ANNEXURE 10

DAVIS TAX COMMITTEE: SECOND INTERIM REPORT ON BASE EROSION AND PROFIT SHIFTING (BEPS) IN SOUTH AFRICA

SUMMARY OF ACTION 12: REQUIRE TAXPAYERS TO DISCLOSE THEIR AGGRESIVE TAX PLANNING ARRANGEMENTS

The OECD notes that lack of timely, comprehensive and relevant information on aggressive tax planning strategies is one of the main challenges faced by tax authorities worldwide. Early access to such information provides the opportunity to quickly respond to tax risks through informed risk assessment, audits, or changes to legislation or regulations. Action 12 of the OECD 2013 *Action Plan on Base Erosion and Profit Shifting* recognises the benefits of tools designed to increase the information flow on tax risks to tax administrations and tax policy makers. It therefore called for recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules.

The 2015 OECD Final Report on Action 12 provides a modular framework that enables countries without mandatory disclosure rules to design a regime that fits their need to obtain early information on potentially aggressive or abusive tax planning schemes and their users. The recommendations in this Report do not represent a minimum standard and countries are free to choose whether or not to introduce mandatory disclosure regimes. Where a country wishes to adopt mandatory disclosure rules, the recommendations provide the necessary flexibility to balance a country's need for better and more timely information with the compliance burdens for taxpayers. The Report also sets out specific recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations. A summary of the main aspects of the Report is as follows:

(i) Design principles and key objectives of a mandatory disclosure regime

Mandatory disclosure regimes should be clear and easy to understand, should balance additional compliance costs to taxpayers with the benefits obtained by the tax administration, should be effective in achieving their objectives, should accurately identify the schemes to be disclosed, should be flexible and dynamic enough to allow the tax administration to adjust the system to respond to new risks (or carve-out obsolete risks), and should ensure that information collected is used effectively.

The main objective of mandatory disclosure regimes is to increase transparency by providing the tax administration with early information regarding potentially aggressive or abusive tax planning schemes and to identify the promoters and users of those schemes. Another objective of mandatory disclosure regimes is deterrence: taxpayers may think twice about entering into a scheme if it has to be disclosed. Pressure is also placed on the tax avoidance market as promoters and users only have a limited opportunity to implement schemes before they are closed down. Mandatory disclosure regimes both complement and differ from other types of reporting and disclosure obligations, such as co-operative compliance programmes, in that they are specifically designed to detect tax planning schemes that exploit vulnerabilities in the tax system early, while also providing tax administrations with the flexibility to choose thresholds, hallmarks and filters to target transactions of particular interest and perceived areas of risk.

(ii) Key design features of a mandatory disclosure regime

In order to successfully design an effective mandatory disclosure regime, the following features need to be considered: who reports, what information to report, when the information has to be reported, and the consequences of non-reporting. In relation to the above design features, the Report recommends that countries introducing mandatory disclosure regimes:

- impose a disclosure obligation on both the promoter and the taxpayer, or impose the primary obligation to disclose on either the promoter or the taxpayer;
- include a mixture of specific and generic hallmarks, the existence of each of them triggering a requirement for disclosure. Generic hallmarks target features that are common to promoted schemes, such as the requirement for confidentiality or the payment of a premium fee. Specific hallmarks target particular areas of concern such as losses;
- establish a mechanism to track disclosures and link disclosures made by promoters and clients as identifying scheme users, as this is also an essential part of any mandatory disclosure regime. Existing regimes identify these through the use of scheme reference numbers and/or by obliging the promoter to provide a list of clients. Where a country places the primary reporting obligation on a promoter, it is recommended that they also introduce scheme reference numbers and require, where domestic law allows, the production of client lists;
- link the timeframe for disclosure to the scheme being made available to taxpayers when the obligation to disclose is imposed on the promoter; link it to the implementation of the scheme when the obligation to disclose is imposed on the taxpayer;
- introduce penalties (including non-monetary penalties) to ensure compliance with mandatory disclosure regimes that are consistent with their general domestic law.

(iii) Coverage of international tax schemes

There are a number of differences between domestic and cross-border schemes that make the latter more difficult to target with mandatory disclosure regimes. International schemes are more likely to be specifically designed for a particular taxpayer or transaction and may involve multiple parties and tax benefits in different jurisdictions, which can make these schemes more difficult to target with domestic hallmarks. In order to overcome these difficulties, the Report recommends that:

- Countries develop hallmarks that focus on the type of cross-border BEPS outcomes that cause them concern. An arrangement or scheme that incorporates such a cross-border outcome would only be required to be disclosed, however, if that arrangement includes a transaction with a domestic taxpayer that has material tax consequences in the reporting country and the domestic taxpayer was aware, or ought to have been aware, of the cross-border outcome.
- Taxpayers that enter into intra-group transactions with material tax consequences are obliged to make reasonable enquiries as to whether the transaction forms part of an arrangement that includes a cross-border outcome that is specifically identified as reportable under their home jurisdictions' mandatory disclosure regime.

(iv) Enhancing information sharing

Transparency is one of the three pillars of the OECD/G20 BEPS Project and a number of measures developed in the course of the Project will give rise to additional information being shared with, or between, tax administrations. The expanded Joint International Tax Shelter Information and Collaboration Network (JITSIC Network) of the OECD Forum on Tax Administration provides an international platform for an enhanced co-operation and collaboration between tax administrations, based on existing legal instruments, which could include co-operation on information obtained by participating countries under mandatory disclosure regimes.

Mandatory disclosure rules in South Africa and recommendations to enhance their effectiveness

South Africa has Reportable Arrangements provisions in Part B of the Tax Administration Act 28 of 2011 (TAA - fully discussed in the main report below), which are supposed to work as an "early warning system" for SARS, allowing it to identify potentially aggressive transactions when they are entered into. Over the years the SARS Unit responsible for Reportable Arrangements started managing the listed Reportable Arrangements in a more proactive manner, which has resulted in an increase in the number of arrangements reported in line with SARS expectations. SARS statistics on Reportable Arrangements[1] show that between 2009 and first quarter of 2016, 838 arrangements have been reported (see details in paragraph 9.2 of the Report below).

The OECD recommends that where a country places the primary reporting obligation on the promoter, it should introduce scheme reference numbers and require the preparation of client lists in order to fully identify all users of a scheme and to enable risk assessment of individual taxpayers.[2] South Africa has a dual reporting system. in term of section 38 of the TAA, the "promoter" has the primary obligation to report. If there is no promoter in relation to the "arrangement" or if the promoter is not a resident, the "participants" must disclose the information.

- ➢ In light of the dual reporting mechanism in South Africa and in the interest of not placing administrative burdens on taxpayers to submit client lists it is recommended that client lists should not be introduced in South Africa. Such information could be easily accessed from the disclosures submitted by the participants in terms of section 38 of the TAA. It should also be noted that SARS Form RA 01 for Reporting Reportable Arrangements contains detailed aspects of what must be disclosed by a participate or a promoter – the information that would be provided on completion of these Forms is broad enough to capture what could be required from client lists. It should, however be noted that the RA01 Form available on the SARS website refers to pre-TAA legislation and is, thus, not up to date with current law (see below). It is recommended that it be updated.
- ➢ Section 38 of the TAA provides that an arrangement must be disclosed in the prescribed form. Disclosing the arrangement in any other manner than with the prescribed form would therefore not constitute compliance to the TAA. Form RA-01 expressly stipulates that it is the form in which to report arrangements in terms of sections 80M – 80T of the ITA. Sections 80M – 80T were repealed by the TAA in 2011. No form exists in terms of the TAA with which to disclose reportable arrangements. It is, thus, important that SARS urgently provides a form that is line with the current law. Without a valid prescribed form, it is impossible to comply with the provisions.

The OECD provides certain recommendations regarding structuring monetary penalties for non-disclosure. It recommends that in setting penalty levels:

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[1] SARS "Tax Avoidance and Reportable Arrangements Unit". See reportable@sars.gov.za.

[2] OECD/G20 2015 Final Report on Action 12 in para 172.

