1. Introduction

Revenue bodies were faced with aggressive tax planning schemes and evasion more than ever during the last two decades and are still doing so. Considering the fact that the tax system gets more complex and more tax returns are logged every year, revenue bodies were confronted with situations they could not handle properly with the given recourses. Australia tried to address these problems by introducing a pyramidal model of responsive regulation. It should improve the Australian management of taxpayer compliance. The OECD also recognised the problems revenue bodies are faced within all member states and therefore has taken up the Australian Compliance Model as a guideline for its “Enhanced Relationship Model”. The OECD follows the notion that revenue bodies and taxpayers can establish a relationship which is based on mutual trust between both parties and therefore the currently existing “command-and-control regulation” should give way to a “responsive regulation”.¹ This paper examines the current programs and strategies which are taken in order to achieve a co-operative relationship between revenue bodies and taxpayers and the further improvements in respect of enforcement strategies for non-compliance, generally known as the Risk Management Approach. Due to the fact that many taxpayers especially those ones which are characterised as large or middle size businesses operate offshore the need for an enhanced co-operation between revenue bodies of the source countries and the residency countries in case of non-compliance gets obvious. Without well working mechanisms for the international information exchange a worldwide taxation cannot be guaranteed. It therefore has to be considered whether or not the existing Risk Management Approach can influence the form and the requirements for an international information exchange. Accordingly the first section of this paper (2.) outlines the main issues of the enhanced relationship model and its implementation in the national legal framework by certain states. The second part of this paper (3.) then turns to the Risk Management Approach and its implementation in Australia and the UK. This section ends with a summarising assumption which tries to bring the different approaches together and pointing out their advantages and disadvantages. The third part (4.) uses the gained results as a guideline for working out the international implications of a compliance program. Firstly the legal basis for an international information exchange and the protection of the taxpayers´ rights are outlined briefly, subsequently, the possibilities for simplified requirements for an information exchange for

high-risk taxpayers is discussed. Lastly, the fourth section (5.) brings all problems and provided solutions together to a final conclusion.

2. The Enhanced Relationship Model – The Theory

2.1. Background: Aggressive Tax Planning and the Need for Tax Advice

It cannot be ignored that most tax systems are complex and challenge the taxpayer. The complexity can be caused by different factors. The main reasons – especially for the Australian Tax System – might be the judiciary interpretation of tax legislation by referring to legal definitions from other areas, a large number of exemptions and the frequency of change of the taxation law.\(^2\) Due to the complexity and uncertainty the taxpayer is confronted, many decide to make use of professional tax advice. Notwithstanding the majority of taxpayers want their tax agent to prepare an honest return, there are taxpayers which try to maximize their income by aggressive tax planning which minimizes their tax liability.\(^3\)

Aggressive tax planning can in general be understood as “a risky choice due to the uncertainty of its final disposition”.\(^4\) The unjust allocation of the tax burden between those ones who logged an honest tax return and those who tried to minimize their tax liability by aggressive tax planning caused passionate debates. The Australian Tax Office (ATO) for example had faced a barrage of criticism,\(^5\) it was claimed that the ATO was “out of touch” and “lacked understanding”.\(^6\) Hence, a change in the Australian Tax Administration, which moved the existing model toward a more effective model of regulatory enforcement, had been necessary.

Not only the ATO faces issues of aggressive tax planning, tax avoidance and evasion also revenue bodies of other jurisdictions have to deal with these problems. In the last two decades a consistent upward trend in trying to minimize tax liabilities by aggressive tax planning could be recognized mostly all over the world. Hence, strategies have been necessary to protect the integrity of the tax system. The OECD acknowledged the problems revenue bodies are confronted with and it therefore published a “Study into the Role of Tax Intermediaries”, in January 2008. The content of this working paper goes far beyond the title may indicate. On the one hand the OECD provides guidelines how

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\(^4\) Hite, P., & McGill, G. (Fn 3) 400.


\(^7\) OECD, Study into the Role of Tax Intermediaries, available at [http://www.oecd.org/tax/taxadministration/39882938.pdf](http://www.oecd.org/tax/taxadministration/39882938.pdf), (in the following “the Study”).
revenue bodies can allocate available resources in a targeted and effective manner (Risk Management) and on the other hand how revenue bodies can gather necessary information in a co-operative way (Enhanced Relationship).

2.2. OECD Guidelines for an Enhanced Relationship Model

Due to the revenue bodies’ needs of gathering information in order to understand the taxpayer and its risk-potential, the OECD came up with the idea to establish a “more collaborative, trust-based relationship (...) between revenue bodies and large corporate taxpayers who abide by the law and go beyond statutory obligations to work together co-operatively”\(^8\). This new model was summarised under the term “enhanced relationship”. In general, the model is based on communication amongst the taxpayer and the revenue bodies which leads to better tax compliance and more efficient administration. The key elements within this relationship are transparency and trust. In theory entering into the enhanced relationship model is an advantage for taxpayers and revenue bodies as well.

2.2.1. Benefit for Revenue Bodies

The enhanced relationship model wants each taxpayer to be fully transparent in his communication and dealing and to disclose significant risks in a timely manner. To be fully transparent a taxpayer must volunteer information about tax return positions where he sees potential for a significant difference of interpretation between himself and the revenue body. Further the taxpayer should provide comprehensive responses in order to make the revenue body understand the significance of the issue.\(^9\) If the revenue body could gather important information directly from the taxpayer resources would be allocated much more appropriately.

2.2.2. Benefit for Taxpayers

Each taxpayer wants to resolve his tax matters in a quick, quiet, fair and final way. In general the taxpayer can profit by an early disclosure because the taxpayer gains an early certainty in respect of his tax issues. Being fully transparent causes a low-risk status that limits unnecessary audit time. By taking all these factors into account it can be seen clearly that the entry into an enhanced relationship can minimize the taxpayer’s compliance costs.

Notwithstanding the taxpayer profits by entering into an enhanced relationship model, the OECD pointed out that revenue bodies need to demonstrate five requirements in order to give taxpayers the incentive to enter into an enhanced relationship:\(^{10}\)

\(^8\) The Study (Fn 7) 39.
\(^{10}\) Ibid. p. 6 onwards.
2.2.2.1. Requirement one: Commercial Awareness

Taxpayers who engage in the enhanced relationship voluntarily disclose about different matters in respect of its business. In order to understand information disclosed by the taxpayer in the right way, revenue bodies require an understanding of the peculiarities or unique characteristics of a taxpayer’s industry and business and the taxpayer’s risk-management strategy, appetite for risk in the tax area and its decision making process. If the revenue body has an understanding of the business of how to do business, the taxpayer will not fear that the revenue body will misunderstand the information and use it to the disadvantage of the taxpayer.

2.2.2.2. Requirement two: An Impartial Approach

Due to the fact that the disclosure of uncertain tax positions provides a “roadmap” for revenue bodies to find issues where the taxpayer has doubts, the taxpayer must be certain that the revenue body acts fair and is not driven by the desire to extract the maximum amount of tax.

2.2.2.3. Requirement three: Proportionality

It can be seen as a fact that there is no “right” amount of tax because this amount is a sum of many individual tax items, the determination of each of which is often a matter of judgement. Revenue bodies should not examine if a single judgment made by a single taxpayer is equal with its own judgement, but they should determine whether the taxpayer has pitched the total tax liability disclosed on its return within a rage which is “acceptable”.

On the other hand the requirement of proportionality wants the revenue body to take the taxpayer’s history into account. If the taxpayer shows a history of no errors and hence a low-risk profile it should be subject to less examination than taxpayers with the opposite characters.

2.2.2.4. Requirement four: Disclosure and Transparency by Revenue Bodies

The revenue body must act transparently as well. The taxpayer might expect openness about why the revenue body perceives particular behaviour or tax positions to be a risk, why revenue bodies ask particular questions or seeking particular information. It might expect willingness to disclose information. This also might include early information of new laws, the provision of guidance, giving reasons for decisions and provision of guidance.

