

# Curtailing aggressive tax planning: the case for introducing mandatory disclosure rules in Australia (part 1)

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## ***Abstract***

Globalisation has increased opportunities for aggressive tax planning (ATP) schemes by multinational enterprises. However, tax administrations may not always have timely, targeted and comprehensive information about these schemes. This presents a struggle from a policy perspective, since most anti-avoidance laws are reactive – rather than proactive – in nature.

One exception is the use of mandatory disclosure rules (MDRs), which require the upfront disclosure of tax information. These rules can provide governments with the transparency needed to respond more quickly to tax risks.

This article explores the general case for introducing MDRs by (in part 1) presenting a case study of Australia's experience in considering whether to adopt such a regime. This will be followed (in part 2) by a comparative legal analysis of how these rules apply in the UK and South African contexts, the experiences of which are informative in framing a regime suitable for adoption in other Commonwealth law jurisdictions such as Australia.

**Key words:** mandatory disclosure rules, aggressive tax planning, multinationals, international tax law

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## 1. INTRODUCTION

Globalisation has increased opportunities for aggressive tax planning (ATP) by multinational enterprises, which often adopt tax planning strategies by utilising loopholes in tax laws within legal parameters.<sup>1</sup> However, these schemes may also go well beyond what is legally acceptable, by using artificial transactions that have little or no actual economic impact and which are in turn at odds with the intention of countries' tax legislation.<sup>2</sup>

Over the past three decades, countries have seen a proliferation of ATP schemes and have developed responses that include general and specific anti-avoidance rules, penalty regimes, tax rulings, disclosure regimes, exchange of tax information agreements and cooperative corporate governance practices.<sup>3</sup>

In general, most of these measures are reactive – rather than proactive – in nature. As such, the problem is that most tax administrations do not have timely, targeted and comprehensive information, which is essential to enable governments to quickly identify and respond to risk areas.<sup>4</sup> Tax administrations usually detect these schemes by auditing taxpayers' returns, which is followed by enactment of anti-avoidance rules. While audits remain a key source of relevant information, the inevitable delays in the rule-making process mean that years may pass before the schemes are curtailed.<sup>5</sup> This renders audits ineffective for early detection of ATP schemes.<sup>6</sup>

Accordingly, one measure that is increasingly being adopted by countries is enacting mandatory disclosure rules (MDRs) to help governments respond more quickly – and proactively – to tax risks. The rules operate as a self-assessment system by requiring scheme promoters and/or their clients to make early disclosure of their ATP arrangements so that they can be curtailed, if necessary, before they are put in place.<sup>7</sup> Despite the increasing number of countries that have introduced MDRs, Australia does not yet have them. One of the main arguments made is that Australia already has a number of anti-avoidance and disclosure rules which serve to deter ATP, thus obviating the need for MDRs.<sup>8</sup> However, like Australia, other countries also have anti-avoidance and other disclosure rules, but they have also enacted MDRs, due to differences in the objectives of MDRs and the other rules (as explained in section 3 below). Nevertheless, after the OECD issued its 2015 report on curtailing base erosion and profit shifting

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<sup>1</sup> David Meyerowitz, *Meyerowitz on Income Tax* (2008), para 29.1; Annamarie Rapakko, *Base Company Taxation* (Kluwer Law and Taxation Publishers, 1989) 39; Ann Kayis-Kumar, 'What's BEPS Got To Do With It? Exploring the Effectiveness of Thin Capitalisation Rules' (2016) 14(2) *eJournal of Tax Research* 359.

<sup>2</sup> Review of Business Taxation (John Ralph, chair), *A Tax System Redesigned: More Certain, Equitable and Durable*, Final Report of the Review of Business Taxation (1999) recommendation 6.2(c).

<sup>3</sup> Organisation for Economic Co-operation and Development (OECD), *Tackling Aggressive Tax Planning through Improved Transparency and Disclosure* (OECD Publishing, 2011) 11.

<sup>4</sup> OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD Publishing, 2013) 22.

<sup>5</sup> Gilles Larin and Robert Duong with a contribution from Lyne Latulippe, 'Effective Responses to Aggressive Tax Planning: What Canada Can Learn from Other Jurisdictions, Instalment 4: United Kingdom – Disclosure Rules' (Study by the Research Chair in Taxation and Public Finance, University of Sherbrooke, July 2009).

<sup>6</sup> OECD, *Action Plan on Base Erosion and Profit Shifting*, above n 4, 22.

<sup>7</sup> OECD, 'OECD's Work on Aggressive Tax Planning', [www.oecd.org/tax/exchange-of-tax-information/atp.htm](http://www.oecd.org/tax/exchange-of-tax-information/atp.htm).

<sup>8</sup> Stephanie Caredes, 'Mandatory Disclosure: Is This Necessary in Australia?' (2016) 15(3) *Taxation in Australia* 117.

(BEPS),<sup>9</sup> which recommended using MDRs to curtail ATP, the Australian Treasury issued a Discussion Paper<sup>10</sup> that sought community views on how MDRs should be framed in the Australian context having regard to the disclosure rules already in place. Although the closing date for submissions was 15 July 2016, the government anticipates further consultations on implementation design issues.<sup>11</sup>

This two-part study explores the case for introducing MDRs, presenting (in part 1) a case study of the Australian experience in considering whether to adopt such a regime, to be followed (in part 2) by a comparative legal analysis of how these rules apply in the UK and South Africa, whose experiences may be informative in framing a regime suitable for adoption in a Commonwealth law jurisdiction.

Specifically, the Australian Treasury's Discussion Paper serves as a framework for the analysis in this article, which will provide resourceful and comprehensive responses to the matters raised in the context of a jurisdiction contemplating whether to introduce MDRs. It highlights the objectives and advantages of MDRs; and, in response to the concerns in the Discussion Paper, it argues that MDRs will enhance the information available to the Australian Taxation Office (ATO) to crack down on ATP. It provides recommendations to ensure that the rules do not unnecessarily overlap with existing disclosure rules, do not impose unnecessary compliance burdens on taxpayers, and ensure an appropriate balance of competing policy priorities.<sup>12</sup> In Part 2, the study will make recommendations with respect to the government's anticipated further consultations on implementation design issues.<sup>13</sup> In this regard, it will draw on the OECD recommendations for the design features of effective MDRs. Acknowledging the OECD recommendation that countries that wish to adopt MDRs should draw on the experiences of other countries that have such rules,<sup>14</sup> Part 2 will provide a comparative study of how the rules apply in two Commonwealth countries – the UK and South Africa – the experiences of which may be informative in framing a regime suitable for a Commonwealth law jurisdiction. This study overall contributes to the body of knowledge and resources that the Australian Government, and other Commonwealth countries, may refer to if they wish to introduce MDRs.

## 2. BACKGROUND

To meet the challenge faced by most tax administrations in responding quickly and adequately to prevent ATP schemes from exploiting tax systems, one measure that is increasingly being adopted worldwide is to enact MDRs. These rules require scheme promoters and/or their clients to report their ATP arrangements in advance, enabling tax administrations to curtail them, if necessary, before they are put into use. The timely and targeted detection of such schemes enables countries to quickly adopt risk management strategies as well as legislative and administrative measures to counteract tax risk.<sup>15</sup> The United States was the first country to introduce these rules in 1984 (which

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<sup>9</sup> OECD, *Mandatory Disclosure Rules: Action 12 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2015).

<sup>10</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information: Discussion Paper* (2016).

<sup>11</sup> *Ibid* para 7.

<sup>12</sup> *Ibid* para 9.

<sup>13</sup> *Ibid* para 7.

<sup>14</sup> OECD, *Action Plan on Base Erosion and Profit Shifting*, above n 4, 22.