- Jurisdictions may take into account factors such as whether negligence or deliberate non-compliance or tax benefit may be linked to the level of penalties levied.
- Penalties should be set at a level that maximises their deterrent value without being overly burdensome or disproportionate.
- Consideration should be given to percentage based penalties based upon transaction size or the extent of any tax savings.[3]

In South Africa, section 212 of the TAA, sets out the penalties “a participant” to a reportable arrangement is liable for in case of failure to disclose the reportable arrangement. Section 34(c) of the TAA defines a “participant” as “any other person who is a party to an arrangement”. However the TAA does not explain who is included or excluded in the term “party to an arrangement”. It is for instance not clear whether it includes beneficiaries of discretionary trusts. If the phrase “a party to an arrangement” is interpreted so widely, there are concerns that SARS may impose unfair and unjust penalties on innocent persons i.e. those who have no knowledge of the actions of the trust. It should be noted though (in line with the OECD recommendations on penalties) that in terms of section 217 of the TAA, SARS does apply some discretion in the way the section 212 reportable arrangements penalties are levied. Section 217(2) provides that SARS may “remit the ‘penalty’ or a portion thereof if appropriate, up to an amount of R2000 if SARS is satisfied that:

(i) reasonable grounds for non-compliance exist; and
(ii) the non-compliance in issue has been remedied”.

Specific recommendations on certain issues regarding penalties in South Africa’s reportable arrangements provisions:

- As mentioned above, the reportable arrangements penalty provision - section 212(1) of the TAA - stipulates that participant who has the duty to report the arrangement but fails to do so is liable for the penalty ‘penalty’, for each month that the failure continues (up to 12 months), in the amount of—
  (*a*) R50 000, in the case of a ‘participant’ other than the ‘promoter’; or
  (*b*) R100 000, in the case of the ‘promoter’.
  However, the conjunction “or” used between subsections 1(a) and 1(b) makes it unclear whether only one person will be held liable for the penalty, in the corresponding amount, or whether all persons will be held liable simultaneously, in the amount applicable to their role in the arrangement. It is not clear whether SARS imposes a penalty on each of the promoters or if the penalty will be imposed jointly and severally. It is suggested that the legislation be made clearer.
- The penalties have serious economic implications for participants and promoters. Non-disclosure by a promoter for up to 12 months could amount to penalties of 1.2million (100, 000 per month). It is possible that the amount

[3] OECD/G20 2015 Final Report on Action 12 in para 183.

could even be higher if a promoter is involved in more than one arrangement that must be reported. With such hefty penalties, it is important that SARS ensures that the provisions are well worded and clear, so that taxpayers are not left to their own devices to interpret what was meant. It is also important that SARS raises more awareness to taxpayers about the reportable arrangements provisions especially regarding the penalties for not complying with the provisions.

The OECD notes that many countries have lower numbers of disclosures of international schemes because the way international schemes are structured and the formulation of some countries' disclosure regimes may not be effective in curtailing BEPS in a cross-border context, since such structures typically generate multiple tax benefits for different parties in different jurisdictions.[4] In South Africa, Government Gazette No. 39650 issued on 3 February 2016 which has extended the scope of reportable arrangements, has the potential of making the rules more appropriate from a BEPS angle, as much of what BEPS is concerned with relates to commercial arrangements. For example, paragraph 2.3 of the Gazetted list covers any arrangement in terms of which a person that is a resident makes any contribution or payment on or after the date of publication of this notice to a trust that is not a resident and has or acquires a beneficial interest in that trust. Section 37 of the TAA also provides that if the promoter of a scheme is not a resident, all other "participants" (whether resident or non-resident) must disclose the information regarding to the arrangement to SARS.

- Nevertheless more needs to be done to ensure the provisions are more effective in preventing BEPS.
- There are however concerns about the phrasing of the reporting provisions listed in Government Gazette No. 39650 of 3 February 2016. As is explained fully in the main report below, wording of certain terms and phrases in the provisions is not clear. For example it is important that SARS clarifies the meaning of terms such as "beneficial interest" and "contribution or payment" where a resident makes a contribution to a non-resident trust. The lack of clarity has implications on who is liable to report. It is uncertain whether a beneficiary of a discretionary trust in terms of which it is completely within the discretion of the trustees whether or not any distribution will be made to a specific beneficiary, has a beneficial interest. Unless the trustees have decided to vest any capital or income in the beneficiary, that beneficiary only has a contingent right, which is no more than a *spes* - a hope or an expectation.
- Where reporting in the case of a trust applies where "the value of that interest exceeds or is reasonably expected to exceed R10 million", there are some uncertainties as to how this value is to be determined. One may not be sure when the value is likely to exceed R10 million at any point in the future, and

4 OECD/G20 2015 Final Report on Action 12 in para 227.

thus when there is the obligation to report.[5] Even if the value of the interest of a beneficiary can be established and even if can be expected to exceed the threshold, there are numerous factors which could influence the value: changes in the exchange rate, a decrease or crash in the markets, a discretionary distribution made to another beneficiary, *et cetera*. SARS need to come up with a more concrete, rather than a very broad, way of determining the value.

- Paragraph (c) of the definition of participant provides that "any other person who is a party to an arrangement" is a participant. However the TAA does not explain who is included or excluded in the term "party to an arrangement". It is, for instance, not clear whether it includes beneficiaries of discretionary trusts i.e. persons who are appointed beneficiaries but have no other connection or discourse with the trust and, thus, may have no knowledge of the trust's activities. If the phrase "a party to an arrangement" is interpreted so widely, it may impose unfair and unjust penalties on innocent persons.

The OECD notes that there is a need to ensure that the generic hallmarks for disclosure discriminate between schemes that are wholly-domestic and those that have a cross-border component. [6] The OECD specifically points out the ineffectiveness (in a cross-border context) of disclosure regimes that require reportable schemes to meet a formal threshold condition for disclosure (such as the *main benefit* or *tax avoidance* test) since some cross-border schemes may not meet this threshold if the taxpayer can demonstrate that the value of any domestic tax benefits was incidental when viewed in light of the commercial and foreign tax benefits of the transaction as a whole.[7] In South Africa section 36(3)(a) and (b) make it clear that an arrangement is reportable if the main purpose, or one of the main purposes, of entering into the arrangement is to obtain a tax benefit (i.e. the intention of the taxpayer); or if the arrangement is entered into in a specific manner or form that enhances or will enhance a tax benefit (i.e. even if there is no intention but the result is a tax benefit).

- Thus both the intention to gain a tax benefit and the result of a tax benefit without intention are taken into consideration; the South African rules are not dependent on the "main purpose to obtain a tax benefit" as the threshold condition for disclosure. Thus even though a taxpayer can reason that the value of any domestic tax benefits was incidental (not main purpose) when viewed in light of the commercial and foreign tax benefits of the transaction as a whole, the arrangement is still reportable, in light of section 36(b), if it is

5 *SARS gazettes new list of arrangements deemed reportable,* News & Press: Tax Talk (22 September 2015). Available at http://www.thesait.org.za/news/251710/SARS-gazettes-new-list-of-arrangements-deemed-reportable-.htm accessed 9 June 2016.

6 OECD/G20 2015 Final Report on Action 12 in para 227.

7 OECD/G20 2015 Final Report on Action 12 in para 229.

entered into in a specific manner or form that enhances or will enhance a tax benefit.

The OECD notes that cross-border tax planning schemes are often incorporated into broader commercial transactions such as acquisitions, refinancing or restructuring and they tend to be customised so that they are taxpayer and transaction specific, and may not be widely-promoted in the same way as a domestically marketed scheme. Thus generic hallmarks that are primarily focussed at promoted schemes that can be easily replicated and sold to a number of different taxpayers may not be effective in curtailing BEPS. [8] In this regard, the OECD recommends the use of specific hallmarks to target cross-border tax schemes to address particular tax policy or revenue risks in the country. Examples include leasing and income conversion schemes which can apply equally in the domestic and cross-border context.