2.2.2.5. Requirement five: Responsiveness

The first four requirements are linked to the taxpayer’s need for certainty, but the forth is more linked to the wish to get information quickly. Taxpayers expect prompt, efficient and professional responses when they make queries or requests of revenue bodies.
Following some national approaches which try to implement the enhanced relationship model within their national jurisdiction will be outlined and their differences and synergies will be discussed:

2.3. Implementation in national Jurisdictions

2.3.1. Australian’s Pyramidal Model – First steps towards a Responsive Regulation

The pyramidal model of responsive regulation was introduced into the ATO in 1998 with the target to improve the ATO’s management of taxpayer compliance, and is still part of the ATO’s compliance program. The pyramidal model espouses responsive regulation in a way that revenue authorities have to select an enforcement strategy based on the specific taxpayer behaviour.

The different strategies should influence as many taxpayers as possible to move down the pyramid into the “willing to do the right thing” zone. The ATO tries to help those taxpayers that try to comply – it provides support depending on the taxpayer’s needs. The assistance could be in a form of a reminder or a visit to help get things going correctly. But the ATO uses its full force of law for those taxpayers who decided not to comply and try to minimize their tax liability which causes tax avoidance and evasion.

This model has two positive implications: On the one hand the ATO assists taxpayers who are willing to comply and help them to understand their obligations which leads to the result that the taxpayer itself assumes the “right” amount of tax. On the other hand the ATO can pool its strength to combat tax avoidance and evasion.

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13 Freedman, J. & Loomer, G. & Vella, J., Analysing the Enhanced Relationship (Fn 1), 106.
14 Compliance Program 2012-13 (Fn 1) 1.
15 Ibid, 2.
The ATO also acknowledges that it has to understand the taxpayer and his issues in order to allocate his position in the pyramid. Taxpayers may operate in a dynamic social, political and economic environment – “understanding these factors, as well as the policy, legislative and administrative processes of the law, enables [the ATO] to make more informed judgements”\(^\text{16}\) on taxpayers – especially large businesses. Therefore the BISEP model forms part of the ATO’s compliance model:

![Factors that influence taxpayer behaviour](image)

**Figure 2 „Factors that influence taxpayer behaviour“**

The fundamental intention of trying to understand and help the taxpayer to do the right thing clearly indicates the shift from a “command-and-control regulation” to a “responsive regulation”\(^\text{17}\). The new compliance model leads to a rethink of the “relationship” between the ATO and the taxpayer. Hamilton described the ongoing process as an “enormous cultural change within (...) [the] tax administration (...) – the recognition that taxpayers are their clients – and that how (...) clients are treated matters a great deal and can significantly influence acceptance of the tax system and overall compliance levels”\(^\text{18}\).

### 2.3.2. Netherlands

The Netherlands has also implemented an approach which is based on co-operation between revenue bodies and taxpayers in its jurisdiction – known as horizontal monitoring. Horizontal monitoring entails “mutual trust between the taxpayer and the Tax and Customs Administration (TCA) and clearer communication about each other’s responsibilities and capabilities in order to do what is right, as well as laying down and observing reciprocal agreements”\(^\text{19}\). The approach is based on three key elements: mutual trust, understanding and transparency. The TCA started its pilot project in 2005 consisting of 20 very large companies, most of them were listed. The companies and the TCA entered into an agreement based on collaboration between the parties. In broad terms the agreement tries to create a


\(^{17}\) Freedman, J. & Loomer, G. & Vella, J., Analysing the Enhanced Relationship (Fn 1)


sustained understanding of ongoing tax risks and rapidly establish up-to-date positions on them under the dictates of law, regulations and case law in order to improve legal certainty. Companies which enter in such a “supervision agreement” will commit itself to full transparency on current tax issues. In return, the TCA will give its binding opinion on issues which arise, what creates legal certainty for the taxpayer. On the other hand, the TCA benefits because the co-operation with the taxpayer reduces the need for vertical supervision like audits what reduces administrative burdens. Trust in the context of horizontal monitoring means the “expectation that the other party will conduit itself well” It does not mean that the TCA assumes that the taxpayer makes no mistakes but it does mean, however, that the TCA expects the taxpayer to display good conduct.

2.3.3. US

Currently the United Sates of America have introduced several co-operative approaches which try to address the difficulties revenue bodies are faced by assessing LMSB (Large and Midsize Businesses). There is evidence that it took two years on average before complicated corporate returns found their way into the hands of the assigned examiner, and it took five years from the date the return was filed for the Internal Revenue Service (IRS) to complete the audit of a large, complex corporation and these numbers do not include the appeals process, which needs another two years before the matter is settled or goes to court.

The current approach followed by the IRS is “Anchoring Change”, which basically involves institutionalising and implementing improvements on existing programs and processes, rather than developing new compliance strategies. These programs and strategies created in recent years include – among others – the “Industry Issue Resolution” (IIR) Program, the “Compliance Assurance Program” (CAP), the “Limited Issue Focus Examination Program” (LIFE), the “Fast Track Settlement” (FTS) Strategy, the “Pre-Filing Agreement” (PFA) Strategy and the “Industry Issue Focus” (IIF) initiative. In the following only the main co-operative approaches will be discussed briefly:

[20] Ibid.
[23] Tax Control Framework (Fn 19) 8.
[27] Ibid.
The PFA for example is part of the Pre-filling processes and is an example of existing programs where taxpayers may request the use of special processes and make voluntary disclosures of issues and relevant information in order to achieve certainty prior to filling the return.\textsuperscript{28} The LIFE process should address the timeframe of audits – it should help to perform audits in a shorter time frame without compromising the quality of results. The process aims to include restricting examinations of large businesses to the few issues on their tax returns that pose the greatest compliance risk.\textsuperscript{29} The concept of LIFE is based on the assumption that, by focusing on a few critical issues, the scope, depth, length, and burdens of examinations can be reduced while higher degrees of productivity are realised.\textsuperscript{30}

The CAP program was initiated by the IRS in 2005 as a pilot project for large business return filers. In general, the CAP is designed to establish the correct tax treatment of tax returns position prior to the filing of a federal tax return. The results given by the piloting phase leads to the result that the CAP program is now a permanent program for taxable years beginning after 31. December 2012. The program is eligible to taxpayers who have assets of 10 million dollars or more, be a publicly held entity with SEC filing requirements and not be under investigation or in litigation with the IRS. An application is filled\textsuperscript{31} and a “Memorandum of Understanding” (MOU)\textsuperscript{32} is signed that outlines the program requirements and serves as an agreement between the taxpayer and the revenue bodies. This program consists of three phases: The Pre-CAP, the CAP and the Post-CAP phase. The first one aims to close the open tax years within an agreed upon timeframe.\textsuperscript{33} Within the CAP phase taxpayers work collaboratively with the IRS to identify and resolve potential tax issues before the return is filled. If the taxpayer enters into significant business transactions he discloses its tax position regarding those transactions to the IRS.\textsuperscript{34} During the Post-filling Review the IRS will issue a “No Change” letter if the taxpayer disclosed all information regarding those transactions. Otherwise the IRS will issue a “Partial Acceptance” letter and commence a traditional audit for those unresolved issues.\textsuperscript{35} In general, the taxpayer may benefit because of the gains certainty before a return is filed.

2.3.4. Summarising Statement in respect of “Binding Rulings”: A Key-Feature for an Enhanced Relationship Model?

Many countries try to follow the OECD’s enhanced relationship model in order to achieve an efficient tax administration. As pointed out above the strategies and processes which are chosen by each state are different however, all have in common that revenue bodies work closer together in fields where the

\textsuperscript{28} Ibid.
\textsuperscript{29} LMSB Subgroup Report (Fn 26) page 5.
\textsuperscript{30} Ibid.
\textsuperscript{34} Ibid.
likelihood is relatively high that the taxpayer has a tax outcome the revenue body does not agree with. Notwithstanding the jurisdiction of one state commits to work closely together with the taxpayer the benefits will only be achieved if revenue bodies create “an environment of trust”. The relationship between taxpayers and revenue bodies was dominated by control and command since the beginning – the taxpayers have never seen revenue bodies as their “friends” which give them a helping hand in order to fulfil their obligations. This cultural change needs time on the one hand and much afford by the revenue bodies in order to show taxpayers that they can trust them on the other hand.

