they had been using questionable avoidance schemes.

Asked about risks for tax advisers arising from retroactivity of tax legislation, Andrew Cole explained that the UK GAAR is not retrospective but only applies for returns and schemes after July 2013. HMRC is aware of uncertainty issues with past arrangements and has endeavoured to provide guidance.

Giuseppe Arbore, Head of the Revenue Protection Office of the III Department "Operations" of the General Command of the Italian Tax Police (*Comando Generale della Guardia di Finanza*), explained the practice of the Italian *Guardia di Finanza* on the concept of "abuse of right".

Giuseppe Arbore started by raising two key questions:

(1) Where do the boundaries between aggressive tax planning and legitimate tax planning lie?

(2) Which liabilities may tax advisers incur?

6. IT: Legislative Decree No. 74 of 10 Mar. 2000, *ex* article 5.
7. Id., *ex* article 4.
8. Pursuant to the aforementioned article 4.
9. Anti-Money Laundering Directive (2005): Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, OJ L 309/15 (2005), EU Law IBFD.
10. UK: Finance Act 2013, Part 5 and Schedule 43, National Legislation IBFD.
11. According to UK: ECJ, 21 Feb. 2006, Case C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v. Commissioners of Customs & Excise, BUPA Hospitals Ltd, Goldsborough Developments Ltd v. Commissioners of Customs and Excise and University of Huddersfield Higher Education Corporation v. Commissioners of Customs and Excise,* ECJ Case Law IBFD.

Arbore outlined the complexity and the divergencies concerning the definition of "abuse of law" between countries and stressed that countries compete among themselves even in the field of "abuse of law" (different approaches and different definitions). The concept "abuse of right" in Italy is the result of an interpretative construction of a jurisprudential nature and there is not a clear provision defining it.

Based on case law, the key element to assess an "abusive practice" in Italy is the obtainment of an undue tax advantage from the distorted use of an available juridical instrument, which is inconsistent with any specific provision, with the aim of achieving a tax saving in the absence of clear economic reasons (other than the mere expectation of obtaining a tax advantage or saving) for entering into that operation.[12]

To assess the "distorted use" the taxpayer must have obtained a tax saving and also made use of an available tool with the sole aim of obtaining a tax advantage. In light of this, tax authorities must delve deep into the merits of the transactions and must demonstrate that the transactions under assessment lack clear and significant business reasons that could justify them.

The difference between the Italian tax framework and the German tax framework was also highlighted. Italy adopted a semi-general rule to counteract abusive legal transactions,[13] while Germany opted for setting forth a general anti-avoidance rule.[14]

On the interpretation of concepts such as "abuse", the key role of ECJ case law – setting the limits and providing guidance – was stressed. The *Halifax* decision was cited, and the proposed test for abuse, which involves an objective element (that the tax advantage achieved is contrary to an EU law rule) and a subjective element (that the main purpose of the transactions was obtaining a tax advantage) was discussed.

Arbore then emphasized the Italian Supreme Court's Decision No. 30055 of 23 December 2008,[15] in which, for the first time, the Court held that a general anti-avoidance principle derives directly from the Constitution (article 53), pursuant to which where there are no actual economic reasons for entering into a transaction, i.e. the sole aim is to obtain a tax advantage, the transaction can be challenged by the competent tax authorities.

According to the operational experience of the *Guardia di Finanza*, as set out in their auditing activity reports, most of the tax recovery proposals are based on article 37bis of Presidential Decree No. 600/1973, which sets forth a general principle of artificiality in tax arrangements. Arbore stressed that, since 2010, there have been only 150 audits to which article 37bis was applied. The findings of the *Guardia di Finanza* based on the "abuse of right" stem from a pragmatic approach aimed at detecting aspects of business operations that are economically unreasonable based on normal market logic, if not merely ensuring tax savings. The *Guardia di Finanza* does not mechanically apply the anti-abuse rule. A careful assessment of the effective "business purpose" is carried out. The technical advice given by tax advisers with regard to a specific operation is also taken into consideration whenever the liability of the taxpayer is assessed in order to better assess the merits of the transactions under review.

Arbore also addressed penalties with regard to tax avoidance and abusive conduct. Although the ECJ has ruled, "that the finding of the existence of an abusive practice must not lead to a penalty, which would require a clear and unambiguous legal basis, but simply to an obligation to repay some or all undue deduction of VAT paid upstream […]",[16] it is common practice that administrative and criminal penalties will apply (as is the case in Italy).

As for the prospects and expectations of legislative action, Giuseppe Arbore would favour the codification of the "abuse of right". In his opinion, a stable and more certain framework would foster foreign investment in Italy. This provision would clearly set the limits between legal tax saving and illegal tax advantage. Giuseppe Arbore also commented that abuse should be redefined in a statute of taxpayers' rights, as opposed to specific tax laws, so that it would apply to all taxes.

12. IT: SC, 16 Feb. 2012, Decision No. 2193.
13. IT: Presidential Decree No. 600 of 29 September 1973, article 37bis, paragraphs 1 and 2 provide that:

    1) Acts, facts and transactions, whether or not they are interrelated, having no valid economic reasons, designed to evade obligations or prohibitions imposed by the Italian tax regulations and to obtain tax reductions or refunds – otherwise not due – are not enforceable vis-à-vis the tax authorities.

    2) The tax authorities shall disallow any tax advantage obtained as a result of the acts, facts and transactions referred to in the previous paragraph, assessing the taxes determined on the basis of the provisions which have been evaded, net of any taxes due as a result of the arrangements which are not enforceable vis-à-vis the tax authorities.
14. The German GAAR is provided for under DE: General Tax Code (*Abgabenordnung*), section 42, National Legislation IBFD.
15. IT: SC, 23 Dec. 2008, Decision No. 30055.
16. *Halifax* (C-255/02), para. 93.