- Although South Africa has specific hallmarks in section 35(1) of the TAA; as well as arrangements listed by the Commissioner by public notice in section 35(2) of the TAA, the DTC recommends that more international schemes be targeted that could cause potential loss of revenue – for example conversion, restructuring, acquisition schemes and other innovative tax planning techniques.
- In targeting more international schemes, cognisance could be taken of the challenge the OECD points to, of ensuring that, in the design of specific hallmarks, the relevant definition is sufficiently broad to pick up a range of tax planning techniques and narrow enough to avoid over-disclosure. To effectively deal with this challenge the OECD suggests that focus should be placed on *outcomes* that raise concerns from a tax policy perspective, rather than the techniques that are used to achieve them (e.g. using the effects-based, approach of the USA, that extends the disclosure obligations to “substantially similar” transactions). [9]

The OECD recommends that countries should have a broad definition of “arrangement” that includes offshore tax outcomes. The definition of “arrangement” in section 34 of the TAA states that it “means any transaction, operation, scheme, agreement or understanding (whether enforceable or not)”. Although this definition does not specifically refer to offshore arrangements, the use of the word “any” implies that it includes both domestic and offshore arrangements. Reference to offshore outcomes is also indicated in section 37, which provides that if there is no promoter in relation to the “arrangement”, or if the promoter is not a resident, all other “participants’ must disclose the information.

- Perhaps to make this offshore implication much more clear, the legislation should consider re-drafting the definition of an arrangement to specifically

[8] OECD/G20 2015 Final Report on Action 12 in para 230.
[9] OECD/G20 2015 Final Report on Action 12 in para 232.

state that the word “any” covers both domestic and offshore outcomes.

- The rules that apply to domestic schemes for identifying the promoter, and for determining who has the primary disclosure obligation, should also apply in the international context.

To ensure there are no undue administrative burdens on domestic taxpayers, disclosure obligations should not be placed on persons that are not subject to tax in South Africa, or on arrangements that have no connection with South Africa. At the same time, disclosure obligations should not be framed in such a way as to encourage a taxpayer to deliberately ignore the offshore aspects of a scheme simply to avoid disclosure. [10]

- Taxpayers should only be required to disclose information that is within their knowledge, possession or control. They can however be expected to obtain information on the operation and effect of an intra-group scheme from other group members. Outside of the group context, a reporting taxpayer should not be required to provide any more information than the taxpayer would be expected to have obtained in the course of ordinary commercial due diligence on a transaction of that nature. [11]

The OECD recommends that information that should be required to be disclosed in respect of domestic schemes should be the same as the information required for cross-border schemes. Such information should include information about the operation of the scheme including key provisions of foreign law relevant to the elements of the disclosed transaction. [12] Where information about the scheme is held offshore and may be subject to confidentiality or other restrictions that prevent it from being made available to the person required to make disclosure then;

- Domestic taxpayers, advisors and intermediaries should only be required to disclose the material information about the scheme that is within their knowledge, possession or control.
- In the case where the person holds only incomplete information about the scheme or is unable to disclose such information, that person should be required, to the extent permitted by domestic law, to:
    - Identify the persons with possession or control of that information; and
    - certify that a written request for that information has been sent to such persons. [13]
    - If this is applied by SARS, it can then use this certification as the basis of an exchange of information request under the relevant double tax treaty or under a Tax Information Exchange Agreement (TIEA) that may have been signed with a country.

[10] OECD/G20 2015 Final Report on Action 12 in para 234.
[11] OECD/G20 2015 Final Report on Action 12 in para 235.
[12] OECD/G20 2015 Final Report on Action 12 in para 253.
[13] OECD/G20 2015 Final Report on Action 12 in para 236.

The OECD does recommend the use of monetary thresholds, set at levels that avoid over-disclosure, to filter-out irrelevant or non-material disclosures.[14] In South Africa, Government Gazette No 39650 issued on 3 February 2016 which lists reportable arrangements and excluded arrangements excludes from the rules any arrangement referred to in s 35(1) of the if the aggregate tax benefit which is or may be derived from that arrangement by all participants to that arrangement does not exceed R5 million.

- ➢ It is important that this limit is reviewed regularly taking into consideration cross-border perspectives.

[14] OECD/G20 2015 Final Report on Action 12 in para 244.

DTC REPORT ON ACTION 12: REQUIRE TAXPAYERS TO DISCLOSE THEIR AGGRESIVE TAX PLANNING ARRANGEMENTS

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1 BACKGROUND

To prevent global tax exposure, taxpayers often get involved in tax avoidance schemes that result in the erosion of countries' tax bases and shifting of profits to low tax jurisdictions. Aggressive tax planning has been defined as consisting of "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". [1] The OECD uses the term "aggressive tax planning strategies"[2] to refer to sophisticated tax schemes that include a number of steps and make use of complex mechanisms, which may comply with the letter but abuse the spirit of the law. Often these transactions blur the dividing line between tax evasion and tax avoidance. Aggressive tax planning schemes can take a multitude of forms. It frequently involves circular movements of funds, shell companies or the use of financial instruments or hybrid entities that are treated differently depending on the tax jurisdictions. [3] 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. income which is not taxed in the source state is exempt in the state of residence)."[4]

Even before the OECD issued its BEPS report, countries have been concerned about aggressive tax planning. In September 2006, members of the OECD Forum on Tax Administration held a meeting in Korea in which they identified compliance with tax legislation as one of the two main challenges facing tax administrations in the coming years. They emphasized that:

> "[e]nforcement 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."[5]

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1 Quebec Ministry of Finance "Aggressive Tax Planning Working paper" (2009) at 13. Available at http://www.finances.gouv.qc.ca/documents/Autres/en/AUTEN_DocCons_PFA.pdf accessed 9 July 2015.

2 OECD May 2015 Public Discussion Draft on Action 12 in the Executive Summary.

3 Quebec Ministry of Finance "Aggressive Tax Planning Working paper" (2009) at 13. Available at http://www.finances.gouv.qc.ca/documents/Autres/en/AUTEN_DocCons_PFA.pdf accessed 9 July 2015.

4 European Commission "Recommendation on Aggressive Tax Planning" 6 December 2012. Available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/c_2012_8806_en.pdf accessed 9 July 2015.

5 OECD "*Seoul Declaration*, third meeting of the OECD Forum on Tax Administration" (14-15 September 2006). Available at ttp://www.oecd.org/dataoecd/38/29/37415572.pdf accessed 9 July 2015).

In order to prevent the tax benefits arising from these aggressive tax planning structures, tax administrations normally detect them by auditing taxpayers' returns, which usually results in tax administrations enacting anti-avoidance rules to block the relevant scheme - a process that can extend over many years.[6] However audits pose various constraints as tools for the early detection of tax planning schemes.[7] Tax audits often take a long time and yet governments need timely access to relevant information in order to identify and respond to tax risks posed by tax planning schemes. Aggressive taxpayers and their advisers are often a step ahead as they often devise other schemes outside the scope of the rule that has been enacted, and the cycle goes on. Thus, in most countries, tax authorities find it challenging to respond adequately to prevent aggressive tax planning transactions that exploit their tax systems. The inevitable delays between the conclusion of taxpayers' transactions, submission of annual returns and then the assessment and the audits; implies that years may pass by before tax-avoidance transactions are detected, analysed and challenged.

The OECD notes that "one of the challenges faced by tax authorities is a lack of comprehensive and relevant information on potentially aggressive or abusive tax planning strategies". If tax authorities can obtain or have access to such information, at an early stage, this would give them an opportunity to respond quickly to tax risks either through timely and informed changes to legislation and regulation or through improved risk assessment and compliance programs.[8] If countries can have early access to such information, this could provide them with the opportunity to quickly respond to tax risks through informed risk assessment, audits, or changes to legislation or regulations.[9]

2 INTERNATIONAL RESPONSES

One measure to improve response times that is increasingly being adopted worldwide involves enacting "mandatory disclosure rules" that entail the advance reporting of transactions meeting criteria that indicate that they may give rise to concern. The USA was the first country to introduce such rules in 1984, which have undergone many changes since. This 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. Then in June 2013, Canada enacted

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6 LARIN, Gilles N., Robert DUONG, and Lyne LATULIPPE. "Effective Responses to Aggressive Tax Planning What Canada Can Learn from Other Jurisdictions Instalment 4: United Kingdom-Disclosure Rules." (2009). Available at http://www.usherbrooke.ca/chaire-fiscalite/fileadmin/sites/chaire-fiscalite/documents/Tax_avoidance/Avoidance_Instalment4.pdf accessed on 15 June 2015.