The OECD describes the enhanced relationship model as to be based on “establishing and sustaining mutual trust between taxpayers and revenue bodies”\(^{36}\). An enhanced relationship can therefore not exist if the taxpayer cannot trust the revenue body and vice versa. It might therefore not be surprising that the pioneers of this model are states which always want to make their tax administration transparent and understandable for taxpayers and grant their taxpayers certainty in their tax affairs by introducing legal binding rulings within their legal system. Australia, the US and the UK have a long history of legal binding rulings which create – beyond doubt – certainty for taxpayers because it commits revenue bodies to any representation made.\(^{37}\) Taxpayers can rely on advance rulings and can plan their tax affairs in certainty. Whereas taxpayers in jurisdictions which do not have any form of advance ruling always have to plan their tax matters within an uncertain environment.

If the legal system of one state cannot grant its taxpayers certainty by introducing legal binding rulings the relationship between revenue bodies and taxpayers might not be imbued with trust. The taxpayer might think that the unwillingness of the revenue bodies to expose their opinion in a binding manner is based on their aim to leave the taxpayer in uncertainty and assess the taxpayer on their “right” interpretation of the law and the given circumstances by maximizing the tax outcome because the taxpayer has no further chances to dispose in a different way – first taxpayers have the uncertainty by planning their tax matters and they have to bear the risk because they cannot go back and dispose in a different way. A lack of trust within the relationship between revenue bodies and taxpayers is not a good basis for introducing an enhanced relationship model. Counties which have not made use of a legal binding ruling system also have troubles by following the enhanced relationship model. If those counties decide to follow an enhanced relationship model they have to take the decision whether they implement a general binding ruling system or a binding ruling system which is restricted to certain taxpayers which enter into an enhanced relationship with the revenue bodies. An enhanced relationship model might not work without any form of advanced ruling because why should the taxpayer disclose everything by not getting anything in return. The taxpayer still has to wait until he receives his final assessment till he is “safe”. It is right that taxpayer which can ask for a binding ruling may not often do that within an enhanced relationship model however, the fact that the taxpayer

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\(^{36}\) The Study (Fn 7) 40.

has the opportunity to get a binding ruling and the fact that the revenue bodies are bound by their representations have a positive impact on the “trust environment” which is necessary for a well working co-operative model.

Even though the OECD has not indicated that an enhanced relationship requires an advanced ruling it is a pre-requirement. No taxpayer would make himself “naked” by disclosing everything voluntarily to the revenue bodies and not getting anything beneficial in return. A jurisdiction which has no advanced ruling might also have a long and hard road till it really reaches an enhanced relationship because you cannot build up trust in one week, this is a process which takes time and trust without certainty can never be achieved.

3. Risk Management: Improvement of the basic model or pre requirement

3.1. Overview

Revenue authorities normally have a range of administrative treatments which they can use in order to address non-compliance: education, assistance, review and enforcement products. These treatments should help to change the taxpayer’s behaviour and encourage its future compliance. In order to provide the taxpayers with the treatment they need and address non-compliance in an appropriate manner, it is necessary to identify relevant differences between taxpayers. Attributes like particular taxpayer circumstances, behaviour and risk profile can help revenue bodies to better tailor their taxpayer interactions.38

The question one can ask is if risk management is a pre-requirement for an enhanced relationship model or if it is an improvement. Can one exist without the other one? Even though tax authorities establish a tax environment which is or should be based on trust and co-operation (enhanced relationship) there might be taxpayers which do not want or can comply. The different behaviour of taxpayer needs a different treatment. Taxpayers which comply and disclose information voluntarily should profit from a low risk rating. The benefits on the one hand and the enforcement in case of non-compliance on the other hand should encourage taxpayers to work together with the revenue body in a co-operative way. Hence, there is a need to figure out which taxpayer does not comply or is likely to not comply. Besides the behaviour of the taxpayer there are other indicators which should influence the choice of the tools revenue bodies can use in order to address potential non-compliance. These indicators may be of a nature the taxpayer cannot influence and are therefore “inherent risk factors”. The size of the business, the amount of offshore activities and the taxpayers’ turnover may be factors of this category. In general, the risk management approach tries to catch all these factors and the behaviour of the taxpayer to give a final result in respect of his risk potential.

Broadly, the risk management approach is based on the revenue body’s knowledge about potential tax issues and the taxpayer. The gathered information should help the revenue body to form an objective judgement about risk. The two key elements in risk management are therefore: understanding the taxpayer and understanding the tax issue. The risk management approach should help revenue bodies to estimate the potential risk of each taxpayer (identification) in order to treat each one with appropriate instruments (treatment of risk) and to bundle their resources and use them where they are needed most.

Currently several states use a risk management approach in order to promote an enhanced relationship between the revenue body and the taxpayer, which is based on trust and transparency. Even though each of them wants to determine the risk potential of taxpayers in order to know which treatment suits them best, the way in which the risk management approaches are designed vary: The Australian and UK approach are without doubt those ones which are developed in the most accurate way. Therefore these two systems are discussed in detail in the following:

### 3.2. Australian’s Risk Management Program

The ATO acknowledged its approach to identify and assess compliance risk by categorising businesses through its Risk Differentiation Framework (RDF) in Chapter 7 of the Large Business and Tax Compliance Booklet. Due to the value, volume and complexity of transactions undertaken by large businesses they have inherent risks for tax compliance and therefore they have been addressed by the RDF in first instance. Recently the ATO extended this approach also to small-to-medium sized enterprises to understand the level of risk each taxpayer represents.

In general the RDA should help to assess the tax risk of each taxpayer and to determine the intensity of the ATO’s response in a coherent, consistent and considered way. The whole approach is based on two key elements: The likelihood of non-compliance and the consequences of non-compliance. The likelihood of non-compliance means how likely it is, that the taxpayer has a tax outcome the ATO does not agree with. The consequences are measured in dollars, relativities, reputation, precedent and so on in order to bring the caused consequences of non-compliance to a real measurable quantity.

Combining these two key elements the following diagram for working out the taxpayer’s compliance risk is given:

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39 The Study (Fn7) 25.
40 ATO, Large bussiness and tax compliance (Fn 16).
41 ATO, Compliance Program 2012-13 (Fn 12) 32.
42 ATO, Large bussiness and tax compliance (Fn 16) 23.
This diagram clearly indicates the approach: The more likely it is that a taxpayer does not comply the more it moves from the left to the right on the x-axis. If your likelihood of non-compliance is high you cannot be a low risk taxpayer – you are at least a medium risk taxpayer. The y-axis on the other hand demonstrates the consequences of non-compliance. The higher the consequences are the more you move up the y-axis. The huge impact the consequences have on the categorisation of the taxpayer can be seen clearly. Notwithstanding the taxpayer is willed to comply he is categorised as a key taxpayer if the consequences of non-compliance are high. Therefore large businesses normally will be classified as a key taxpayer or a high-risk taxpayer depending on its behaviour. The move to a medium risk taxpayer for a big business shouldn’t be impossible however based on the current model it is hard to reach. The ATO predicted in its Large Business and Tax Compliance Booklet\(^\text{43}\) that the majority of taxpayers will fall within the lower risk category (72%). 18% taxpayers will be characterised as being of a medium risk and only 8% form key taxpayers. High-risk taxpayers will form the minority (2%).\(^\text{44}\)

Based on the risk of non-compliance and the caused consequences the ATO applies different instruments: For high-risk taxpayers it is more likely that the ATO uses its formal powers of information gathering, while taxpayers which are low risk rated should benefit from their behaviour.\(^\text{45}\)

\(^{43}\) ATO, Large business and tax compliance (Fn 16) 24.