<sup>15</sup> OECD, 'OECD's Work on Aggressive Tax Planning', above n 7.

have since undergone many changes),<sup>16</sup> with a focus on the use of abusive tax shelters.<sup>17</sup> It was followed by Canada, which in 1989 enacted a tax shelter regime for specific tax planning arrangements involving gifting arrangements and the acquisition of property; and which also in June 2013 enacted reportable tax avoidance transactions legislation, with much broader reporting requirements.<sup>18</sup> South Africa introduced reportable arrangements legislation in 2003; the legislation came into force in 2005 and was subsequently revised in 2008.<sup>19</sup> The UK enacted MDRs in 2004<sup>20</sup> and revised them substantially in 2006; they entered into force on 1 January 2011. Ireland introduced MDRs in 2011, and since then Korea, Portugal and Israel have also introduced these rules.<sup>21</sup>

With the increasing number of countries introducing MDRs, the OECD has over the years issued a number of reports that validate the importance of these rules in curtailing ATP. In 2011, the OECD issued a report on transparency and disclosure initiatives.<sup>22</sup> It evaluated the effectiveness of various disclosure initiatives in OECD countries in the early detection of ATP and recommended that OECD member countries should adopt MDRs, taking into consideration their particular needs and circumstances.<sup>23</sup> In 2013, the OECD issued a further report on cooperative compliance programmes,<sup>24</sup> which encouraged taxpayers to make full disclosure of material tax issues and transactions they have undertaken so as to enable tax authorities to understand their tax impact. In addition to these reports, the OECD has an ATP Directory,<sup>25</sup> which is a confidential database of ATP schemes maintained by certain OECD and G20 countries. The directory is populated with ATP schemes submitted by countries that have access to it and it covers over 400 ATP schemes.<sup>26</sup>

When the OECD issued its 2013 Action Plan<sup>27</sup> and its 2015 package of 15 measures to curtail BEPS, it reiterated the usefulness of MDRs in providing tax authorities with comprehensive and relevant information for the early detection of ATP strategies. After reviewing the operation of MDRs in various countries,<sup>28</sup> in Action 12 of the BEPS reports, the OECD recommended best practices for the design of effective MDRs to effectively target aggressive tax planning by multinational enterprises. These recommendations aim to ensure international consistency in how the rules are applied,

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<sup>16</sup> Jay A Soled, 'Tax Shelter Malpractice Cases and Their Implications for Tax Compliance' (2008) 58(2) *American University Law Review* 267.

<sup>17</sup> Stephen Dellett, 'Abusive Tax Shelters After the Tax Reform Act of 1984' (1985) 42(1) *Washington and Lee Law Review* 247.

<sup>18</sup> OECD, *Public Discussion Draft, BEPS Action 12: Mandatory Disclosure Rules* (11 May 2015) para 37.

<sup>19</sup> See the Reportable Arrangements Rules in Part B of the *Tax Administration Act 28 of 2011*.

<sup>20</sup> *Finance Act 2004* (UK).

<sup>21</sup> OECD, *Public Discussion Draft*, above n 18, para 37.

<sup>22</sup> OECD, *Tackling Aggressive Tax Planning*, above n 3.

<sup>23</sup> OECD, *Tackling Aggressive Tax Planning*, above n 3, 6.

<sup>24</sup> OECD, *Co-operative Compliance: A Framework, From Enhanced Relationship to Co-operative Compliance* (OECD Publishing, 2013).

<sup>25</sup> OECD, 'Aggressive Tax Planning Directory', <http://www.oecd.org/tax/exchange-of-tax-information/oecdaggressivetaxplanningdirectory.htm>. The directory is a secure online resource for government officials which is intended to help governments keep pace with aggressive tax planning.

<sup>26</sup> OECD, 'Aggressive Tax Planning', <http://www.oecd.org/tax/aggressive/>.

<sup>27</sup> OECD, *Action Plan on Base Erosion and Profit Shifting*, above n 4, 22.

<sup>28</sup> OECD, *Public Discussion Draft*, above n 18, 1.

taking into consideration the needs and risks in specific countries as well as the administrative costs for tax administrations and businesses.<sup>29</sup>

For completeness, the term ‘aggressive tax planning’ (ATP) appears to have been coined by the OECD Forum on Tax Administration. The Forum was established in July 2002<sup>30</sup> to bring together the heads of tax authorities in OECD member countries and some non-OECD countries to develop effective responses to current tax administration issues in a collaborative way.<sup>31</sup> In 2006, the Forum held a meeting in South Korea, which identified ATP as one of the issues they would focus on so as to identify its trends and to come up with measures to counter the same.<sup>32</sup> Members of the Forum expressed the concern that:

Enforcement of our respective tax laws has become more difficult as trade and capital liberalisation and advances in communications technologies have opened the global marketplace to a wider spectrum of taxpayers. While this more open economic environment is good for business and global growth, it can lead to structures which challenge tax rules, and schemes and arrangements by both domestic and foreign taxpayers to facilitate non-compliance with our national tax laws.<sup>33</sup>

The concept of ATP was, however, only defined by the OECD in 2008, when it conducted a study of the role of tax intermediaries<sup>34</sup> in enhancing relationships between tax authorities and large business taxpayers. The glossary in that study<sup>35</sup> defines ATP with respect to two areas of concern for revenue bodies:

**Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences.** Revenue bodies’ concerns relate to the risk that tax legislation can be misused to achieve results which were not foreseen by the legislators. This is exacerbated by the often lengthy period between the time schemes are created and sold and the time revenue bodies discover them and remedial legislation is enacted.

**Taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law.** Revenue bodies’ concerns relate to the risk that taxpayers will not disclose their view on the uncertainty or risk taken in relation to grey areas of law (sometimes, revenue bodies would not even agree that the law is in doubt).

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<sup>29</sup> OECD, *Action Plan on Base Erosion and Profit Shifting*, above n 4, 22.

<sup>30</sup> OECD, ‘Forum on Tax Administration’, <http://www.oecd.org/tax/forum-on-tax-administration>.

<sup>31</sup> Philip Baker, ‘The BEPS Project: Disclosure of Aggressive Tax Planning Schemes’ (2015) 43(1) *Intertax* 85; John McLaren, ‘The Distinction Between Tax Avoidance and Tax Evasion Has Become Blurred in Australia: Why Has It Happened?’ (2008) 3(2) *Journal of the Australasian Tax Teachers Association* 141.

<sup>32</sup> OECD, *Seoul Declaration: Third Meeting of the OECD Forum on Tax Administration* (14–15 September 2006), <http://www.oecd.org/dataoecd/38/29/37415572.pdf> (accessed 30 August 2019).

<sup>33</sup> *Ibid* 3.

<sup>34</sup> OECD, *Study into the Role of Tax Intermediaries* (OECD Publishing, 2008).

<sup>35</sup> *Ibid* 87.

This definition suggests that the focus of the OECD's concern with regard to aggressive tax planning relates either to schemes or arrangements that achieve a result not foreseen by the legislators, or that rely upon an uncertain tax position.<sup>36</sup>

Baker<sup>37</sup> rightly asserts that this definition is vague and difficult to apply in practice as it provides very little real guidance on the arrangements that are the target of the disclosure rules. Baker<sup>38</sup> is of the view that the real target of concern for most revenue authorities involves two types of arrangements. First are:

mass-marketed arrangements which may or may not achieve a result that may have been foreseen by the legislators, and may or may not involve an element of uncertainty in tax law, but which cumulatively have a significant impact on tax revenue.<sup>39</sup>

Second are arrangements that are 'not mass-marketed, and may only be available to one taxpayer or a small number of taxpayers, but which result in a massive reduction in the tax liability of that ... taxpayer'.<sup>40</sup>

A clearer definition of ATP is provided by the European Commission, which defines ATP as 'taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability'<sup>41</sup> and that its consequences include 'double deductions (e.g. the same loss is deducted both in the state of source and residence) and double non-taxation (e.g. the income is not taxed in the source state and yet is exempt from tax in the state of residence)'.<sup>42</sup>

In Canada, the Quebec Ministry of Finance<sup>43</sup> explains that ATP can take a multitude of forms and that it often includes a number of steps that make use of complex mechanisms which may comply with the letter, but abuse the intention, of the law. ATP frequently involves circular movements of funds, shell companies or the use of financial instruments or entities that are treated differently for tax purposes in different jurisdictions.<sup>44</sup>

The ATO refers to ATP as 'planning that goes beyond the policy intent of the law and involves purposeful and deliberate approaches to avoid any type of tax'.<sup>45</sup> It encompasses schemes that try to get around the tax system and push the boundaries of what is considered to be acceptable. The schemes are promoted to taxpayers with incentives like reducing taxable income, increasing tax deductions and rebates and sometimes even avoiding tax completely.<sup>46</sup> Most schemes that the ATO has confronted

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<sup>36</sup> Ibid.

<sup>37</sup> Baker, above n 31, 85.

<sup>38</sup> Ibid.

<sup>39</sup> Ibid.

<sup>40</sup> Ibid.

<sup>41</sup> European Commission, Recommendation of 6 December 2012 on Aggressive Tax Planning, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32012H0772>.

<sup>42</sup> Ibid.

<sup>43</sup> Ministry of Finance, Quebec, *Aggressive Tax Planning: Working Paper* (2009) 13, [http://www.finances.gouv.qc.ca/documents/Autres/en/AUTEN\\_DocCons\\_PFA.pdf](http://www.finances.gouv.qc.ca/documents/Autres/en/AUTEN_DocCons_PFA.pdf) (accessed 30 August 2019).