7 OECD May 2015 Public Discussion Draft on Action 12 in para 5.

8 OECD/G20 2015 Final Report on Action 12 at 9.

9 OECD/G20 2015 Final Report on Action 12 at 9.

Reportable Tax Avoidance transactions legislation with much broader reporting requirements. South Africa introduced Reportable Arrangements legislation in 2003 which came into force in 2005, subsequently revised in 2008, and which is now set out in the Tax Administration Act 28 of 2011 (TAA), supported by Government Gazettes which set out additional arrangements that specifically fall within the provisions.

The UK enacted mandatory disclosure rules named the "Disclosure of Tax Avoidance Schemes" (DOTAS) Rules in 2004. The rules were revised substantially in 2006 and came into force on 1 January 2011. The DOTAs rules require promoters of certain types of tax avoidance schemes, or in some cases users of the schemes, to disclose them to HMRC. The DOTAS regime has two objectives. Primarily, it is intended to ensure that HMRC becomes aware of potential avoidance schemes as early as possible. It is also intended to act as a deterrent to more egregious schemes. HMRC claims DOTAS as a successful part of their multi-pronged strategy for dealing with tax avoidance. Most of the professional firms and the tax directors of large companies agreed that DOTAS had proved important, and that the number of disclosures in which they had been involved was now small.[10]

Ireland introduced its mandatory disclosure regime in 2011 and since then Korea, Portugal and Israel have also introduced mandatory disclosure rules. The design (and consequently the effect) of these regimes varies from one country to another.[11]

In 2004, the UK, Australia, Canada and the USA, formed the "Joint International Tax Shelter Information Centre", which aims to deter promotion of investment in abusive tax schemes, by sharing information, experience and best practices. Membership has since expanded to include China, France, Germany, Japan and Korea. In 2009, the then permanent secretary of the HRMC, Dave Hartnett, estimated that the sharing of information by JITSIC members had "saved or prevented the loss of more than £1 billion for the UK alone in four years." [12]

3 PREVIOUS OECD WORK ON MANDATORY DISCLOSURE PROVISIONS

On an international front, the OECD has also done some work on ensuring disclosure of aggressive tax planning schemes.

- In 2008, the OECD conducted a study on the role of Tax Intermediaries[13] which encouraged tax authorities to establish enhanced relationships with their large business taxpayers. This 2008 Report was followed by the 2013

10 UK House of Lords Committee on Fiscal Affairs "Tackling Corporate Tax Avoidance In A Global Economy: Is A New Approach Needed?"(July 2013) in para 41.

11 OECD May 2015 Public Discussion Draft on Action 12 in para 37.

12 UK House of Lords Committee on Fiscal Affairs "Tackling Corporate Tax Avoidance In A Global Economy: Is A New Approach Needed?" (July 2013) in para 46.

13 OECD "Study into the role of Tax Intermediaries" (OECD, 2008).

Report on co-operative compliance programmes.[14] In terms of the 2013 Report, by using co-operative compliance programmes, taxpayers agree to make full disclosure of material tax issues and transactions they have undertaken to enable tax authorities to understand their tax impact. Co-operative compliance relationships allow for a joint approach to tax risk management and compliance and result in more effective risk assessment and better use of resources by the tax administration. The 2013 Report noted the number of countries that had developed co-operative compliance programmes since the publication of the 2008 Report concluded that their value was now well-established.[15]

- In 2011, the OECD issued a report on transparency and disclosure initiatives.[16] This report explained the importance of timely, targeted and comprehensive information to counter aggressive tax planning and it provided an overview of disclosure initiatives introduced in certain OECD countries and discussed their experiences regarding such initiatives.[17]
- In 2013 the OECD issued a report on co-operative compliance programmes.[18]
- The OECD's previous work on aggressive tax planning includes its Aggressive Tax Planning Directory[19] - a database of tax planning schemes maintained by certain OECD and G20 countries who adhere to certain confidentiality undertakings and agree to submitting aggressive tax planning schemes to the directory, which now covers over 400 aggressive tax planning schemes.[20] The purpose of the directory is to allow government officials from member countries to share information on aggressive tax planning trends. Timely sharing of information on aggressive tax planning schemes assists member states in understanding new tax planning techniques, facilitates their detection, enables countries to rapidly adapt their risk management strategies and to identify appropriate legislative and administrative responses.[21] Some countries are intensively drawing on this work to improve their audit performance. Since improving tax compliance for both, on-shore and off-shore

[14] OECD "Co-operative Compliance: A Framework: From Enhanced Relationship to Co-Operative Compliance" (OECD, 2013).
[15] OECD May 2015 Public Discussion Draft on Action 12 in para 9.
[16] OECD "Tackling Aggressive Tax Planning through Improved Transparency and Disclosure" (OECD, 2011).
[17] OECD May 2015 Public Discussion Draft on Action 12 in para 8.
[18] OECD "Co-operative Compliance: A Framework: From Enhanced Relationship to Co-Operative Compliance" (OECD, 2013).
[19] OECD "Aggressive Tax Planning Directory". The directory is a secure online resource for government officials which is intended to help governments keep pace with aggressive tax planning. See http://www.oecd.org/tax/exchange-of-tax-information/oecdaggressivetaxplanningdirectory.htm accessed 16 May 2014.
[20] OECD "OECD's work on tax planning". Available at http://www.oecd.org/tax/aggressive/ accessed 9 July 2015.
[21] OECD "Co-operation and exchange of information on ATP" Available at http://www.oecd.org/ctp/aggressive/co-operation-and-exchange-of-information-on-atp.htm accessed 8 July 2015.

remains a key priority for securing government revenue and levelling the playing field for businesses, there is need for determined action from tax administrations, which should co-operate in exchanging intelligence and information, as well as monitoring the effectiveness of the strategies used collecting tax revenue and for enhancing compliance".[22]

With public concerns engineered by non-governmental organizations like Christian Aid,[23] the Tax Justice Network[24] and ActionAid[25] about MNEs paying little or no corporation tax in the countries they do business in, after the 2007/8 global financial crisis, national leaders at the 2012 G20[26] summit in Mexico, called for the need to prevent base erosion and profit shifting (BEPS).[27] Thus at the behest of the G20, in February 2013 the OECD issued a report in which it noted that "BEPS constitutes a serious risk to tax revenues, tax sovereignty and tax fairness for OECD member countries and non-members alike".[28] Subsequently it came up with a 15 Point BEPS Action Plan which is intended to ensure that profits are taxed where the economic activities generating those profits are performed and where value is created.

4 THE 2013 OECD BEPS REPORT: ACTION 12

In its 2013 BEPS report,[29] the OECD notes that comprehensive and relevant information on tax planning strategies is often unavailable to tax administrations. Yet the availability of timely, targeted and comprehensive information is essential to enable governments to quickly identify risk areas. Further that, while audits remain a key source of relevant information, they suffer from a number of constraints as tools for the early detection of aggressive tax planning techniques.[30]

22 OECD "Addressing Base Erosion and Profit Shifting (2013) at 49.

23 Christian Aid "Death and Taxes: The True Toll of Tax Dodging" (May 2008) at 21-23. Available at http://www.christianaid.org.uk/images/deathandtaxes.pdf; accessed on 28 September 2010.

24 Tax Justice Network "Economic Crisis + Offshore". Available at http://www.taxjustice.net/cms/front_content.php?idcat=136 accessed on 6 June 2015.

25 See ActionAid on Tax Justice on http://www.actionaid.org.uk/policy-and-research/research-and-publications/tax-justice accessed on 04 February 2016.

26 The G20 (Group of twenty) is an international forum for the governments and central bank governors from 20 major economies. The members, include European Union and 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States. The G-20 was founded in 1999 with the aim of studying, reviewing, and promoting high-level discussion of policy issues pertaining to the promotion of international financial stability. For details see Wikipedia "G-20 Major Economies" available at http://en.wikipedia.org/wiki/G-20_major_economies accessed 78 May 2015.

27 G 20 Leaders' Declaration) Los Cabos Mexico 2012). Available at http://g20mexico.org/images/stories/temp/G20_Leaders_Declaration_2012.pdf accessed 3 August 2013.