\(^{44}\) For the exact numbers of small to medium size companies falling within the several categories see the ATO’s Compliance Program 2012-13 (Fn 12) 32.

\(^{45}\) Ibid.
“Certainty for these taxpayers is not in relation to their tax position but rather a certainty that they will be reviewed by us. Such an experience will be fair and professional but may also be quite formal and intense”.

The framework illustrates a relatively intense focus on clients categorised as high-risk taxpayers. The ATO uses a significant amount of recourses to identify, review and understand any material transaction which have the potential for tax planning. Therefore the ATO can quickly form a view as to their appropriate treatment.

In contrast for key taxpayers which have high consequences by non-compliance but a small likelihood of non-compliance a continuous monitoring stance is suggested. It is even less likely that the ATO uses its formal power of accessing and questioning. The choice of remedy for non-compliance is more likely to involve alternative dispute resolution approaches where it is appropriate.

Medium risk rated taxpayers underlie a periodic review stance and for low risk rated taxpayers a periodic monitoring stance is suggested. The benefits of being low or medium risk rated are obvious: The ATO may involve the business in specific risk reviews, where matters of concern relating to specific issues. These issues are identified in the annual Compliance Program. The taxpayer’s compliance costs are reduced because they are not confronted with unnecessary audits or other forms of the ATO’s power of information gathering.

3.3. UK’s Risk Rating Approach

The HM Revenue & Customs (HMRC) launched its Review of Links with the Large Business project (Varney Review) in November 2006, which highlights the need for an “efficient risk based approach to dealing with tax matters”. Besides this, three further desires are mentioned in this report: greater certainty, speedy resolutions of issues and clarity through effective consultation and dialogues. Under UK’s Risk Rating Approach (RRA) every large business is awarded a risk rating, which determines the volume of HMRC’s intervention in the affairs of the company and the nature of the working relationship between the company and the HMRC. The risk rating should help to create a “more cost effective use of resources and efficient resolution of issues” by implementing an audit approach which focuses on key risks. The risk which should be figured out by the risk rating is “compliance

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46 Speech by Michael D’Ascenzo, Commissioner of Taxation to the 22nd Australian Tax Teachers Association Conference 2012, University of New South Wales, 22nd of January 2010.
48 Ibid, 512.
51 2006 Review of Links with Large Businesses, para 4.8.
risk” which is defined by the HMRC as “the likelihood of failure to pay the right tax at the right time, or of not understanding what the right position might be”\(^{52}\).

The Australian RDF and the UK’s RRA show similarities in respect of the awarded risk rating: The likelihood of non-compliance and their caused consequences are the key factors for defining the taxpayer’s risk. But the UK has moved past Australia in modernising its risk management approach to risk based regulatory guidance, enforcement and sanctioning.\(^{53}\) A code of conduct for regulators called the “Statutory Code of Practice for Regulators” came already into effect in the end of 2007. The British government acknowledge that regulation and its enforcement must be proportional and flexible enough to allow or even encourage economic process. The Code should “promote efficient and effective approaches to regulatory inspection and enforcement which improve regulatory outcomes without unnecessary burdens on business”\(^{55}\). In general, the Code highlights the need for regulators to adopt a positive and proactive approach toward ensuring compliance by helping and encouraging regulated entities to understand and meet regulatory requirements more easily on the one hand and reporting proportionately to regulatory breaches on the other hand.\(^{55}\) Section 4 of the Code focuses on the Risk Assessment. In general terms, the section tries to highlight the need that regulators and the whole regulatory system use risk management to concentrate resources in the area that need the most.

Even though the whole regulatory system should be flexible and allocate recourses to areas where they are needed most, the regulators’ penalty regime was cumbersome and ineffective.\(^{56}\) Based on these findings the Macrory Review\(^{57}\) set out a blueprint for transforming the UK’s regulatory sanctioning regime towards a more flexible one which is based on the risk assessment approach. The main issues outlined in the review are the lack of flexibility and the backlog of criminal prosecution.\(^{58}\) The Macrory Review recommendations want to ensure that regulators have access to a flexible set of sanctioning tools which are consistent with the risk-based approach.\(^{59}\)

The Regulatory Enforcement and Sanctions Act 2008\(^{60}\) vests regulators with an extended tool kit of alternative civil sanctions. These sanctions are more proportionate and flexible sanctions to address

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\(^{52}\) HMRC Approach to Compliance Risk Management for Large Business. Compliance Risk is defined as “this is a risk that the correct amount of tax or duty may not be paid to the Exchequer” under the Tax Compliance Risk Management Process (TCRMP) (available at [http://webarchive.nationalarchives.gov.uk/20110314113412/http://www.hmrc.gov.uk/manuals/tcmanual/TCRM1100.htm](http://webarchive.nationalarchives.gov.uk/20110314113412/http://www.hmrc.gov.uk/manuals/tcmanual/TCRM1100.htm))

\(^{53}\) Hamilton, S., New dimensions (Fn 48) 523.


\(^{55}\) Regulators’ Compliance Code, 1.3.


non-compliance. The financial benefits which are gained by some taxpayers through non-compliance should be removed by these sanctions and they should help to increase compliance.

Compared to other risk management approaches the British compliance model moved forward further and it already consists of a statutory Code of Conduct for regulators and a codified enforcement and sanction system which is based on the risk assessment approach.

3.4. Summarising Assumptions

The risk management approach is a mechanism in order to estimate the taxpayer’s risk of non-compliance which has two parameters: On the one hand it means the likelihood of non-compliance and the consequences of a potential non-compliance. It should help revenue bodies to use efficient tools (education, enforcement, sanctions) to address non-compliance and to help increase compliance. It seems to be a general trend to base the whole relationship between revenue bodies and taxpayers on their risk rating. Not only the way how revenue bodies interact with the taxpayer (review, audit, etc.) but also the sanctions are influenced by the taxpayer’s risk rating. The British model has codified a range of different tools in order to create a flexible sanction model to address non-compliance in an effective manner. At the moment only the British model stands on a legal basis. Beyond doubt, this gives taxpayers certainty – if the interaction between revenue bodies and the taxpayer is not defined by law it may give rise to uncertainty for the taxpayer. Therefore the need for transparency and predictability is discussed in the following and if a legal determination is the only way to achieve them.

3.4.1. Transparency – the key feature within the Risk Rating Approach

If the risk management approach is embedded in an enhanced relation program it must be ensured that the risk management approach is designed in a way which does not destroy the mutual trust relationship between the taxpayer and the revenue body. This relationship might be infringed if the taxpayer has no idea on which criteria the risk rating is based. Taxpayers need to know why they are classified as being a low- or high-risk taxpayer and they have to have the chance to debate the given result with the revenue body. Therefore the risk rating process must be transparent and the taxpayer must be able to understand the risk rating process. The ATO expressly outlines in its Compliance Program the criteria which are relevant for assessing the risk of each taxpayer (past compliance behaviour, business performance over time compared to the tax outcomes and that of the taxpayers’ peers etc). However, the risk rating will only be discussed if the ATO has concerns about it. There is no actual right of the taxpayer to discuss and debate his risk rating assessment with the ATO, further the taxpayer has no right to object against his rating. As the survey by Freedman, Loomer and Vella has pointed out that even though the risk rating criteria might be set out and made visual to the taxpayer there might be uncertainty how these criteria interact and which one will be given more
weight within the risk rating assessment. In case of the UK risk rating taxpayer were unsure whether or not the existence of structural issues or their management (inherent risk factors) was more important than their behaviour and thus there was the misconception that companies of a certain size and complexity can never be low risk.\(^{61}\) This result clearly shows that it is necessary that taxpayers should not only get their risk rating based on the specific criteria but they also must be convinced why they are low- or high-risk taxpayers. If the impression is created that the risk rating is not influenced by the taxpayer’s performance he will not have any further motivation to comply and disclose information voluntarily. Taxpayers must be informed how the risk rating works and how inherent risks influence their risk rating. If they cannot understand the revenue bodies’ result they might also not understand why the revenue bodies use the “sanctions” which are caused by the risk rating. A taxpayer who is rated as high risky must understand what causes this rating and why he is faced with the full force of law in future. However, the most important thing is that taxpayers who are on the border between two risk rating categories understand what he could do in order to shift across the risk categories. These taxpayers have to understand that they can influence their risk rating and how they can. The revenue bodies therefore must invest a certain amount of time in order to explain the risk rating assessment to the taxpayer, otherwise they risk that their trust relationship might break. The key features of a risk rating model are therefore transparency and enlightenment.