<sup>44</sup> Ibid.

<sup>45</sup> Australian Taxation Office (ATO), 'About Tax Minimisation and Tax Avoidance Schemes' (2010).

<sup>46</sup> ATO, 'Aggressive Tax Planning' (ATO Tax Talk, March 2017),

generally involve claiming excessive deductions, such as interest related to debt loading, or complex financing arrangements.<sup>47</sup> Often these schemes involve ‘boutique’ or once-off arrangements tailored for high income individuals and large corporate entities as well as arrangements that are mass marketed widely to all taxpayers.<sup>48</sup> The Australian Taxation Ombudsman has, for instance, investigated and issued reports about the Budplan scheme<sup>49</sup> and the Main Camp mass marketed scheme, which involved claims for tax deductions by investors.<sup>50</sup> Details of the Main Camp investigation are reflected in the Senate Economic References Committee inquiry into Mass Marketed Tax Effective Schemes and Investor Protection.<sup>51</sup> The Australian Taxation Ombudsman also investigated a complaint about the ATO by a promoter of film schemes.<sup>52</sup> The ATO considers ATP a priority tax risk as an increasing number of schemes are being targeted at Australians.<sup>53</sup> As is the case with other tax authorities, one of the ways that the ATO uses to detect ATP arrangements is by auditing taxpayers’ returns, which usually results in the enactment of anti-avoidance rules to block a given scheme.<sup>54</sup> Since there are inevitable delays between the conclusion of taxpayers’ transactions, submission of annual returns and the audits, years may pass before ATP arrangements are detected, analysed and challenged. In the meantime, aggressive taxpayers and their advisers would have devised other schemes outside the scope of the enacted anti-avoidance rule, and so the cycle goes on. Hence, the Australian Government is concerned that ATP impacts on the integrity, efficiency and effectiveness of the operations of the tax system. It poses a risk to revenue collection and it affects community confidence in the tax system.<sup>55</sup> As such, the proactive approach adopted by mandatory disclosure regimes (MDRs) has considerable appeal over the otherwise reactive legislative tools available as part of the anti-avoidance framework.

### 3. OBJECTIVES OF MDRS

The objectives of MDRs are threefold. First, they ensure early detection of ATP schemes that exploit vulnerabilities in the tax system, allowing tax administrations to respond more quickly to tax policy and revenue risks through operational, legislative or regulatory changes.<sup>56</sup> Secondly, they are instrumental in identifying schemes and their

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<http://www.sbs.com.au/yourlanguage/punjabi/en/content/ato-tax-talk-march-2017-aggressive-tax-planning> (accessed 9 August 2017).

<sup>47</sup> Australian National Audit Office (ANAO), *The Australian Taxation Office’s Management of Aggressive Tax Planning* (2004), <https://www.anao.gov.au/work/performance-audit/australian-taxation-offices-management-aggressive-tax-planning> (accessed 9 August 2017).

<sup>48</sup> Ibid.

<sup>49</sup> Taxation Ombudsman, *The ATO and Budplan – Report of the Investigation into the Australian Taxation Office’s Handling of Claims for Tax Deductions by Investors in a Tax-Effective Scheme Known as Budplan* (1999), cited in ANAO, above n 47, 11.

<sup>50</sup> Taxation Ombudsman, *The ATO and Main Camp – Report of the Investigation into the Australian Taxation Office’s Handling of Claims for Tax Deductions by Investors in a Mass Marketed Tax Effective Scheme Known as Main Camp* (2001), cited in ANAO, above n 47, 11.

<sup>51</sup> ANAO, above n 47.

<sup>52</sup> Taxation Ombudsman, *Report on Investigation of a Complaint by a Promoter of a Series of Films about ATO Decisions* (2001), cited in ANAO, above n 47, 12.

<sup>53</sup> ANAO, above n 47.

<sup>54</sup> Larin, Duong and Latulippe, above n 5.

<sup>55</sup> ANAO, above n 47.

<sup>56</sup> OECD, *Mandatory Disclosure Rules: Action 12 – 2015 Final Report*, above n 9, para 31.

promoters and users.<sup>57</sup> Thirdly, they act as a deterrent to the promotion and use of ATP schemes.

These three objectives differentiate MDRs from other disclosure rules, which have varied objectives. For example, countries usually require taxpayers to disclose particular transactions and investments as part of the return filing process; some countries have voluntary disclosure regimes that incentivise taxpayers to disclose offshore investments so that they can qualify for reduced tax penalties; some tax administrations use surveys and questionnaires to gather information from certain groups of taxpayers, with a view to undertaking risk assessments; and some countries have cooperative compliance programmes where participating taxpayers agree to make full and true disclosure of material tax issues and transactions and provide sufficient information to understand the transaction and its tax impact.<sup>58</sup> In general, most of these initiatives are voluntary and reactive in nature. The 2011 OECD report on transparency and disclosure initiatives<sup>59</sup> evaluated these disclosure initiatives, including MDRs, and specifically concluded that MDRs ‘can substantially reduce the time-lag between the creation and promotion of ATP schemes and their identification by authorities, thus enabling governments to more quickly develop a targeted response’.<sup>60</sup> Unlike other disclosure initiatives, MDRs focus exclusively on the timely or early detection of revenue risks raised by ATP schemes; they seek to identify such schemes and their promoters and users so as to deter the promotion of such schemes before they are put into use. In addition, unlike other disclosure initiatives, MDRs are broad in scope. They can capture any type of tax or taxpayer – and not only taxpayers who voluntarily choose to disclose.<sup>61</sup> Countries that have introduced MDRs indicate that the rules have improved the quality, timeliness and efficiency of information-gathering on ATP schemes, resulting in far more effective compliance, legislative and regulatory responses.<sup>62</sup> From the deterrence perspective, a taxpayer is less likely to enter into a tax planning scheme knowing that the tax outcomes will need to be disclosed and may subsequently be challenged by the tax administration. In addition, pressure is placed on the ATP market, as promoters and users only have a limited opportunity to implement schemes before they are closed down.<sup>63</sup> Although MDRs are intended to assist tax administrations, they also provide certainty to taxpayers in that they would have knowledge in advance about the likely views of tax administrations in respect of an arrangement so that they can avoid any potential dispute that could arise from any differing positions taken in respect to the arrangement.<sup>64</sup>

The OECD notes that the decision whether to introduce a mandatory disclosure regime and the structure and content of such a regime depend on a number of factors; these include an assessment of the tax policy and revenue risks posed by tax planning within the jurisdiction, and the availability and effectiveness of other disclosure and compliance tools.<sup>65</sup> It should also be noted that the OECD recommendation to introduce MDRs under Action 12 of its BEPS Project is not a ‘minimum standard’ that was agreed

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<sup>57</sup> Ibid para 29.

<sup>58</sup> Ibid para 24.

<sup>59</sup> OECD, *Tackling Aggressive Tax Planning*, above n 3.

<sup>60</sup> Ibid 6.

<sup>61</sup> OECD, *Mandatory Disclosure Rules: Action 12 – 2015 Final Report*, above n 9, para 26.

<sup>62</sup> Ibid para 32.

<sup>63</sup> Ibid para 15.

<sup>64</sup> Karen Payne, ‘Mandatory Disclosure Rules and Reporting’ (Paper Presented at the 2018 Financial Services Taxation Conference, Gold Coast, 7-9 February 2018) 4.

<sup>65</sup> OECD, *Mandatory Disclosure Rules: Action 12 – 2015 Final Report*, above n 9, para 32.



upon (whereby no action by some countries would create negative spillovers on other countries). Rather, it falls into the category of common approaches based on best practices that have been agreed upon to facilitate convergence of national practices, and which could in future become minimum standards.<sup>66</sup> Thus, countries are free to choose whether or not to introduce MDRs.

#### 4. IS A MANDATORY DISCLOSURE REGIME NECESSARY IN AUSTRALIA?

Following the OECD's recommendation in Action 12 of its BEPS Project calling on countries to enact MDRs, the Australian Government announced as part of its 2016-17 Federal Budget that it would introduce MDRs to 'uncover aggressive tax planning schemes'.<sup>67</sup> At the same time, the Australian Treasury released a Discussion Paper entitled 'OECD Proposals for Mandatory Disclosure of Tax Information',<sup>68</sup> seeking the community's views on how a mandatory disclosure regime should be framed in the Australian context, taking into account the disclosure rules already in the tax system. Section 4.1 below explores the current disclosure regimes in Australia and how they differ from MDRs.