28 OECD *Addressing Base Erosion and Profit Shifting* op cit note 1 at 5.

29 OECD "Action Plan on Base Erosion and Profit Shifting" (2013) at 22.

30 OECD "Action Plan on Base Erosion and Profit Shifting" at 22.

In Action 12, the OECD recognises the usefulness of “Mandatory disclosure” rules in availing tax authorities comprehensive and relevant information, on tax planning strategies, and it calls on OECD and G20 countries to:

- require taxpayers to disclose their aggressive tax planning arrangements;
- come up with measures to improve information flow about tax risks to tax administrations and tax policy makers;
- develop mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration:
  - the administrative costs for tax administrations and businesses and
  - draw on experiences of the increasing number of countries that have such rules;
- design and put in place models of information sharing for international tax schemes between tax administrations; and
- develop measures regarding co-operative compliance programmes between taxpayers and tax administrations.[31]

On the international front the OECD planned to:

- use a modular design allowing for maximum consistency but allowing for country specific needs and risks;
- focus on international tax schemes and explore the use of a wide definition of "tax benefit" in order to capture such transactions;
- co-ordinate its work on this Action Plan with the work on co-operative compliance; and
- design and put in place enhanced models of information sharing for international tax schemes between tax administrations. [32]

In May 2015, the OECD issued a discussion draft[33] which provides an overview of mandatory disclosure regimes as applied in certain countries and it sets out recommendations for the design of a mandatory disclosure regime, to ensure some consistency, and also options that can be applied to provide sufficient flexibility to deal with country specific risks and to allow tax administrations to control the quantity and type of disclosure.[34] Subsequently in October 2015, the OECD issued its final report on Action 12[35] which recognises the benefits of tools designed to increase the information flow on tax risks to tax policy makers and tax administrations. Action 12 covers three key outputs:

(i) recommendations for the modular design of mandatory disclosure rules to provide flexibility for country specific needs;

31 OECD “Action Plan on Base Erosion and Profit Shifting” at 22.
32 OECD “Action Plan on Base Erosion and Profit Shifting” (2013) at 22.
33 OECD May 2015 Public Discussion Draft on Action 12 at 1.
34 OECD May 2015 Public Discussion Draft on Action 12 at 10.
35 OECD/G20 2015 Final Report on Action 12.

(ii) a focus on international tax schemes and consideration of a wide definition of tax benefit to capture relevant transactions; and

(iii) designing and putting in place enhanced models of information sharing for international tax schemes.

5 SUMMARY OF THE OECD/G20 2015 FINAL REPORT ON ACTION 12 ON MANDATORY DISCLOSURE RULES

5.1 ADVANTAGES OF MANDATORY DISCLOSURE RULES OVER OTHER DISCLOSURE RULES IN DETECT TAX PLANNING SCHEMES

The OECD notes that a number of countries have different types of disclosure initiatives used by tax administrations to collect taxpayer compliance information. Such include:

- Rulings regimes that enable taxpayers to obtain a tax authority's view on how the tax law applies to a particular transaction or set of circumstances and provides taxpayers with some degree of certainty on the tax consequences.
- Additional reporting obligations that require taxpayers to disclose particular transactions, investments or tax consequences usually as part of the return filing process.
- Surveys and Questionnaires that are used by some tax administrations to gather information from certain groups of taxpayers with a view to undertaking risk assessments.
- Voluntary disclosure as means of reducing taxpayer penalties.
- Co-operative 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.[36]

The objective of these disclosure initiatives is, normally to require, or incentivise taxpayers and their advisers to provide tax authorities with relevant information on taxpayer behaviour that is either more detailed, or more timely, than the information recorded on a tax return. These objectives are different from those of mandatory disclosure rules, since the other disclosure initiatives are not exclusively focused on identifying the tax policy and revenue risks raised by aggressive tax planning. Such disclosure initiatives typically lack the broad scope of mandatory disclosure rules which can capture any type of tax or taxpayer and they do not focus on obtaining specific information about promoters, taxpayers and defined schemes.[37] The key feature that distinguishes mandatory disclosure from these other types of disclosure rules are:

[36] OECD/G20 2015 Final Report on Action 12 in para 24.
[37] OECD/G20 2015 Final Report on Action 12 in para 25.

- Mandatory disclosure rules are specifically designed to ensure early detection of tax planning schemes that exploit vulnerabilities in the tax system while also providing tax administrations with the flexibility to choose thresholds, hallmarks and filters in order to target transactions of particular interest and perceived areas of risk.[38]
- Mandatory disclosure applies to a broader range of persons: All taxpayers (both large and small) and not simply those who choose to disclose for example through a voluntary compliance measure. [39]
- Mandatory disclosure provides specific information on the scheme, users and suppliers: the focus on tax avoidance enables tax authorities to identify the scheme from available information so as to prevent significant revenue loss. [40] Because mandatory disclosure requires promoters and taxpayers to report specific scheme information directly to the tax administration it is a more efficient and effective method of obtaining comprehensive information on tax planning than relying on an analysis or audit of tax return information. Mandatory disclosure also provides tax administrations with information on the users of the scheme and those responsible for promoting and implementing them. The use of client lists and scheme identification numbers allows the tax administration to rapidly obtain an accurate picture of the extent of the tax risk posed by a scheme and to easily identify when a taxpayer has used a scheme. [41]
- Mandatory disclosure provides information early in the tax compliance process: early warning allows tax administrations to respond more quickly to tax policy and revenue risks through operational, legislative or regulatory changes. Other disclosure initiatives do not generally provide tax administrations with the same degree of advanced warning.[42]

Countries that have introduced mandatory disclosure rules indicate that these rules help to deter aggressive tax planning behaviour and they improve the quality, timeliness and efficiency in gathering information on tax planning schemes allowing for more effective compliance, legislative and regulatory responses. [43]

5.2 CO-ORDINATION WITH OTHER DISCLOSURE AND COMPLIANCE TOOLS

The OECD notes that decisions as to whether to introduce a mandatory disclosure regime and the structure and content of such a regime depend on a number of factors including an assessment of the tax policy and revenue risks posed by tax

38 OECD/G20 2015 Final Report on Action 12 in para 25.
39 OECD/G20 2015 Final Report on Action 12 in para 26.
40 OECD/G20 2015 Final Report on Action 12 in para 28.
41 OECD/G20 2015 Final Report on Action 12 in para 29.
42 OECD/G20 2015 Final Report on Action 12 in para 31.
43 OECD/G20 2015 Final Report on Action 12 in para 32.

planning within the jurisdiction and the availability as well as effectiveness of other disclosure and compliance tools.[44]

The OECD clarifies that mandatory disclosure rules cannot replace or remove the need for other types of disclosure and compliance tools. Mandatory disclosure can, however, reinforce other disclosure and tax compliance tools such as co-operative compliance or voluntary disclosure in ensuring a more level playing field as between large corporates and other taxpayers that do not have the same kind of compliance relationship with the tax administration.[45]

There is also some inevitable (and desirable) overlap between the operation and effects of mandatory disclosure and General Anti-Avoidance Rules ('GAARs'). GAARs can provide tax administrations with an ability to respond directly to instances of tax avoidance that have been disclosed under a mandatory disclosure regime. Equally, from a 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. Mandatory Disclosure and GAARs are therefore mutually complementary from a compliance perspective. Equally, however, the purpose of a mandatory disclosure regime is to provide the tax administration with information on a wider range of tax policy and revenue risks other than those raised by transactions that would be classified as avoidance under a GAAR. Accordingly the definition of a "reportable scheme" for disclosure purposes will generally be broader than the definition of tax avoidance schemes covered by a GAAR and should also cover transactions that are perceived to be aggressive or high-risk from a tax planning perspective.[46]

The OECD notes that its BEPS Action Plan covers a number of other disclosure and information exchange initiatives, such as country by country reporting under Action 13 and the work on spontaneous exchange of rulings as part of the work on Action 5. The work of the Forum on Tax Administration is also developing a framework for cooperation between tax administrations. Recommendations for the design of enhanced models of information sharing will need to take into account the outcome of these initiatives and developments.[47]

5.3 OBJECTIVES OF MANDATORY DISCLOSURE RULES

The main objectives of mandatory disclosure rules can be summarised as follows:

(i) obtaining early information about tax avoidance schemes, which enhances tax authorities' effectiveness in their compliance activities;

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[44] Ibid.

[45] OECD/G20 2015 Final Report on Action 12 in para 34.