3.4.2. The need for a Legal Basis

Revenue bodies are confronted with thousands of individual taxpayers which should be taxed in respect of their individual circumstances. This as well as the smooth and efficient operation of the tax system and the allowances of minor corrections and robust defences attempts at manipulation by taxpayers\(^{62}\) highlight the need for revenue bodies to be allowed to employ some discretion. Whilst discretion in the hand of revenue bodies make the tax administration system work it contradicts the taxpayer’s demands for certainty, legitimacy, consistency and equality. This problem was also acknowledged by Ian Ayres and John Braithwaite\(^{63}\) who are one of the main advocates of the responsive regulation model:

“ Obviously, the rule of law is needed as protection against the excesses that we have seen from regulators with the backing of the ruling party in countries such as China, excesses that have included execution and arrest without trial. The rule of law is not only essential to a republican regulatory order, it is definitional of it”.

\(^{61}\) Freedman, J. & Loomer, G. & Vella, J., Analysing the Enhanced Relationship (Fn 1), 120.


The rule of law concerns the powers of executive, of government and it governs the relationship of the executive to the law. The core meaning of the rule provides that “the executive may do nothing without clear legal authority first permitting its actions.” This concept requires that vagueness must be eliminated and that the legal system does not achieve the rule of law to the extent that its law is vague. The indeterminacy of law has raised various debates in academia. These debates cover primarily two main points of criticism: It was argued that the rule of law and in particular the determinacy of law is definitional of responsive regulation because this concept depends upon everyone knows what the law is and how “gaps” in the letter of the law ought to be resolved. If the interpretation of the taxpayer generally will be acknowledged to be wrong because it is inconsistent with the regulator’s “right” interpretation it is hard to see how the rule of law is definitional of responsive regulation, because this would turn regulators into judges in their own cause and lay the way for autocratic power. Therefore indeterminacy of law can lead to uncertainty in respect of what taxpayers have to do in order to be compliant and causes that a responsive compliance model cannot be reached. On the other hand, if regulators have to decide what is the “right” argumentation they are acting much more like a judge than an executive agency what infringes the principle of separation of powers.

In the following I want to leave the question when the legislation is determined in a way which is in line with the rule of law aside and focus on the question whether or not the whole system of responsive regulation or enhanced relationship and risk management has to be based on legislation. Currently different approaches can be seen in those states which try or tried to implement an enhanced relationship model and a risk management approach in their national legal system. Australia – the pioneer of the enhanced relationship model – has not codified anything of its current compliance concept. The Commissioner informs the taxpayer through his Annual Compliance Program issued at the beginning of each tax year about the ATO’s Compliance Model. In contrast the US has codified the Taxpayers’ Bill of Rights – it outlines the main rights each taxpayer has against revenue bodies within its tax affairs. However, the UK goes even further and tries to codify the set of tools regulators have in order to address non-compliance. It enacted “The Regulatory Enforcement and Sanctions Act 2008” which vests the regulators with an extended tool kit of alternative civil sanctions but gives the taxpayer the chance to predict the sanctions which are caused by its behaviour. Besides this Act the

UK also codified a Code of Conduct for its regulators called “Statutory Code of Practice for Regulators” which came into existence in 2007.

The enhanced relationship model as well as the risk management approach embodies an intrinsic demand of flexibility – revenue bodies need a tool kit of different sanctions to address the taxpayer’s non-compliance. It is hardly impossible to codify the specific sanction a specific behaviour causes or which benefit a taxpayer gets if he complies. The ATO for example outlines the possible sanctions the behaviour could cause – non-compliance will cause an escalation up the compliance pyramid or a move from the left to the right on the x-axis within the RDF which has the use of full force of law as its final result. The taxpayers may be able to suggest which compliance strategy they are facing due to their behaviour but there is no precise provision which tells the taxpayer and the revenue bodies which strategy is caused by which behaviour. Beyond doubt, these modes allow revenue bodies to employ more discretion when compared to the basic relationship between revenue bodies and taxpayer because within the basic relationship the parties are solely interacting by reference to what each is legally required to.69 On the other hand it might be questionable which consequences are caused by interactions of the revenue body: Do some particular interactions between the revenue body and the taxpayer fulfil the criteria to be an assessment or not? This has an impact on the possibility of a judicial review. It might also be the main reason why especially civil law countries, which assert the rule of law as a main principle within their legal system and want to restrict the revenue bodies´ discretion as much as possible, have problems by introducing an enhanced relationship model and a risk management approach.70 This may also be the reason why the Dutch approach needs a formal contract to be signed by both parties: the revenue body and the taxpayer. Due to the signed contract there is no need to have legislation which determines the possible “reactions” of revenue bodies in detail.

The main question may be: Does every potential action or reaction of an executive body has to be determined in detail or are there other mechanisms which can be used in order to restrict the revenue bodies´ discretion without forming laws which are determined in detail and cover every scenario you may think of.

As we have seen from the US and the UK it is possible to codify parameters for an enhanced relationship model and a risk management approach however the important question is: How can we fill the gap between these parameters which may only outline the bulk of “tools” revenue body can use for addressing “non-compliance” and the concrete action set by revenue bodies? In short, it must be questioned how the discretion, each revenue body is allowed to employ, can be transformed from a

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69 The Study (Fn 7) 39.
general discretion to a “guided” discretion. What means that a revenue body is allowed to choose between certain tools (sanctions) to address the taxpayer’s behaviour but it is bound by guidelines on how to use them. Guidelines on how revenue bodies should act within an enhanced relationship model or risk management approach can be principles. A principle is intended to be something higher level than just a vague or broad rule.\textsuperscript{71} Such principles provide answers which are derived by the courts and the revenue bodies from the legislature through their use of the principles and so are entirely in accordance with the requirement for tax law to derive from Parliament.\textsuperscript{72}

A principle based model is nothing which is totally new. The Australian Government made a commitment to use general principles in preference to long and detailed provisions in 1998.\textsuperscript{73} Currently this system is better known as “the Coherent Principles Approach”. This approach makes the principle a part of the framework or architecture of a specific piece of legislation.\textsuperscript{74} Pinder described the coherent principles approach for the Australian’s current tax law design as a mechanism which helps the reader to make sense and order out of the law and it is intuitive or obvious to someone who understands the law’s context.\textsuperscript{75}

It might be questioned whether a principle approach can be used to guide the revenue body’s discretions in the field of an enhanced relationship model and risk management. If the principle and the purpose of legislation are made visible to revenue bodies they have to scrutinise the accordance of their actions with the principles. The legislation might be not applicable to each action because it does not cover the given scenario or is formed in a too broad and vague way. Principles can therefore help to limit the revenue bodies’ discretion to a “guided” discretion by limiting the need for long and detailed legislation. The US and the UK show that the taxpayers’ rights and the sanctions revenue bodies are allowed to use in order to address non-compliance can be codified however, principles can help to combine these two sets of law and ensure that the discretion of the revenue body by choosing one of these tools in order to enforce the taxpayer’s compliance is not unguided.