In its Discussion Paper, the Australian Treasury focused on:

- ensuring that there is no unnecessary overlap with existing disclosure rules;
- enhancing information available to the ATO to crack down on tax avoidance;
- avoiding the imposition of unnecessary compliance burdens on taxpayers; and
- appropriately balancing competing policy priorities.<sup>69</sup>

These concerns are addressed in section 4.2 below (in no particular order as some of them are interrelated). Since submissions to the Treasury's Discussion Paper are not yet publicly available, a detailed analysis of community views presented through the consultation process is not possible at present. Nonetheless, section 4.2 includes an analysis of the four submissions that are currently within the public domain.<sup>70</sup>

<sup>66</sup> Ibid para 11.

<sup>67</sup> Australian Treasury, *Budget 2016-17: Budget Paper No 1, Budget Strategy and Outlook* (2016) 1-12, <https://archive.budget.gov.au/2016-17/>.

<sup>68</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10.

<sup>69</sup> Ibid para 9.

<sup>70</sup> These are the submissions by: Greenwoods & Herbert Smith Freehills, 'OECD Proposals for Mandatory Disclosure of Tax Information – Discussion Paper' (15 July 2016), <http://www.greenwoods.com.au/media/1798/oecd-proposals-for-mandatory-disclosure-of-tax-information-submission-to-treasury-july-2016.pdf> (accessed 3 August 2017); The Law Council of Australia, 'Mandatory Disclosure' (15 July 2016), <https://www.lawcouncil.asn.au/resources/submissions/mandatory-disclosure> (accessed 3 August 2017); The Tax Institute, 'OECD Proposals for Mandatory Disclosure of Tax Information' (14 July 2016), <https://www.taxinstitute.com.au/tisubmission/mandatory-disclosure-of-tax-information> (accessed 3 August 2018); Law Institute of Victoria, 'Submission to the Australian Government Regarding the OECD Proposals for Mandatory Disclosure of Tax Information' (6 September 2016), [https://www.liv.asn.au/getattachment/e1a3f6ab-8fba-42c9-88f3-3a502040ec3a/20160901\\_Submission\\_LP\\_OECDMandatoryReporting\\_FINAL.pdf.aspx](https://www.liv.asn.au/getattachment/e1a3f6ab-8fba-42c9-88f3-3a502040ec3a/20160901_Submission_LP_OECDMandatoryReporting_FINAL.pdf.aspx) (accessed 30 August 2019); and Chartered Accountants Australia and New Zealand, 'OECD Proposals for Mandatory Disclosure of Tax Information – Discussion Paper May 2016' (15 July 2016), <https://www.acuitymag.com/-/media/b60f870f0a2048b08aa63fd0356b36b1.ashx>

## 4.1 Current disclosure regimes in Australia and how they differ from MDRs

One of the key arguments against the adoption of a mandatory disclosure regime in Australia is that the country already has various disclosure rules which serve to deter ATP.<sup>71</sup> As noted earlier, other countries also have various disclosure rules, which the OECD reviewed,<sup>72</sup> but they also have MDRs.

The Treasury's Discussion Paper lists the categories and examples set out below of disclosure rules that are currently in place in Australia.<sup>73</sup> It is not the intention of this article to provide a detailed analysis of how all the rules work. Rather, it is to briefly highlight the purpose of the relevant rules and provide an explanation for why those rules fall short of the objectives of MDRs.

Specifically, this article highlights the limitations of two particular rules: the Reportable Tax Position Schedule and the Promoter Penalty Regime, in sections 4.1.3 and 4.1.5, respectively. These have mandatory provisions that mimic MDRs, but an explanation is provided as to why these rules still fall short of the objectives of MDRs, and recommendations are provided as to how any overlaps could be prevented.

### 4.1.1 Disclosures recommended by the OECD

*OECD Common Reporting Standard.* This is a framework for exchange of financial account information between governments. Financial institutions are required to undertake due diligence to identify 'reportable accounts' (accounts held or controlled by foreigners) and to report them to the ATO. The ATO can then exchange this information with international tax authorities.

*Country-by-country reports.* In light of Action 13 of the OECD BEPS Project, multinational enterprises with annual global income exceeding AUD 1 billion are required to provide detailed information in relation to their transfer pricing policies and methodologies.<sup>74</sup>

Unlike the above disclosure rules, which are limited to financial institutions (Common Reporting Standard) and large multilateral enterprises (country-by-country reports), MDRs are broad in scope – they can capture any type of tax or taxpayer.

### 4.1.2 Disclosure before lodgement of tax returns

*Tax rulings.* A taxpayer can voluntarily apply to the ATO for its view on how the law applies to a specific tax arrangement.<sup>75</sup> Greenwoods & Herbert Smith Freehills, Australia's largest specialist tax advisory firm, is of the view that the ruling system has exposed most schemes and that there may not be a sizeable market for mass marketed

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(accessed 30 August 2019).

<sup>71</sup> Greenwoods & Herbert Smith Freehills, above n 70, para 2.

<sup>72</sup> Examples of other disclosure rules in countries the OECD surveyed include disclosure when filing tax returns, voluntary disclosure regimes, surveys and questionnaires and cooperative compliance programmes; see OECD, *Mandatory Disclosure Rules: Action 12 – 2015 Final Report*, above n 9, para 24.

<sup>73</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10, Table 1.

<sup>74</sup> Ibid.

<sup>75</sup> Ibid.

arrangements that have not already come to the attention of the ATO through the ruling applications.<sup>76</sup>

*Annual compliance arrangements.* These are voluntary administrative arrangements which set out a framework for managing the compliance relationship between the ATO and a taxpayer. An example is the Voluntary Tax Transparency Code developed by the Board of Taxation in 2016<sup>77</sup> at the Treasurer's request to encourage disclosure of tax avoidance information by corporations.<sup>78</sup>

*Pre-lodgement compliance review.* This is an administrative process primarily used by the ATO for some large public companies not covered by an annual compliance arrangement. It is aimed at identifying and managing material tax risks through early, tailored and transparent engagement with taxpayers.<sup>79</sup>

*Advance pricing agreements.* These are voluntary arrangements entered into between the ATO and taxpayers, whereby an appropriate set of criteria is used to determine, in advance, the transfer pricing outcomes of controlled transactions over a fixed period of time.<sup>80</sup>

Clearly, the above disclosures before lodgement of a tax return are largely voluntary in nature. This implies that certain information may not be disclosed – unlike the MDRs, where disclosure of the relevant information is mandatory.

#### 4.1.3 Disclosure as part of tax returns

*Tax returns and schedules.* Tax returns provide a summary of the calculation of a taxpayer's tax payable; schedules to the tax returns provide additional information.<sup>81</sup> The information required can, for example, cover details regarding rental income, capital gains, losses and trust distributions. An example of this information is given in the ATO's annual 'Report of Entity Tax Information' which is taken from tax return data.<sup>82</sup>

*International Dealings Schedule.* This schedule requires taxpayers with international dealings exceeding AUD 2 million (or other certain cross-border transactions) to provide high-level details of those transactions.<sup>83</sup>

*Reportable Tax Position Schedule.* This schedule to the company income tax return has mandatory provisions that mimic MDRs and deserve more discussion. The schedule,

<sup>76</sup> Greenwoods & Herbert Smith Freehills, above n 70, para 2.

<sup>77</sup> Board of Taxation, *A Tax Transparency Code* (2016).

<sup>78</sup> Board of Taxation, 'Corporate Tax Transparency Code and Register' (2016), <http://taxboard.gov.au/current-activities/transparency-code-register> (accessed 3 October 2017); Parliament of Australia, *Corporate Tax Avoidance: Part 1 – You Cannot Tax What You Cannot See*, Report of the Senate Economics References Committee (August 2015) recommendation 3, [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Corporate\\_Tax\\_Avoidance/Report%20part%201/b01](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporate_Tax_Avoidance/Report%20part%201/b01) (accessed 3 August 2017).

<sup>79</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10, Table 1.

<sup>80</sup> Ibid.

<sup>81</sup> Ibid.

<sup>82</sup> ATO, 'Report of Entity Tax Information', <https://www.ato.gov.au/Business/Large-business/In-detail/Tax-transparency/Tax-transparency--reporting-of-entity-tax-information/> (accessed 3 August 2017).