[46] OECD/G20 2015 Final Report on Action 12 in para 35.

[47] OECD May 2015 Public Discussion Draft on Action 12 in para12.

(ii) identifying schemes, the users and promoters of schemes; and

(iii) acting as a deterrent to reduce the promotion and use of avoidance schemes. Taxpayers may think twice about entering into a scheme if it has to be disclosed and they know that the tax authorities may take a different position on the tax consequences of that scheme or arrangement. In addition, pressure is placed on the tax avoidance market as promoters and users only have a limited opportunity to implement schemes before they are closed down. In order to enhance the deterrence effect of a disclosure regime it is therefore important that countries' tax administrations and legislative systems can react rapidly to close down opportunities for tax avoidance. [48]

5.4 PRINCIPLES TO BEAR IN MIND IN THE DESIGN OF EFFECTIVE MANDATORY RULES

The OECD notes that although mandatory disclosure rules will vary from country to country, the design of rules should adhere to the following key principles:

- Mandatory disclosure rules should be clear and easy to understand so as to provide taxpayers with certainty about what is required by the regime. Lack of clarity and certainty can lead to inadvertent failure to disclose (and the imposition of penalties), which may increase resistance to such rules from taxpayers and in tax administrations receiving poor quality or irrelevant information; [49]
- Mandatory disclosure rules should balance additional compliance costs to taxpayers with the benefits obtained by the tax administration**;**[50]
- Mandatory disclosure rules should be effective in achieving the intended policy objectives and accurately identify relevant schemes: Thus the rules need to be drafted so that they capture sufficient information on the schemes and arrangements a tax administration is concerned about. In addition they should provide information to enable identification of users and promoters. Since it is not practical for a mandatory disclosure regime to target all transactions that raise tax avoidance concerns, the identification of "hallmarks" is a key factor to setting the scope of the rules; and
- Information collected under mandatory disclosure should be used effectively. This implies setting up a process to review disclosures and identify the potential tax policy and revenue implications. [51]

5.5 OPTIONS FOR A MODEL MANDATORY DISCLOSURE RULE

48 OECD/G20 2015 Final Report on Action 12 in para 15.
49 OECD/G20 2015 Final Report on Action 12 in para 19.
50 OECD/G20 2015 Final Report on Action 12 in para 20.
51 OECD/G20 2015 Final Report on Action 12 in para 23.

Internationally existing mandatory disclosure regimes fall under two basic categories:

(a) The Transaction-based approach (United States and South Africa)):

- Under this approach mandatory disclosure begins by identifying transactions that the tax administration considers give rise to tax revenue or policy risks (a reportable scheme) and then it requires disclosure from taxpayers who derive a tax benefit from, and any person who provides material assistance in relation to, that reportable scheme.
- The approach defines a reportable scheme with reliance on specific hallmarks and places identical disclosure obligations on both taxpayers and promoters. [52]

(b) The Promoter-based approach (United Kingdom and Ireland)

- Under this approach greater focus is placed on the role played by promoters of tax planning schemes but it does also consider what types of reportable schemes promoters and taxpayers are required to disclose.
- The approach places the primary disclosure obligation on the promoter.
- The approach defines a reportable scheme by focussing on supply of tax planning schemes, may rely more heavily on generic hallmarks and limit the disclosure to those arrangements where tax is one of the main benefits of the scheme.[53]

In general, although both the approaches may have slightly different starting points they cover the same ground and have the same basic set of objectives, design features and effects. Generally existing mandatory disclosure regimes exhibit a purely transaction or promoter-based approach. [54]

5.6 DESIGN FEATURES WHEN CONSTRUCTING A MANDATORY DISCLOSURE REGIME

The OECD recommends that in order to successfully obtain early information about tax planning schemes and the users and promoters of those schemes, certain design features need to be considered when constructing a mandatory disclosure regime. These are:

- Who has to report;
- What has to be reported;
- What information they report;
- When the information is reported;
- Obligations be placed on promoters and/or scheme users;
- Consequences of non-compliance;
- The consequences of disclosure; and

[52] OECD/G20 2015 Final Report on Action 12 in paras 57-58.
[53] OECD/G20 2015 Final Report on Action 12 in paras 57-58.
[54] OECD/G20 2015 Final Report on Action 12 in paras 58-59.

- How to use the information collected**.**

Action 12 recognises that the design of a mandatory disclosure regime has to be flexible to the needs and risks in specific countries.

5.6.1 WHO HAS TO REPORT

Mandatory disclosure rules need to identify the person who is obliged to disclose information under the regime. There are two options that countries can apply:

(i) impose an obligation on both the promoter and the taxpayer; or

(ii) impose the primary obligation to disclose on either the promoter or the taxpayer.[55]

Option A: Both the promoter **and** the taxpayer have the obligation to disclose separately. This is applied in Canada and USA.

Advantages:

- This option may have a stronger deterrent effect on both the supply (promoter) and demand (user) of avoidance schemes; and
- It reduces the risk of inadequate disclosure.[56]

Disadvantage:

- This option poses greater costs due to the dual disclosure obligation imposed, as tax authorities may require the taxpayer to file a separate form for each reportable transaction in which the taxpayer participated; and
- It increases the administrative and compliance costs for the taxpayer, and potentially those of the tax administration.[57]

Option B: Either the promoter **or** the taxpayer has the obligation to disclose. However the promoters have the primary obligation to disclose. This is applied in UK and in South Africa.[58]

- The promoter must provide the participant or user with a scheme reference number to put on their return. The participant's obligation to disclose only falls away when the participant has obtained written confirmation that disclosure has been made by a promoter or another participant. This is applied in South Africa.
    - The focus on the promoter as having the primary obligation to disclose may have the advantage of efficiency particularly in the context of mass-marketed scheme as it is the promoter who has a better

[55] OECD/G20 2015 Final Report on Action 12 in para 61.
[56] OECD/G20 2015 Final Report on Action 12 in paras 63-64.
[57] OECD/G20 2015 Final Report on Action 12 in paras 63-64.
[58] OECD/G20 2015 Final Report on Action 12 in para 66.

understanding of the scheme and the tax benefit arising under the scheme.

- The primary disclosure obligation is placed on the user where:
  - The Promoter is offshore: this is due to practical difficulties in ensuring compliance so a scheme user is instead required to disclose the scheme details to the tax authority (applied in UK).[59]
  - Where there is no promoter: disclosure is required of the person using the scheme.[60]
  - Where the promoter asserts legal professional privilege: where legislation recognises legal professional privilege, this may act to prevent the promoter from providing the information required to make a full disclosure.[61]

OECD recommendation on who has to report: The OECD recommends that even though countries are free to choose either option, where the primary obligation is placed on the promoter (option (ii)) that obligation should switch to the taxpayer where; the promoter is offshore; there is no promoter or the promoter asserts legal professional privilege.[62]

5.6.2 WHAT HAS TO BE REPORTED

This can be broken down into two issues:

(i) Countries need to decide what types of schemes and arrangements should be disclosed under their regime (i.e. what transactions are reportable).

(ii) Countries also need to determine what specific information needs to be disclosed about a reportable scheme (i.e. name, taxpayer number, details of transaction, etc.).[63]

Deciding what types of schemes and arrangements should be disclosed:

To determine what is reportable, countries can use tests such as: **threshold requirements**, **de-minimis filters** or use of certain **hallmarks** – each of these tests, and the options for applying them, is discussed below.

(i) **Threshold requirements**

[59] OECD/G20 2015 Final Report on Action 12 in para 68.
[60] OECD/G20 2015 Final Report on Action 12 in para 69.
[61] OECD/G20 2015 Final Report on Action 12 in para 70.
[62] OECD/G20 2015 Final Report on Action 12 in para 18.
[63] OECD/G20 2015 Final Report on Action 12 in para 78.