4. International Dialogue between Revenue Bodies: Next step to prevent international tax fraud?

4.1. Overview

The enhanced relationship model and the risk management approach try to improve the relationship between revenue bodies and taxpayers and are in general from a domestic nature. These approaches address revenue bodies and taxpayers in one country. However, many taxpayers especially those ones which are rated as high-risk taxpayers may operate offshore – also the level of international dealings

\textsuperscript{72} Freedman, J., Improving (Fns 67) 720.
\textsuperscript{74} Freedman, J., Improving (Fns 67) 725.
\textsuperscript{75} Pinder, G., The coherent principles approach (Fns 67).
influences their risk rating. Taxpayers which have a significant part of their business offshore could benefit from situations in which the revenue bodies of the countries they are operating in do not exchange information. If revenue bodies do not know what their taxpayers are doing offshore and on which amount they are assessed in other countries revenue bodies may have problems by assessing them on the “right” amount. The unwillingness to exchange information and the therefore inherited lack of information is also used by taxpayers for financial crimes across international boundaries. In order to strengthen international co-operation between revenue bodies, the OECD has advocated greater co-operation and better information exchange between tax and law enforcement agencies involved in the fight against financial crimes, both domestically and internationally.76

There are different mechanisms which can be used to exchange information between states. However, it should be tried to combine the enhanced relationship model and the risk management approach with the existing mechanisms of information exchange. Especially the risk rating approach which takes the offshore activity of the taxpayer into account indicates the need for access to information from foreign tax administrations in case of a high-risk taxpayer. A lack of information could cause that the taxpayer is assessed on the “wrong” amount which could be in favour of or at the cost of the taxpayer. In the following it should be outlined how the risk management approach and the foreign information exchange mechanisms can be combined.

4.2. Need for information

The OECD highlighted the revenue bodies’ need for information in its Study into the Role of Tax Intermediaries77 and pointed out that revenue bodies generally have two broad methods of obtaining information from taxpayers: They can either obtain information by using statutory powers or obtaining information on a voluntary basis. However, the OECD encourages all member states to follow a voluntarily disclosure approach (enhanced relationship model) in order to obtain relevant information.78 At the international level similarities can be seen: Revenue bodies often have a huge need to access information relating to offshore operations of their taxpayers. If the taxpayer is compliant the fear that he exploits the lack of information relating to his offshore activity in his favour might be limited because a compliant taxpayer would disclose all relevant facts even those relating to his offshore activities. However, if a taxpayer is known as being non-compliant the need to obtain information from foreign tax administrations gets obvious. Hence, in case of high-risk taxpayers who are operating offshore barriers to cross-border information exchange have to be removed in order to ensure that the taxpayers cannot profit out of a lack of information exchange between countries and to address international criminal activity.

77 The Study (Fn 7) 27.
78 The Study (Fn 7) 27.
4.3. Design for a High-Risk Taxpayer International Information Exchange Model

4.3.1. Facts influencing the Entrance into an International Dialogue

For designing a “High-Risk Taxpayer International Information Exchange Model” it is necessary to take all the information gained from the risk management approach and the current mechanisms which can be used for an information exchange into account. The parameters which indicate the level of foreign information needed are: The taxpayer’s overall attitude to compliance, the amount of his offshore activity and the consequences (dollars, relativities, reputation, precedent etc) of potential non-compliance:

As the diagram shows, the higher the consequences of potential non-compliance are, the higher the likelihood of non-compliance is and the more the taxpayer operates offshore the more revenue bodies have to enter into an international dialogue with the other revenue bodies in order to exchange information. Now as we know which facts influence the question whether or not revenue bodies should enter into a dialogue with foreign tax administrations, it should be examined how this international information exchange dialogue could look like and on which legal basis it could rely on.

4.3.2. Legal Basis for an International Information Exchange Dialogue

In a first step it is necessary to examine the legal basis of an international information exchange. The OECD tries to encourage member states to exchange information and to remove existing barriers to cross-border information exchange. To achieve transparency and a well working information exchange approach for tax purposes the OECD has developed different systems and procedures to improve the
quality of information sharing and to facilitate the exchange of tax information between countries taking into account the latest technological developments.\(^{79}\) Better transparency and information exchange for tax purposes is the key to ensure that taxpayers have no safe haven to hide their income and assets and that they pay the right amount of tax in the right place.\(^{80}\) The main legal basis for an information exchange is Art 26 of the OECD Model Convention, which provides in its first subparagraph:

“The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.”

Importantly, the information exchange which can be based on Art 26 OECD MC is not restricted to those taxes covered by the convention it can go far beyond these taxes. The provision seeks to increase international co-operation in tax matter through information exchanged between member states.\(^{81}\) The information exchange based on Art 26 OECD MC does not allow member states unlimited opportunities to seek information: The wording of this provision restricts the information gathering possibility to information which is foreseeably. On the one hand foreseeably information intends “to provide for exchange of information in tax matters to the widest possible extent”, and should clarify on the other hand that member states “are not at liberty to engage in fishing expeditions or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer”\(^{82}\). Fishing expeditions can be described as “an attempt, through broad discovery request or random questions, to elicit information from another party in the hope that something relevant might be found”\(^{83}\). The information sought under the high-risk taxpayer information exchange approach must be foreseeably in order to bring it outside the fishing expedition prohibition.\(^{84}\)

In general Art 26 OECD MC allows for tax information to be exchanged by competent authorities in three ways: on-request, automatically and spontaneously. However, these forms of information exchange differ in its design but have in common that the international co-operation between local tax offices should be improved. These mechanisms should also not provide a member state with

\(^{79}\) OECD, Crime (Fn 77) 23.
\(^{80}\) OECD, Implementing the Tax Transparency Standards A Handbook for Assessors and Jurisdictions, 9, available via OECD iLibrary.
\(^{82}\) OECD MC Commentary (July 2010) Art 26, para 5.
information it could obtain by using means available in its own territory. The information exchange is therefore restricted to information which is only available for the source state. An information exchange in respect of high-risk taxpayers between those countries he is operating in (source countries and the country of residency) could be based on all three forms of the information exchange depending on which kind of information is exchanged. The automatic information exchange involves the systematic and periodic transmission of “bulk” taxpayer information by the source country to the residence country. This type of information exchange concerns various categories of information like dividends, interests, royalties but can also include other useful types of information like a purchase of disposition of immovable property, VAT refunds and so on. The spontaneous information exchange instead may be used if a local tax office “discovers” information which is foreseeable relevant to another member state. Normally such information may be “discovered” during audits or other forms of information gathering used by revenue bodies. Circumstances which indicate a spontaneous information exchange are for example, payments made to residence of another country where there is suspicion that they have not been reported, a country has grounds for suspecting that a saving of tax may result from artificial transfers of profits within groups of enterprises or where the likelihood of a particular tax avoidance or evasion scheme being used by other taxpayers. The information exchange on-request is beyond doubt that one which is differentiated most. The OECD outlines the requirements which a request has to fulfil in order to be entitled to receive information from another member state. In general, the request should be as detailed as possible and contains “all the relevant fact, so that the competent authority that receives the request is well aware of the needs of the applicant contracting party and can deal with the request in the most efficient manner”.

In the following it should be questioned how an international information exchange for high-risk taxpayer could be based on these forms of information exchange:

4.3.3. Reduced Requirements for an Information Exchange On-Request for High-Risk Taxpayers

A member state may not be able to nominate one taxpayer as a “high-risk” taxpayer and expects that each contracting state exchanges all information it obtains in relation to this taxpayer. Currently the qualification as being a high-risk taxpayer cannot be the only basis for an information exchange. However, this qualification could have an impact on the information exchange itself by simplifying the requirements for an active exchange of information of these taxpayers. If a taxpayer is qualified as

88 OECD, Manual on request (Fn 85) para 4.
89 See above 4.3.2.
being a high-risk taxpayer, he is unwilling to comply on the one hand and the likelihood of losing a huge amount of revenue is high on the other hand. As the OECD pointed out, high-risk taxpayers attract greater scrutiny and enforcement attention;\textsuperscript{90} therefore, it is reasonable that the exchange of information in respect of these taxpayers is simplified on an international level.