<sup>83</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10, Table 1.

which was issued on 1 April 2011, requires some large corporations to make early disclosure of contestable and material tax positions which may not be sustained when analysed by the ATO. The schedule was extended in two tranches over the 2017 and 2018 income years.<sup>84</sup> It is considered a powerful weapon in the ATO's arsenal of information-gathering procedures.<sup>85</sup> For the purposes of the schedule, a 'reportable tax position' is one that falls under the following three categories: (a) a material position that is about as likely to be correct as incorrect or less likely to be correct than incorrect; (b) a material position in respect of which uncertainty about tax payable is recognised and/or disclosed in the taxpayer's or related party's financial statements; or (c) a position in respect of a reportable transaction.<sup>86</sup> These three categories are not homogenous, but represent broad descriptions of transactions and arrangements that are not precisely defined.<sup>87</sup> If a taxpayer is required by the ATO to file a reportable tax position, the taxpayer must disclose a concise description of the facts, the position taken and its tax treatment (with reference to case law and legislative provisions) and the related parties involved. If the ATO requests a report, it expects a response from the taxpayer even if the taxpayer has no position to disclose.<sup>88</sup> The disclosure requirement does not, however, require taxpayers to disclose any advice or opinions about the income tax treatment of the reportable tax position.<sup>89</sup>

In general, disclosures as part of tax returns fall short of the timeliness objective of MDRs. Although some aspects of the Reportable Tax Position Schedule mimic some aspects of MDRs, the disclosure obligation only falls on a taxpayer, and the obligations do not require the taxpayer to disclose any advice or opinions about the income tax treatment of the reportable tax position. This falls short of requirements under MDRs (as discussed in section 3 above), where the reporting obligation falls primarily on the promoter (who designs the scheme and has a better understanding of the tax benefit arising under the scheme), and the duty shifts to the taxpayer if the promoter is not able to disclose by reason of being offshore or due to legal professional privilege. The fact that disclosure under the Reportable Tax Position Schedule does not extend to all taxpayers, but only large corporations, means that this measure falls short of MDRs, which apply to all taxpayers. This presents an issue of taxpayer neutrality, which may be particularly problematic given that the rise in e-commerce now provides all taxpayers with greater access to other tax systems and tax structuring devices. A comprehensive, mandatory disclosure regime would ensure that the rules apply equitably across all taxes and to all taxpayers.<sup>90</sup>

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<sup>84</sup> ATO, 'Guide to Reportable Tax Positions' (2017), <https://www.ato.gov.au/Forms/Guide-to-Reportable-Tax-Positions-2017/> (accessed 3 August 2017).

<sup>85</sup> Christopher Branson QC, 'Reportable Tax Positions: A Recent Innovation by the ATO' (2012) 46(7) *Taxation in Australia* 296.

<sup>86</sup> ATO, 'RTP Early Disclosure Form' (2011), [www.ato.gov.au/content/downloads/bus00279408nat73857.pdf](http://www.ato.gov.au/content/downloads/bus00279408nat73857.pdf) (accessed 17 August 2017).

<sup>87</sup> Stuart Edwards and Daren Yeoh, 'Reportable Tax Positions (RTP) Schedule Released' (9 October 2011), *Mondaq.com*,

<http://www.mondaq.com/australia/x/148174/Corporate+Tax/Reportable+Tax+Positions+RTP+schedule+released> (accessed 17 August 2017).

<sup>88</sup> ATO, RTP Early Disclosure Form, above n 86, item 8.

<sup>89</sup> *Ibid.*

<sup>90</sup> Nicole Wilson-Rogers and Dale Pinto, 'A Mandatory Information Disclosure Regime to Strengthen Australia's Anti-avoidance Income Tax Rules' (2015) 44(1) *Australian Tax Review* 24, 41.

#### 4.1.4 Disclosure after lodgement of tax returns

*Exchange of information.* Australia has double taxation agreements<sup>91</sup> and tax information exchange agreements<sup>92</sup> with other tax jurisdictions, which ensure exchange of taxpayer information.

*Questionnaires sent by the ATO to selected taxpayers.* An example of a questionnaire sent to taxpayers is the Private Group Structure Questionnaire, which is an information-gathering method to obtain a better understanding of how wealthy individuals conduct their business and tax affairs.<sup>93</sup>

*Formal powers that enable the ATO to gather information.* Australia's tax framework makes strong legislative information-gathering powers available to the ATO.<sup>94</sup> The ATO can require a person or entity to provide information to the ATO, to attend and give evidence or to produce documents. Penalties apply for non-compliance.<sup>95</sup>

In general, disclosures after lodgment of returns fall short of the timeliness objective of MDRs, as the information is only received after the ATP scheme has been implemented.

#### 4.1.5 Penalty regimes to encourage compliance

*Promoter penalty regime.* In 2006, Australia introduced a promoter penalty regime, in Divisions 290 and 298B of Schedule 1 to the *Taxation Administration Act 1953*. Prior to the introduction of this regime, there were no civil or administrative penalties for the promotion of ATP schemes. This meant that promoters could obtain substantial profits from the sales of these schemes whereas the users could be subject to penalties under the tax laws.

Section 290-50(1) of Schedule 1 requires that an entity must not engage in conduct that results in that entity or another entity being a promoter of a tax exploitation scheme. A scheme is considered to be a 'tax exploitation scheme' if, at the time of promotion, it would be reasonable to conclude that an entity that entered into or carried out the scheme has a sole or dominant purpose of that or another entity getting a scheme benefit, if it is not reasonably arguable that the scheme benefit sought is, or would be, available at law.<sup>96</sup> An entity is considered a promoter if it markets or encourages the growth of the scheme, the entity or its associate directly or indirectly receives consideration in respect of marketing or encouragement, it has a substantial role in the marketing or encouragement of the scheme or it causes another entity to be a promoter. If an entity is found to be a promoter of a tax exploitation scheme, the ATO can request the Federal

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<sup>91</sup> Article 25 of treaties based on the OECD Model Tax Convention on Income and on Capital.

<sup>92</sup> Tax information exchange agreements are usually signed with low tax jurisdictions that do not have double tax treaties. These are based on the OECD Model Agreement on the Exchange of Information in Tax Matters, developed in 2002.

<sup>93</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10, Table 1.

<sup>94</sup> Other information-gathering powers include cross-checks with third-party data, such as the Australian Transaction Reports and Analysis Centre data; referrals from other government departments; formal information seeking powers in ss 353-10 and 353-15 in Sch 1 of the *Taxation Administration Act 1953* (Cth); and information-seeking powers through the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth). See Wilson-Rogers and Pinto, above n 90, 40.

<sup>95</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10, Table 1.

<sup>96</sup> *Taxation Administration Act 1953*, Sch 1, s 290-65.

Court of Australia to impose a civil penalty.<sup>97</sup> The maximum penalty the Federal Court can impose is the greater of:

- 5,000 penalty units (currently equal to AUD 1.05 million) for an individual; and
- 25,000 penalty units (currently equal to AUD 5.25 million) for a body corporate,

or twice the consideration received or receivable, directly or indirectly, by the entity or its associates in respect of the scheme.<sup>98</sup>

Since the rules were introduced, the ATO has litigated three cases<sup>99</sup> in which civil penalties were levied against the promoters. Tax practitioners at PricewaterhouseCoopers suggest that the promoter penalty regime seems to have been deliberately put in place in preference to a mandatory disclosure regime recommended by the OECD.<sup>100</sup> Tax practitioners assert that even though the envisaged MDRs:

could co-exist with the promoter penalty rules, it is questionable whether the ATO will learn more than it already does by existing methods. This is because the promoter penalty rules provide a strong incentive to either seek ATO rulings or to not engage in schemes which could be penalised.<sup>101</sup>

It is submitted, however, that even though the promoter penalty rules play a significant role in deterring ‘prohibited conduct’ due to the heavy penalties imposed on entity promoters, the penalties only apply after the scheme has been promoted.<sup>102</sup> The ATO explains that:

The promoter penalty laws are not intended to obstruct tax advisers and intermediaries from giving typical advice to their clients. For example, there are exceptions for advisers who rely on the Commissioners advice, or who make reasonable mistakes, or are subject to events beyond reasonable control. But for advisers who are more closely involved in the design, marketing and implementation of schemes that claim to provide taxation benefits, you should consider the promoter penalty laws as part of your own due diligence and good governance. In introducing the promoter penalty legislation, the government addressed the imbalance of the taxpayer bearing the risk while the scheme promoters avoided penalties. The objective of the promoter penalty law is to deter tax avoidance and tax evasion schemes. An additional objective is to enhance the integrity of the product ruling system by deterring implementation

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<sup>97</sup> *Taxation Administration Act 1953*, Sch 1, s 290-50(3).