Countries can use **threshold requirements** to determine what is reportable. A transaction is reportable if it falls within the descriptions or hallmarks set out in the regime. Some regimes first apply a threshold or pre-condition that a scheme must satisfy before it is assessed against the hallmarks. Threshold tests:

- may consider whether a transaction has the features of an avoidance scheme or whether a main benefit of the scheme was obtaining a tax advantage;[64]
- can be used to filter out irrelevant disclosures and reduce the compliance and administration burden;[65] and
- target only tax motivated transactions that are likely to pose the greatest tax policy and revenue risks.[66]

The challenges of the main benefit test are that:

- it sets a relatively high threshold for disclosure;
- it can be used inappropriately as a justification for not disclosing tax avoidance schemes that would be of interest to a tax administration; and
- such a pre-condition may also make enforcement of the disclosure obligations more complex and create uncertain outcomes for taxpayers.[67]

Based on the above analysis there are two options for thresholds: the multi-step or single step approach to defining the scope of a disclosure regime.

Option A: Countries can adopt a single-step approach

Under this option, the threshold conditions are excluded in that a domestic tax benefit does not need to be identified as tax avoidance or as the main benefit of the transaction (this is applied in USA)

- Disadvantage: The adoption of this option could generate a large number of disclosures increasing the costs to both taxpayers and tax administrations and also diluting the relevance of the information received. (However this can be prevented by using tightly defined hallmarks, and/or filtering disclosures by reference to a monetary threshold or listing specific transactions).[68]

Option B: Countries can adopt a multi-step or threshold approach

64 OECD/G20 2015 Final Report on Action 12 in para 79.
65 OECD/G20 2015 Final Report on Action 12 in para 80.
66 Ibid.
67 OECD/G20 2015 Final Report on Action 12 in para 82.
68 OECD/G20 2015 Final Report on Action 12 in paras 84-85.

Under this approach all schemes need to meet a threshold condition (e.g. tax benefit) as part of their mandatory disclosure regime (this applies in UK, Ireland, Canada, Portugal and South Africa).

- Advantages:
  - This approach separately identifies the tax planning element in each scheme by reference to a common standard;
  - Thus, hallmarks can be targeted at particular categories of transaction (such as leasing transactions) without the need to separately identify and define any tax planning element; and
  - Generic hallmarks, that do not necessarily identify a separate tax motive, can be used.
- Disadvantages:
  - A precondition that focuses on a tax benefit may not work well in the context of international schemes so those countries who apply a pre-condition may need to limit its application to domestic schemes.
  - The tax benefit threshold condition may be used by taxpayers to justify non-disclosure (as noted above, this could be addressed by lowering the threshold for disclosure or exempting certain hallmarks from the threshold requirement). This approach is one that applies in South Africa in that certain arrangements are excluded where the tax benefit is not the main or one of the main benefits unless the arrangement is listed (i.e. equivalent to specific hallmarks), in which case it is reportable, regardless of whether it satisfies the main benefit test. [69]

(ii) The *de-minimis* filter

A *de-minimis* filter could be considered as an alternative to, or in addition to, a broader threshold test and could operate to remove smaller transactions, below a certain amount, from the disclosure requirements. [70] A *de-minimis* filter could be applied to all transactions potentially within scope or just to certain categories of transactions where there might otherwise be large numbers of reportable transactions. Different threshold amounts could also be applied to specific hallmarks to calibrate the disclosures in a particular area, and some countries already adopt this approach. For instance, in the US regime, reportable loss transactions have their own dollar thresholds.

The advantages of the *de-minimis* filters are that they:

- narrow the ambit of the mandatory disclosure regime;
- reduce the risk of over-disclosure;

69 OECD/G20 2015 Final Report on Action 12 in para 86.
70 OECD/G20 2015 Final Report on Action 12 in para 87.

- may enhance the usefulness of the information collected because the focus would be on more significant transactions and excessive or defensive filings could be reduced; and
- could reduce the costs and administrative burden for certain taxpayers and for the tax administration. [71]

The disadvantage of the *de-minimis* filters is that they could unhelpfully suggest that tax avoidance, in small amounts, is acceptable.

(iii) Hallmarks

Hallmarks act as tools to identify the features of schemes that tax administrations are interested in. Hallmarks are generally divided into two categories:

- Generic hallmarks (which target schemes that promoters replicate and sell to more than one person); and
- Specific hallmarks (the disclosure obligation is triggered by describing certain potentially abusive transactions and including them as a hallmark.

Generic hallmarks

Generic hallmarks target features that are common to promoted schemes. Generic hallmarks can also be used to capture new and innovative tax planning arrangements that may be easily replicated and sold to a variety of taxpayers.[72] Two typical generic hallmarks used for targeting promoted schemes are:

- the requirement for “confidentiality”, where the promoter or adviser requires the client to keep the scheme confidential - implies that the arrangements may be innovative or aggressive (used the UK, the US, Canada and Ireland); and
- the requirement for a “premium fee” or “contingent fee”, where the amount the client pays for the advice can be attributed to the value of the tax benefits obtained under the scheme (this is applied in UK, Irish and Canadian regimes).[73]

<u>Advantages of generic hallmarks</u>

- may increase the amount of reportable transactions
- may be a useful tool for capturing new and innovative transactions which specific hallmarks have difficulty in capturing
- may enable tax administrations to detect and react quickly to new schemes.
- may also have the effect of reducing such transactions in the market.

<u>Disadvantages of generic hall marks</u>:

[71] OECD/G20 2015 Final Report on Action 12 in para 87.
[72] OECD/G20 2015 Final Report on Action 12 in para 91.
[73] OECD/G20 2015 Final Report on Action 12 in para 92.

- potentially increase costs for taxpayers [74]

Specific hallmarks

Specific hallmarks are used to target known vulnerabilities in the tax system and techniques that are commonly used in tax avoidance arrangements.[75] They are designed to target particular transactions, or particular elements of a transaction.

Specific hallmarks should be drafted broadly and avoid providing too much in the way of technical detail. If specific hallmarks are overly narrow or technical they can be given a restrictive interpretation by taxpayers or may provide opportunities for taxpayers and promoters to structure around their disclosure obligations.[76]

Examples of specific hallmarks that reflect the particular or current concerns of tax authorities can target areas of perceived high risk, for example:

- Loss schemes (the US, the UK, Canada, Ireland, Portugal);
- Leasing arrangements (UK);
- Employment schemes (Ireland);
- Converting income schemes (Ireland, Portugal);
- Schemes involving entities located in low-tax jurisdictions (Portugal);
- Arrangements involving hybrid instruments (South Africa);
- Transactions with significant book-tax differences (the US);
- Listed transactions (the US); and
- Transactions of interest (the US).

Advantages of specific hallmarks:

- Listed transactions allow tax administrations to target known or common areas of risk. For example, in South Africa it has been found that specific hallmarks can be more effective in collecting relevant information than generic hallmarks;[77]
- They are useful way of keeping a disclosure regime up to date and for dealing with avoidance on non-mainstream taxes;
- They generally reflect the key risk areas in a given jurisdiction; and
- They provide flexibility in terms of enabling tax administrations to strike a balance between costs and capacity issues for the tax administration and the reporting burden on taxpayers and promoters.[78]

Disadvantages of specific hallmarks:

[74] OECD/G20 2015 Final Report on Action 12 in para 132.
[75] OECD/G20 2015 Final Report on Action 12 in para 91.
[76] OECD/G20 2015 Final Report on Action 12 in para 118-119.
[77] OECD/G20 2015 Final Report on Action 12 in para 136.
[78] OECD/G20 2015 Final Report on Action 12 in para 133.

- May impose costs and reporting burdens on promoters or taxpayers
- Require administrative capacity for tax administrations. [79]

The OECD recommendation on hallmarks: The OECD recommends that where countries introduce a mandatory disclosure regime they have the option to use a single-step approach or a multi-step/threshold approach. It is, however, recommended that mandatory disclosure regimes include a mixture of generic and specific hallmarks.

- Generic hallmarks should include a confidentiality and premium fee hallmark.
- A country may also want to adopt additional generic hallmarks such as the one applying to standardised tax products.
- Countries can choose whether or not to adopt a hypothetical approach or adopt purely factual objectives tests.
- Specific hallmarks should reflect the particular risks and issues in individual countries. The design and selection of specific hallmarks should be left to each country taking into account their own tax policy and enforcement priorities.
- Countries are free to choose whether or not specific hallmarks are linked to a *de-minimis* amount to limit the number of disclosures.
- It is recommended that where a scheme or transaction triggers one hallmark that should be sufficient to require disclosure. [80]

5.6.3 WHEN INFORMATION IS REPORTED

The purpose of mandatory disclosure rules is to provide the tax administration with early information on certain tax planning schemes and their users, and to deter the use of those schemes. The determination of the timeframe of when promoters and/or users are required to make a disclosure is therefore key to achieving that goal. The more quickly a tax administration can act against a scheme the more it may enhance the deterrent effects by reducing the time available to take advantage of any tax benefit, so altering the economics of the transaction. [81]

- The timing of the disclosure depends on the relevant trigger event and the time period for reporting allowed under a regime.[82]
- This time period can vary from within days, months, or longer.