Notwithstanding simplifying the international information exchange in case of high-risk taxpayers is reasonable in order to prevent international tax fraud and evasion the term “high-risk taxpayer” needs to be defined, because each member state may have different criteria for defining a high-risk taxpayer. Allowing reduced requirements for an international information exchange in respect to high-risk taxpayers expresses the need for guidelines on how to define a high-risk taxpayer.

The requirements for an international information exchange in the case of high-risk taxpayers can be reduced to a level that revenue bodies identify the taxpayers and disclose why they are rated as high-risk taxpayers (behaviour of the taxpayer, consequences of being non-compliant ect.) and the circumstances why it is known that these taxpayers are operating in the country from whom information is requested. This seems not to be different to the existing information exchange on-request however, the residence country may also be allowed to ask whether or not this taxpayer has received other source income within the other jurisdiction (source country) which the residence country is not aware of. An international information exchange for high-risk taxpayers may require an identification of the taxpayer, the reasons why he is rated as a high-risk taxpayer and the evidence that this taxpayer is operating in the contracting country but entitles the residence country to ask for information in respect of all transactions this taxpayer is involved in that source state. This would give the residence country the chance to be aware of all transactions this taxpayer is involved in and to be able to enforce worldwide taxation.

Eventually this approach combines the information exchange on-request and the spontaneous information exchange because the country of residency requests in the form that it nominates its high-risk taxpayers and the reasons for rating them as high-risk taxpayers. The residency country also has to show evidence that these taxpayers are operating in the requested country. If these criteria are fulfilled the requested country has to provide the residency country with all information which are foreseeable for assessing the taxpayer on the right amount. The source country therefore has to judge whether or not the information is foreseeable for the residency country – as it is within the spontaneous information exchange.

If we risk a look into the future – the next steps for an international information exchange may be a database in which residence countries can nominate their high-risk taxpayers and disclose the reasons why they are rated as being high-risky. Source countries in which these taxpayers are operating may

\textsuperscript{90} The Study (Fn 7) 24.
exchange foreseeable information relating to those taxpayers in an automatic manner. If revenue bodies want foreign tax authorities to provide them with information relating to their high-risk taxpayer they have to nominate these taxpayers as high-risk taxpayer for which foreign information is needed. This would need a special database wherein countries which are willed to exchange information of high-risk taxpayer can nominate their high-risk taxpayers. If one of these taxpayers operates in one of the participating countries this country (source country) has to provide the country which is asking for information by nominating its high-risk taxpayer within the database (residency country) with information relating to activities of this taxpayer within its jurisdiction which may be foreseeable for the residency country. Conversely, the countries which provided information get all the foreseeable information relating to this taxpayer. This leads to the consequence that the taxpayer is made transparent because all countries he is operating in share all information which are necessary in order to assess him on the right amount and address any kind of criminal activity.

This approach may be efficient in order to exchange information relating to high-risk taxpayers between countries they are operating in and make them “transparent”. However, this approach needs a lot of exploratory work before it can be used in practice. Countries have to sign agreements to share information relating to high-risk taxpayers, databases need to be created in order to give countries the chance to nominate their high-risk taxpayers and the term “high-risk taxpayer” needs to be defined because countries may have a different notion on how a high-risk taxpayer has to be defined. Therefore this approach might be deems of the future, however, currently the only possibility to facilitate the international information exchange on-request is by reducing its requirements in case of high-risk taxpayers.

4.3.4. Protection of Taxpayers’ Rights and the Reduced Requirements for an International Information Exchange for High-Risk Taxpayers

The protection of the rights’ of taxpayers within the information exchange mechanism was and is still a topic which causes huge debates in academia. The raised issue mainly concerns the questions whether or not taxpayers have participation rights if information is exchanged. The OECD states that an adequate protection of taxpayers’ rights and the confidentiality of their tax affairs are essential to prevent the integrity and effectiveness of exchange of information programmes. While the OECD espouses that the taxpayer’s rights have to be protected within an international information exchange there exists very little substantive text dealing with the legal formulation for this concept. Currently there are only a few states which have introduced regulations dealing with participation rights:

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Germany, The Netherlands, Portugal and Switzerland. In general, there are three forms of participation rights which can be considered: The right to notification, the right of consultation and the right of intervention. The right to notification basically means the entitlement to be informed by the requested state of the fact that a request for information has been made. In respect of the timing issue it must be said that a notification to the taxpayer after the information has been exchanged is a futility. The right to consultation goes even further and grants the taxpayer the right to be heard by the competent authority which involves the ability to make oral representations or present written submissions to the tax authority about the merit of the procedure. The right of intervention involves the right to have the legality of the exchange of information procedure reviewed by an independent body.

As already mentioned only a few countries have granted their taxpayer participation rights through their national legal system. The question which arises is whether or not taxpayers which are operating in countries which do not provide any of these rights within their domestic law have a right to participate in the exchange of information procedure based on human rights law. There are strong voices in academia which want to base the taxpayers´ participation rights on Art 6 or Art 8 of the European Convention on Human Rights. Art 6 of the ECHR protects the rights of persons including individuals and legal entities to a fair trial “in the determination of his civil rights and obligations or any criminal charge”. The European Court of Human Rights (ECtHR) ruled that taxes are excluded from the meaning of “civil rights” on the premise that “tax matters still form part of the hard core of public authority prerogatives with the public nature of the relationship between the taxpayer and the community remaining predominant”. This view was confirmed by the ECtHR in later judgements. Nevertheless Art 6 ECHR does not apply to the tax itself, domestic proceedings concerning both taxes and surcharges fall within the competence of the ECtHR to the extent they determine a criminal charge under Art 6 ECHR against the applicant “although that consideration will necessarily involve the pure tax assessment to certain extent”. In the case Engel and Other v. the Netherlands the ECtHR provided criteria for defining a “criminal charge”: First the legal classification of the offence under domestic law, second the nature of the offence and third the nature and degree of severity of the possible penalties. In respect to these criteria it is obvious that the exchange of information does not fall within the scope of criminal charge. In respect of “civil rights” it can be seen that the ECtHR is

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94 Branson, C., International exchange of information, (Fn 93), page 84.
95 Ibid.
96 Ibid page 85.
willed to interpret this term in a broad sense however, tax matters are still marginalized from the area of “civil rights”. Nevertheless Art 6 may apply if the requesting state uses information illegally for tax assessment purposes.

However, the ECtHR ruled in the case F.S. v. Germany that the exchange of information between revenue bodies is subject to Art 8 ECHR (regarding the respect of private life) but is not in violation of this article as it is justified by paragraph 2 of this provision. It provides that there is no interference with the exercise of the right referred to in Art 8(1) ECHR when the public measure is taken in accordance with the law and is necessary in a democratic society to achieve protection of crime.

Hence, the taxpayer has no right to oppose the exchange of information and during the exchange of information the taxpayer has no legal remedy to pursue an effective protection of his rights. If there is a lack of legal protection of the taxpayers´ rights within the international information exchange one may ask whether or not it is justified to extend the information exchange for high-risk taxpayers in a way that the information exchange is not restricted to a specific transaction. The justification can be found in the taxpayers´ behaviour. A taxpayer will only be rated as being a high-risk taxpayer, if he has decided not to comply. He is able to influence the exchange of information in a way that the residence state may not have to request any information from other countries if and in so far the taxpayer discloses all relevant information. It cannot be denied that the missing legal protection of the taxpayers´ rights in case of information exchange between revenue bodies is problematic however the reduction of requirements for an international information exchange for high-risk taxpayers can be justified with the non-compliance of these taxpayers.