<sup>98</sup> *Taxation Administration Act 1953*, Sch 1, s 290-50(4).

<sup>99</sup> *Federal Commissioner of Taxation v Ludekens* [2013] FCAFC 100, 93 ATR 33; *Federal Commissioner of Taxation v Arnold* [2015] FCA 34, 100 ATR 529; *Commissioner of Taxation v Barossa Vines Ltd* [2014] FCA 20, 94 ATR 1.

<sup>100</sup> PwC, ‘OECD Action Plan on BEPS and Recent Tax Transparency Measures: Impact for Banking and Capital Market Sectors’, *TaxTalk Insights* (17 December 2015) 7, <https://www.pwc.com.au/tax/taxtalk/assets/alerts/taxtalk-alert-oced-beps-17dec15.pdf> (accessed 3 August 2017).

<sup>101</sup> *Ibid.*

<sup>102</sup> Rachel Tooma, ‘New Tax Laws to Deter Promoters of Tax Exploitation Schemes’ (2006) 2(1) *Journal of the Australasian Tax Teachers Association* 158.

of a scheme in a materially different manner to that described in its product ruling, where doing so may have potential tax consequences for investors.<sup>103</sup>

The timing issue is an important matter that the promoter penalty laws do not address. MDRs will ensure early detection of ATPs before they are implemented. The promoter penalty rules are also limited to entity promoters, whereas MDRs are broad enough to apply to all taxpayers. Furthermore, unlike MDRs which impose disclosure obligations and penalties on promoters and their users, the promoter penalty laws only concentrate on promoters.

## 4.2 Addressing concerns raised in the Australian Treasury's Discussion Paper

The fourfold concerns raised in the Australian Treasury's Discussion Paper can be summarised as: first, unnecessary duplication; second, unnecessary compliance burden; third, information management issues; and, fourth, balancing competing policy priorities. Each is dealt with in turn below.

### 4.2.1 Will MDRs unnecessarily overlap with existing disclosure rules?

The Treasury's Discussion Paper indicates that the envisaged MDRs should not unnecessarily overlap with existing disclosure rules.<sup>104</sup> This sentiment is echoed as a key concern in three of the four submissions to the Treasury Discussion Paper currently in the public domain, constituting the most pressing issue raised.<sup>105</sup> Based on the discussion above, it is submitted that the various existing disclosure rules are narrow in scope and largely voluntary, thus falling short of the objectives of the MDRs. It is, however, acknowledged that MDRs cannot replace or remove the need for voluntary disclosure rules; in agreement with Wilson-Rogers and Pinto,<sup>106</sup> MDRs will reinforce the voluntary disclosure rules by ensuring a more level playing field between large corporations and other taxpayers that do not have the same kind of compliance relationship with the tax administration.<sup>107</sup>

To prevent overlaps with some disclosure rules, such as the promoter penalty regime and the Reportable Tax Position Schedule<sup>108</sup> which have mandatory provisions that mimic MDRs, we recommend that the legislators should consider repealing these rules and replacing them with MDRs, which will ensure parity with international practices as recommended by the OECD.<sup>109</sup> Some provisions in the promoter penalty regime – such as those relating to the definition of a promoter, meaning of prohibited conduct and the structure of penalties – could be expanded and redrafted to form certain sections of the envisaged MDRs. Similarly, some provisions in the Reportable Tax Position Schedule, such as those relating to reportable tax positions, could be redrafted to form certain sections of the envisaged MDRs that are suitable for Australia's circumstances.

<sup>103</sup> ATO, 'Promoter Penalty Law', <https://www.ato.gov.au/General/Tax-planning/Promoter-penalty-law/> (accessed 13 July 2016).

<sup>104</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10, para 9.

<sup>105</sup> Specifically, Greenwoods & Herbert Smith Freehills, above n 70; Law Council of Australia, above n 70, The Tax Institute, above n 70, and Chartered Accountants Australia and New Zealand, above n 70.

<sup>106</sup> OECD, *Mandatory Disclosure Rules: Action 12 – 2015 Final Report*, above n 9, para 34.

<sup>107</sup> *Ibid.*

<sup>108</sup> ATO, 'Guide to Reportable Tax Positions', above n 84.

<sup>109</sup> OECD, *Action Plan on Base Erosion and Profit Shifting*, above n 4, 22.

Wilson-Rogers and Pinto<sup>110</sup> further suggest that any overlaps resulting from adopting MDRs could be ameliorated by appropriate legislative drafting. Former Commissioner of Taxation Michael D'Ascenzo has noted that 'there is always the problem of definition, and also the preparedness to make corrective legislative change and timeliness of that change'.<sup>111</sup> It is acknowledged that countries have very different practices with respect to the legislative design of their tax laws. Some countries apply very detailed rules and other countries make use of broad principles and illustrative examples.<sup>112</sup> While a principles-based approach is desirable in Australia, this approach also raises a number of interpretive challenges surrounding giving effect to the legislative intention as it is expressed.

*Issues pertaining to overlaps with anti-avoidance rules.* The OECD clarifies that MDRs cannot replace anti-avoidance rules that also serve to deter ATP.<sup>113</sup> The OECD notes that there are some inevitable (and desirable) overlaps between the operation and effects of MDRs and general anti-avoidance rules (GAARs). GAARs can, for instance, provide tax administrations with an ability to respond directly to instances of tax avoidance that have been disclosed under MDRs.<sup>114</sup> Thus MDRs and GAARs are mutually complementary from a compliance perspective. Academics such as Wilson-Rogers and Pinto<sup>115</sup> assert that, rather than conflicting with Australia's existing regulatory framework, MDRs would complement Australia's existing armoury of tax avoidance rules.<sup>116</sup> It should, however, be noted that in addition to this complementarity, MDRs provide a tax administration with information on a wider range of tax policy and revenue risks than those raised by transactions that would be classified as avoidance under a GAAR. Accordingly, the definition of a 'reportable scheme' for mandatory disclosure purposes will generally be broader than the definition of tax avoidance schemes covered by a GAAR, as it covers transactions that are perceived to be aggressive or high-risk from a tax planning perspective.<sup>117</sup>

#### 4.2.2 *Avoiding unnecessary compliance burdens on taxpayers*

Related to the issue of preventing unnecessary overlaps with other disclosure rules and anti-avoidance rules, the other key concern raised by the Discussion Paper is avoiding the imposition of unnecessary compliance burdens on taxpayers.<sup>118</sup> This sentiment is similarly highlighted as a top concern in two of the four submissions to the Treasury's Discussion Paper currently in the public domain, constituting the second most prevalent issue raised.<sup>119</sup> For example, the Law Council of Australia is concerned about the impact

<sup>110</sup> Wilson-Rogers and Pinto, above n 90, 41.

<sup>111</sup> Michael D'Ascenzo, 'BEPS: Thinking Inside or Outside the Box?' (2014) 43(2) *Australian Tax Review* 75, 83.

<sup>112</sup> EY, 'Comments on OECD Discussion Draft on BEPS Action 12: Mandatory Disclosure Rules' (30 April 2015) 1, [http://www.ey.com/Publication/vwLUAssets/ey-comments-on-mandatory-disclosure-rules-under-beps-action-12/\\$FILE/ey-comments-on-mandatory-disclosure-rules-under-beps-action-12.pdf](http://www.ey.com/Publication/vwLUAssets/ey-comments-on-mandatory-disclosure-rules-under-beps-action-12/$FILE/ey-comments-on-mandatory-disclosure-rules-under-beps-action-12.pdf) (accessed 3 October 2017).

<sup>113</sup> OECD, *Mandatory Disclosure Rules: Action 12 – 2015 Final Report*, above n 9, para 35.

<sup>114</sup> *Ibid.*

<sup>115</sup> Wilson-Rogers and Pinto, above n 90, 40-41.

<sup>116</sup> Divs 290 and 298B of Schedule 1 to the *Taxation Administration Act 1953*.

<sup>117</sup> OECD, *Mandatory Disclosure Rules: Action 12 – 2015 Final Report*, above n 9, para 35.

<sup>118</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10, para 9.

<sup>119</sup> Specifically, Law Council of Australia, above n 70; The Tax Institute, above n 70 and Chartered Accountants Australia and New Zealand, above n 70.



of MDRs ‘especially on the vast majority of taxpayers who voluntarily comply with their taxation obligations’.<sup>120</sup> The Discussion Paper points out that:

legislation should make it clear those ATP arrangements which have already been comprehensively disclosed through other disclosure tools or through private rulings should not be subject to further disclosure under MDRs.<sup>121</sup>

As we recommended in section 4.2.1 above, repealing the promoter penalty regime and the Reportable Tax Position Schedule, and replacing them with the envisaged MDRs, would go a long way in reducing compliance costs for taxpayers. It would also prevent valid arguments by taxpayers that the required information has already been disclosed under other rules. In *Foster v Federal Commissioner of Taxation*, the High Court (Latham CJ) ruled that:

Disclosure consists in the statement of a fact by way of disclosure so as to reveal or make apparent that which (so far as the ‘discloser’ knows) was previously unknown to the person to whom the statement was made. Thus the taxpayer could not add anything to the commissioner’s knowledge with respect to the appeal. In my opinion in these circumstances it should be held that the failure of the taxpayer to repeat to the commissioner what he already knew did not constitute a failure to disclose material facts.<sup>122</sup>

Having one effective comprehensive mandatory regime would resolve concerns regarding repeated disclosure of similar information, and penalising taxpayers for information already obtained by the ATO under a different law.<sup>123</sup> This would offer a more systematic way for the ATO to obtain information on ATP schemes.<sup>124</sup>

#### 4.2.3 *Would MDRs enhance information available to the ATO?*

The Australian National Audit Office (ANAO) notes that ‘accurate, comprehensive and current data is vital for the ATO to understand and manage aggressive tax planning issues properly’.<sup>125</sup> Data quality depends on the ATO having an overall strategy for ATP data management. It also depends on the various ATP segments’ willingness to support the process and systems being used to manage ATP data in a holistic way.<sup>126</sup> However, the ANAO notes that the ATO does not have an overall strategy for managing ATP data in a holistic way.<sup>127</sup>

Therefore, and in line with the OECD recommendations, we submit that the introduction of MDRs will enhance management of the information available to the ATO to crack down on ATP (a key priority concern raised in the Discussion Paper).<sup>128</sup> With MDRs,

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<sup>120</sup> Law Council of Australia, above n 70.

<sup>121</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10, Table 2, Issue 2.

<sup>122</sup> (1951) 82 CLR 606, 615.

<sup>123</sup> Greenwoods & Herbert Smith Freehills, ‘Tax Advisor or ATO Informer: The Mandatory Disclosure Proposal’ (15 July 2016), <http://www.greenwoods.com.au/insights/riposte/3-june-2016-tax-adviser-or-ato-informer-the-mandatory-disclosure-proposal/> (accessed 3 August 2017).

<sup>124</sup> Wilson-Rogers and Pinto, above n 90, 40-41.

<sup>125</sup> ANAO, above n 47.

<sup>126</sup> *Ibid.*

<sup>127</sup> *Ibid.*

<sup>128</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10, para 9.

the ATO will have timely, targeted and comprehensive information which is essential to enable the government to quickly identify and respond to tax risk areas.<sup>129</sup> The Law Council of Australia agrees that a mandatory disclosure regime would provide the ATO with more timely information on ATP – a key advantage of such a regime.<sup>130</sup> A caveat to this is that the information gathered should not be an end goal in itself; rather, tax administrators would need to use this additional information effectively for the mandatory disclosure regime to be effective.

#### 4.2.4 *Ensuring MDRs are appropriately balanced with competing policy priorities*

An important matter highlighted by Treasury is to find a way to appropriately balance competing policy priorities, with an emphasis on ensuring that there is no unnecessary overlap with existing disclosure rules.<sup>131</sup> This section considers two layers of policy priorities that need to be balanced; first, balancing the trade-offs that emanate from the key policy objectives of MDRs; and second, balancing civil rights and privileges.

##### *Balancing the trade-offs that emanate from the key policy objectives of MDRs*

Effective MDRs require striking a balance between the competing policy imperatives obtaining relevant information in order to promote fiscal integrity on one hand, and minimising compliance costs on the other hand. In other words, as much as possible the process of redrafting and consolidating existing disclosure rules into a new MDR in Australia should avoid unnecessary additional compliance burdens on taxpayers (as will be discussed further in Part 2 of this study); it is also important that the MDRs ensure fiscal integrity and sustainability, by requiring taxpayers to disclose their ATPs. At present the lack of transparency<sup>132</sup> makes it very difficult for tax administrators such as the ATO to observe whether and how a multinational enterprise is engaging in ATP. To balance these competing policy imperatives, the Board of Taxation has suggested that the MDRs should be designed with the twofold objectives of early detection and deterrence; specifically:<sup>133</sup>

Detection of unknown schemes which are aimed at achieving outcomes inconsistent with, or that go beyond, the policy intent of the relevant tax law – that is, obtaining intelligence regarding vulnerabilities in the tax system at an earlier point in time than when the scheme is implemented (such as when it is made available or marketed).

<sup>129</sup> OECD, *Action Plan on Base Erosion and Profit Shifting*, above n 4, 22.

<sup>130</sup> Law Council of Australia, above n 70.

<sup>131</sup> Australian Treasury, *OECD Proposals for Mandatory Disclosure of Tax Information*, above n 10, para 9: ‘Consistent with the OECD Final Report, the Government will be focused on finding a way to appropriately balance competing policy priorities, including enhancing information available to the ATO to crack down on tax avoidance and avoiding unnecessary compliance burdens on taxpayers. A key priority will be ensuring that there is no unnecessary overlap with existing disclosure rules’.

<sup>132</sup> It is important to note that, given ‘the private nature of their professionals who uphold strict codes of confidentiality’, it is difficult to gather details on the specific cross-border intercompany tax planning structures utilised by multinational enterprises: ‘As several junior and senior expatriate professionals I interviewed in the financial industry informed me, “The brains are in London, Singapore, Hong Kong, and New York. The ideas are formed and constructed abroad and the paperwork is sent to the Cayman Islands to be signed”’: H May Hen, *Sub-elites as Fiduciary Gatekeepers of Global Elites: A Fiscal Anthropology of the Cayman Islands and Offshore Financial Industry* (Masters Thesis, Simon Fraser University, 25 November 2014) 93.

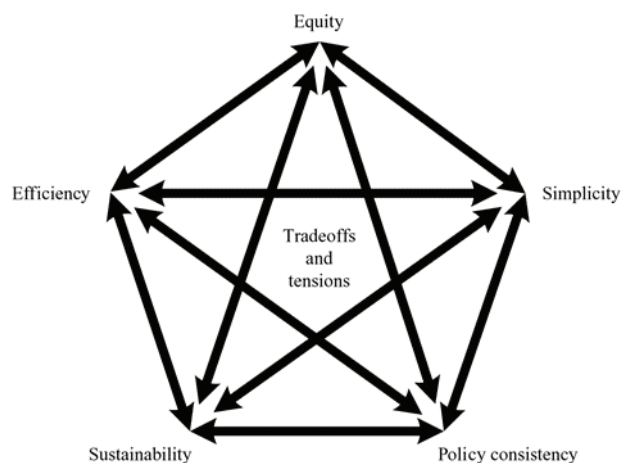
<sup>133</sup> Payne, above n 64, 11-12.

Identification of intermediaries who are not acting in the public interest, which should also deter intermediaries from doing so and help level the playing field for legitimate professional advisers.

An MDR grounded in these policy objectives would promote fiscal integrity and, in turn, fiscal sustainability while also being adequately targeted such that ‘good’ advisers are not unduly burdened.

It is also important to note that balancing the competing policy imperatives of minimising compliance costs on one hand and promoting fiscal integrity and fiscal sustainability on the other hand requires a recognition that there are inevitable conflicts that may, for example, result in a trade-off between simplicity in the design of MDRs and ensuring efficiency of the same, which often poses challenges for policy-makers in designing MDRs for multinational enterprises. For completeness, the key trade-offs in the tax policy design context can be illustrated as shown in Figure 1 below.<sup>134</sup>

**Fig. 1: Tax Design Principles**



Source: Neil Warren, ‘The Henry Review, State Taxation and the Federation’ (2010) 43(4) *Australian Economic Review* 409, 410.