### 4.4. Information Exchange with Tax Havens

An international information exchange may work between countries which signed a tax treaty that is based on the OECD MC and therefore includes a legal basis for an exchange of information however there are normally no tax treaties between OECD member states and so called “Tax Havens”. The OECD defined four key factors in order to constitute the existence of a tax haven: No or only nominal taxes; lack of effective information exchange; lack of transparency and no substantial activities. The last requirement for defining a tax haven was deleted in 2001. The OECD started its work in respect of harmful tax practices in the late 90s and first tried to get rid of these harmful practices by

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107 Progress Report 2001 (Fn 92) para 27 and 28.
eliminating preferential regimes within OECD countries. However, the US forced the OECD to reconsider the whole approach because they did not want to get rid of their preferential regimes – this was clearly a sovereignty issue. When the OECD realised that they cannot force member states to eliminate their existing preferential regimes they tried to address harmful tax practices by making them less harmful through transparency – they encouraged member states to exchange information. Hence, the OECD moved away from trying to get rid of these regimes and is now recognising the sovereignty of each state in its reframed argument in respect of how they tax, whether they tax, whether they have tax concessions or they are tax havens. But on the other hand, source countries must recognise the sovereignty of residence countries to be able to enforce worldwide taxation. The sovereignty of residence countries for worldwide taxation cannot be subverted by tax havens. The OECD therefore encouraged countries which do not exchange information and have a lack of transparency to sign up Commitment Letters in order to exchange information with other states and to achieve a transparent tax system. Before those countries are allowed to sign these Commitment Letters they have to ensure that they have sufficient information collection mechanisms.

Recently Australia has signed a number of Tax Information Agreements (TIEAs) and is in advanced negotiations with a number of other offshore financial centre jurisdictions. The existing difference to the information article under the traditional international tax agreements is significant in two respects: Firstly “TIEAs are broader than international tax agreements as they cover all taxes administered by the Commissioner of Taxation and they cover criminal and civil tax matters, and [secondly] they are narrower in respect of the information exchanged because they can only relate to a specific investigation occurring at the time – the information exchange article under the traditional information tax agreements allow for specific, spontaneous and automatic exchange of information”\textsuperscript{108}. Due to the fact that the information exchange under the TIEAs is restricted to a specific investigation occurring at the time it cannot be extended to all information relating to all transactions a high-risk taxpayer is involved in one particular source country. Notwithstanding the information exchange cannot be facilitated in case of high-risk taxpayers residence countries have to gather information through the existing mechanisms in case the high-risk taxpayer operates offshore. In the following it should be examined whether or not the information exchange based on the existing mechanism is working or if the exchange of information is still a problem.

4.5. International Information Exchange Dialogue currently possible or is it a Dream of the Future?

The OECD or more precisely the Global Forum on Transparency and Exchange of Information for Tax Purposes is charged with in-depth monitoring and peer review of the implementation of the international standards of transparency and exchange of information for tax purposes. In general, all

\textsuperscript{108} ATO, \url{http://www.ato.gov.au/content/00161107.htm}. 

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members of the Global Forum and jurisdictions, which are identified as being relevant to the Global Forums work, are reviewed. The review process is separated in two phases. Phase one of the reviews focuses on assessing the quality of jurisdictions’ legal and regulatory framework for the exchange of information. Instead during the second phase reviewer look at the practical implementation of that framework. Hence, phase 1 examines the legal basis whereas phase 2 looks more to the practical implementation. The reviews concerning countries which are members of the OECD are generally very positive and confirm that the international information exchange which is based on a tax treaty similar to the OECD MC works fairly well. China which has become the world’s second largest economy was characterised as fully endorsing the international standards for transparency and exchange of information for tax purposes nevertheless the exchange of information is a relatively new approach to China.109

Not surprisingly the work of the Global Forum relating to the information exchange with tax havens or former tax havens is still in its beginnings. The reviews have reached the phase 1 however, phase 2 which gives more evidence in respect of the consideration whether or not these TIEAs work is only finalised for the Isle of Man.110 In general, the report was very positive the Global Forum only mentioned that the Isle of Man should review its policy regarding access to information held by legal advisers, tax advisers and auditors and should ensure that it is compatible with effective exchange of information, record and continue to monitor requests for information where these rules are implicated. However, the Global Forum argued that the limitations on the access to information due to exceptions that apply in the case of legal privileges have never been invoked to prevent the tax authorities from obtaining information for the purposes of an exchange of information request. The Global Forum highlighted that the Isle of Man has been exchanging information in accordance with the international standards since its first tax information exchange agreements came into force in 2006. Although this is a relatively short time – the Global Forum reasoned that the exchange of information is effective and expeditious from the experience to date.

While the Global Forum characterised the information exchange based on TIEAs as efficient – of course only in respect of the Isle of Man – there are strong voices which describe the TIEAs as being useless. Richard Murphy highlighted the fact that counties which are classified by the OECD as being a tax haven only have to sign twelve TIEAs in order to lose this negative status. Further he demonstrated that tax havens sign agreements “with the most useless places they could find, or with each other”111. Murphy expressed his opinion even clearer at the meeting between trust experts from

Guernsey, the UK, Cayman Islands, Switzerland and the Bahamas, he said: “TIEAs don’t work. Everyone knows it. As things stand, client funds can be moved of a jurisdiction before an enquiry can develop, thwarting it before it really gets underway”\(^{112}\).

At the moment it may be too early to make a final conclusion regarding the efficiency of TIEAs because the Global Forum has not finalised its work and many countries are in advanced negotiations with a number of other offshore financial centre jurisdictions at the moment. However, the reason that tax havens only have to sign twelve TIEAs in order to lose this negative status may be critical because there are about 200 tax administrations all over the world and tax havens only have to enter into an information exchange with twelve of them and show that they are willed to sign further TIEAs. The lack of ambition to sign TIEAs with countries which are really interested in obtaining information from the contracting country can be easily seen through the fact that tax havens sign TIEAs with other tax havens and try to avoid countries which may really make use of these information gathering mechanisms.

Due to the fact that the information exchange with tax havens or former tax havens itself stands on feet of clay an improvement of the information exchange in case of high-risk taxpayers through reduced requirements may be dreams of the future. However, at the moment it must be tried to achieve a well working information exchange based on TIEAs and tax havens or former tax havens have to be forced to sign further TIEAs in order to guarantee a worldwide information exchange.

5. Conclusion

There are new forms of tax administration which revenue bodies can use in order to allocate their resources in an efficient manner. Reasons why revenue bodies have to reconsider their way in which they interact with taxpayers are the fact that the tax system itself gets more complicated on the one hand and more tax returns are logged every year on the other hand. Within the old “commanded-and-controlled” regulation revenue bodies are faced with aggressive tax planning strategies however they have no appropriate tools and resources to address them. Therefore, tax administration has to be designed in a way in which revenue bodies and taxpayers work closer together whereof both parties can profit. Besides an enhanced relationship between revenue bodies and taxpayers revenue bodies should assess the risk of each taxpayer which reflects the likelihood of non-compliance and the consequences of a potential non-compliance in order to address the taxpayers’ behaviour and the environment they are acting in with the right “reaction”. The paper pointed out that a tax administration which is based on co-operation can only exist if taxpayers and revenue bodies act within an environment of trust. Mutual trust can only grow if the interactions between both parties are

transparent and predictable. Key features for improving the trust relationship between revenue bodies and taxpayers are binding rulings and a legal system which is not vague and undetermined. By taking the co-operative model to the next level the interactions between revenue bodies from different countries have to be improved in order to guarantee a worldwide taxation. Many taxpayers operate offshore and in case of high-risk taxpayers which do not want to comply revenue bodies are faced with the need to gather information through an international information exchange. In case of high-risk taxpayers the requirements for an exchange of information can be reduced in future in order to address international tax fraud and evasion. As the paper pointed out there is still some way to go before an automatic international information exchange for high-risk taxpayers can be introduced – at the moment the focus has to be on tax havens or former tax havens. These countries have to sign up more TIEAs in order to guarantee a well working information exchange system.
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Important Internet Resources


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