*Balancing civil rights and privileges.* In addition to balancing competing policy priorities when designing an MDR in the Australian context, it is important to remain cognisant of established civil rights and privileges. The Law Council of Australia has argued that the design of the envisaged MDRs should not infringe established civil rights, such as the right to privacy, legal professional privilege and the privilege against

<sup>134</sup> Neil Warren, ‘The Henry Review, State Taxation and the Federation’ (2010) 43(4) *Australian Economic Review* 409, 410.

self-incrimination, any more than is necessary or appropriate.<sup>135</sup> This proposition has also been put forward by legal<sup>136</sup> and accounting advisory firms.<sup>137</sup>

*Right to privacy.* Requiring a taxpayer to disclose tax advice is *prima facie* a breach of the right to privacy.<sup>138</sup> It should, however, be noted this civil right is not absolute. Disclosure of confidential information can be justified in accordance with laws in a democratic society that are necessary for the protection of certain interests, such as the tax base of a country; this would make the disclosure of ATP schemes justifiable on these grounds.<sup>139</sup> However, there has to be a balance between the protection of the right to privacy and the public interest in the disclosure of the scheme. To achieve such a balance, we submit that care should be taken to ensure that MDRs target only mass marketed schemes that have a significant impact on the economy. If the regime casts the net too wide, there is a danger that the balance between the rights of the taxpayer and the protection of the public interest may be set at the wrong point.<sup>140</sup>

*Legal professional privilege.* Inherent in legal professional privilege is the right to give and receive legal advice, as well as the taxpayer's right to privacy and confidentiality. A mandatory disclosure regime, which requires compulsory disclosure of the details of a tax planning scheme, would interfere with these rights. MDRs may deter a taxpayer from taking legal advice about the tax consequences of their transactions or deter a tax professional from giving advice on a disclosable scheme. It is important to ensure that MDRs do not trample on the common law principle of legal professional privilege. In the Australian case of *Baker v Campbell* the High Court held that:

The law came to recognize that for its better functioning it was necessary that there should be freedom of communication between a lawyer and his client for the purpose of giving and receiving legal advice and for the purpose of litigation and that this entailed immunity from disclosure of such communications between them.<sup>141</sup>

However, in *Mann v Carnell*<sup>142</sup> and in *Osland v Secretary, Department of Justice*,<sup>143</sup> the High Court ruled that, at common law, the disclosure of the gist or substance of a legal opinion may amount to waiver of legal professional privilege as to the contents of it in terms of the principles of fairness governing implied waiver. But then, in *British American Tobacco Australia Ltd v Secretary, Department of Health and Ageing*,<sup>144</sup> it was held that the disclosure of the gist of a privileged communication does not

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<sup>135</sup> Law Council of Australia, above n 70, para 4.

<sup>136</sup> 'The regime should respect the privilege attaching to legal advice (including the extension of that concept made in the ATO's Accountants' Concession)': Greenwoods & Herbert Smith Freehills, 'Tax Advisor or ATO Informer', above n 121.

<sup>137</sup> 'Transactions that do not involve any significant tax planning that could raise concerns nevertheless often include confidentiality requirements for competitive or commercial reasons. Such confidentiality restrictions alone should not trigger a disclosure requirement': EY, above n 112.

<sup>138</sup> Article 17 of Schedule 2 (International Covenant on Civil and Political Rights) of the *Australian Human Rights Commission Act 1986* (Cth).

<sup>139</sup> Baker, above n 31, 89.

<sup>140</sup> Baker, above n 31, 89.

<sup>141</sup> [1983] HCA 39; 153 CLR 52, 127.

<sup>142</sup> [1999] HCA 66; 201 CLR 1.

<sup>143</sup> [2008] HCA 37; 234 CLR 275.

<sup>144</sup> [2011] FCAFC 107; 195 FCR 123.

necessarily amount to a waiver of privilege, unless the conduct of the person seeking to rely on the privilege is inconsistent with the maintenance of the privilege.

In South Africa, the Reportable Arrangements Rules<sup>145</sup> do not provide for the protection of legal professional privilege, even though this is a fundamental common law principle of South Africa's judicial system.<sup>146</sup> In the South African case of *S v Safatsa and others*,<sup>147</sup> Botha AJ quoted with approval the common law recognition of legal professional privilege as expressed in the Australian case of *Baker v Campbell*.<sup>148</sup> South African author, Zeffertt<sup>149</sup> notes that it is important that:

the confidentiality of all documents that have been communicated to legal advisors for the purpose of obtaining legal advice is protected from seizure by the authorities ... [It] is impossible for an advocate or attorney to advise a client properly unless he is confident that the client is holding nothing back, but such candour would be difficult to obtain if the client thought that his advisors could be compelled to reveal everything that he had told them.<sup>150</sup>

Unlike South Africa, which does not preclude mandatory disclosure in case of legal professional privilege, the UK through its Disclosure of Tax Avoidance Schemes regime<sup>151</sup> tried to resolve the conflict by ensuring that a promoter who is required to disclose a scheme but is subject to legal professional privilege does not bear the duty of disclosure; instead, the client is required to disclose the scheme. Australia may have to follow the UK's approach in this regard. However, this approach merely prevents the promoter from disclosing privileged information; it does not protect the right to confidentiality, as the rules still require the client to disclose the information to the tax authorities. To create the relevant balance, the rules have to be crafted in such a way that they target only truly ATP schemes.<sup>152</sup> In this regard, the Law Council of Australia states that the:

mandatory disclosure regime should be limited to those who design aggressive tax arrangements that are clearly and precisely identified by the ATO to be marketed to taxpayers generally or those who are actively engaged in marketing them.<sup>153</sup>

*Self-incrimination.* Taxpayers may have concerns that disclosure amounts to self-incrimination. The OECD clarifies that the information that a taxpayer is required to provide under MDRs is generally no greater than the information that the tax administration could require under an investigation or audit into a tax return. Potential tax avoidance and ATP transactions reported under MDRs should not therefore give rise

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<sup>145</sup> In Part B of the *Tax Administration Act 28 of 2011* (SA).

<sup>146</sup> Edward Nathan Sonnenbergs Inc, 'Reportable Arrangements and Legal Professional Privilege' (2008) *Integritax* 102, [https://www.saica.co.za/Integritax/2008/1602\\_Reportable\\_arrangements\\_and\\_legal\\_professional\\_privilege.htm](https://www.saica.co.za/Integritax/2008/1602_Reportable_arrangements_and_legal_professional_privilege.htm) (accessed 30 August 2019).

<sup>147</sup> 1988 (1) SA 938 (A).

<sup>148</sup> [1983] HCA 39.

<sup>149</sup> David H Zeffertt, *The South African Law of Evidence* (4th edn, Butterworths, 1988) 257.

<sup>150</sup> *Ibid* 248.

<sup>151</sup> *Finance Act 2004*.

<sup>152</sup> Baker, above n 31, 89.

<sup>153</sup> Law Council of Australia, above n 70, para 4.

to concerns over self-incrimination other than those that would arise under the exercise of other information collection powers.<sup>154</sup>

*Legitimate expectations.* Where MDRs are introduced, taxpayers may assume a legitimate expectation that any disclosure to the tax authorities leads to an implicit agreement that the scheme is valid, if there is no response to the contrary from the tax authority. To avoid such legitimate expectations, it is important that the regime makes clear that the disclosure does not imply any acceptance of the scheme or the tax benefit obtained by any person.<sup>155</sup> Similarly, disclosure does not necessarily mean that the transaction involves tax avoidance.<sup>156</sup>

## 5. CONCLUSION AND RECOMMENDATIONS

This article has highlighted the advantages of mandatory disclosure rules to a country's tax system using Australia as a case study. Australia does not currently have MDRs; however the 2016-17 Federal Budget announcement and the Australian Treasury's 2016 Discussion Paper indicate that the Australian Government is considering the introduction of such rules.

This article has shown that the rules will not overlap with – but rather will complement – most of the current narrowly-focused voluntary disclosure rules. To prevent overlaps with the existing Reportable Tax Positions Schedule and the promoter penalty laws, which have mandatory provisions that mimic the MDRs, it has been recommended that these rules be repealed and relevant provisions in the same be built on as a basis for certain provisions of the envisaged mandatory disclosure regime. This would ensure parity with international best practices and prevent concerns about excessive compliance burdens and costs to taxpayers.

The article has also explained how competing priorities can be balanced when the MDRs are adopted. There is no doubt that MDRs will enhance the information available to the ATO to crack down on aggressive tax planning (a key priority concern raised in the Discussion Paper).<sup>157</sup> Enacting MDRs will enable the ATO to have timely, targeted and comprehensive information which is essential to enable the government to quickly identify and respond to tax risk areas.<sup>158</sup>

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<sup>154</sup> OECD, *Mandatory Disclosure Rules: Action 12 – 2015 Final Report*, above n 9, paras 175-179.

<sup>155</sup> *Ibid* para 174.

<sup>156</sup> *Ibid* paras 175-177.

<sup>157</sup> Caredes, above n 8, 117.

<sup>158</sup> OECD, *Mandatory Disclosure Rules: Action 12 – 2015 Final Report*, above n 9, 22.