Questions that need to be considered in setting the timeframe for disclosure are:

- At what point should the obligation to disclose start, or what event or action should trigger the need to report?
  - How soon after that event should a disclosure be made?

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[79] OECD/G20 2015 Final Report on Action 12 in paras 135-137.
[80] OECD/G20 2015 Final Report on Action 12 in para 134.
[81] OECD/G20 2015 Final Report on Action 12 in para 139.
[82] OECD/G20 2015 Final Report on Action 12 in para 18.

- Should there be different reporting timeframes for promoters and taxpayers?

(i) Options for timing of promoter disclosure

Option A: Timeframe linked to availability of a scheme

In terms of this option, the earliest event that can realistically trigger a disclosure requirement is the point at which a promoter makes a scheme available to users.

- For example under the UK legislation a scheme is regarded as "made available for implementation" at the point when all the elements necessary for implementation of the scheme are in place and a communication is made to a client suggesting that the client might consider entering into transactions forming part of the scheme, it does not matter whether full details of the scheme are communicated at that time.[83] Thus in the UK a promoter must disclose a scheme within 5 working days of making a scheme available for implementation by another person.
- Portugal promoters who are involved in any tax planning must disclose within 20 days following the end of the month in which the scheme was made available.[84]

Option B: Timeframe linked to implementation

Reporting time frames can link the reporting requirement to when a scheme has been implemented by users. However at this point it is more likely that there is a real tax loss and there is also limited potential to influence the taxpayer's behaviour which means that the overall revenue loss could be greater.

- In Canada for example, reportable transaction must be disclosed by 30 June of the calendar year following that in which the transaction became a reportable transaction. The timeframe for reporting is therefore triggered by the transaction becoming reportable. This would occur once it has been implemented.[85]
- In South African section 37 of the TAA (discussed below) provides that an arrangement has to be reported within 45 business days from the date it become a reportable arrangement.

(ii) Options for reporting by the user

Mandatory disclosure regimes either require both the promoter and the taxpayer to disclose (the US and Canada) or they put the primary obligation on the promoter and only require the taxpayer to disclose where there is no promoter or the promoter is unlikely to disclose, for instance, because the promoter is offshore (the UK, Ireland, Portugal and South Africa).[86] Where only the taxpayer/user reports then the reporting

[83] OECD/G20 2015 Final Report on Action 12 in para 141.
[84] OECD/G20 2015 Final Report on Action 12 in para 141.
[85] OECD/G20 2015 Final Report on Action 12 in para 147.
[86] OECD/G20 2015 Final Report on Action 12 in para 148.

requirement can be linked to implementation since it may be difficult to identify another point or event that provides an objective trigger for the reporting obligation. [87]

Similar policy considerations would therefore apply to the timing of a disclosure by a taxpayer as apply to the promoter. This is especially so where there is no promoter disclosure and only the taxpayer discloses.

- In the US the taxpayer reports their involvement in a reportable scheme as part of the tax return process
- The UK, Ireland, Portugal and South Africa only require the taxpayer to disclose in relatively limited circumstances.
- The South African regime applies the same timeframe for taxpayers and promoters. A taxpayer must disclose a reportable arrangement within 45 days after an amount has first been received by or accrued to a taxpayer or is first paid or actually incurred by a taxpayer.[88]

OECD Considerations on time frames: The OECD recommends that the earlier the disclosure, the greater the ability of a disclosure regime to meet its objectives. The bigger the gap between a scheme being marketed and the eventual disclosure, the more users there will be. The tax administration will therefore need to challenge more cases, potentially tying up resources, and if the scheme is successful there will be a greater loss of tax revenues.[89]

- The OECD recommends that where the promoter has the obligation to disclose, then the timeframe for disclosure should be linked to the availability of the scheme and the timescale for disclosure should aim to maximise the tax administration's ability to react to the scheme quickly and to influence taxpayers' behaviour. This would be achieved by setting a short timescale for reporting once a scheme is available.[90]
- Where a taxpayer has to disclose it is recommended that the disclosure is triggered by implementation rather than availability of a scheme. In addition if only the taxpayer discloses (i.e. because there is no promoter or the promoter is offshore) the timescale for reporting should be short to maximise the tax administration's ability to act against a scheme quickly.[91]

The OECD however notes that there is less need to have early disclosure if a government is unable to react quickly to change their legislation. Thus, the administrative constraints on each tax administration do need to be taken into account:

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87 OECD/G20 2015 Final Report on Action 12 in para 152.

88 OECD/G20 2015 Final Report on Action 12 in para 153. See further section 37 of the Tax Administration Act 28 of 2011.

89 OECD/G20 2015 Final Report on Action 12 in para 155.

90 OECD/G20 2015 Final Report on Action 12 in para 156.

91 OECD/G20 2015 Final Report on Action 12 in para 157.

- The timeframe for disclosure should be as efficient as possible within the context of the country's domestic law.[92]
- In case of administrative constraints, the OECD recommends that there are many ways that governments and tax administrations can influence taxpayer behaviour. They could, for instance, publish a view on a scheme or transaction that they would be looking out for.[93]

5.6.4 WHAT OTHER OBLIGATIONS SHOULD BE PLACED ON THE PROMOTERS OR USERS

(i) Process of identifying scheme users

Identifying scheme users is an essential part of any mandatory disclosure regime. Two different ways can be used to identify users:

- through the use of scheme reference numbers which enable the tax authorities to identify which taxpayer has used a specific scheme; and
- instead of (or in addition to) using an identifying number, they impose an obligation on the promoter to provide a list of clients who have made use of a disclosed scheme. [94]

Identification through use of schemes reference number:

Where a scheme reference number is used, the process generally needs to cover three steps:

- The tax authority issues a scheme reference number to a promoter or the user (as appropriate). Where the user is the person required to disclose the scheme then the tax authority will allocate a scheme reference number directly to the user.
- The promoter provides the scheme reference number to the user within a given timeframe. For example in the UK provides a 30 day deadline and the US gives 60 calendar days).
- The user reports the scheme reference number to the tax authority. [95] Thereafter the user must include the scheme reference number on their tax return for every subsequent year or period until the advantage ceases to apply.
- In South Africa a reference number is issued to taxpayers, who must disclose that they entered into a reportable transaction and include the reference number in their annual tax returns. [96]

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92 OECD/G20 2015 Final Report on Action 12 in para 155.

93 This is effected in South Africa through the issue of Government Gazettes setting out the nature of transactions to be included in the regime.

94 OECD/G20 2015 Final Report on Action 12 in para 158.

95 OECD/G20 2015 Final Report on Action 12 in para 159.

96 OECD/G20 2015 Final Report on Action 12 in para 164.

- The allocation of a scheme reference number does not indicate that a tax authority accepts the efficacy of the disclosed scheme or the completeness of a disclosure.

Identification through use of clients list

- Client lists can provide an alternative for user identification if countries do not use a scheme reference number system.
- A promoter is obliged to provide the tax administration with a list of clients who have used a scheme.
- The time limits for providing client lists vary. Under the Irish regime the list must be provided within 30-days of the promoter first becoming aware of any transaction forming part of the reportable transaction having been implemented. On the other hand the UK requires the promoter to provide lists quarterly. [97]
- A variation of this approach is to require the promoter to maintain lists identifying each person to whom the promoter has provided a scheme reference number and furnishing such list to the tax authority upon request. For example, the US requires client lists to be provided to the IRS within 20 business days after the date of a written request by the IRS. [98]

Identification through scheme reference numbers and client lists

- In the USA, the UK and Canada taxpayers must include the scheme reference number on their tax returns and lists of clients must be furnished. [99] For example under the Canada Tax Shelter (TS) regime (introduced in 1989) a promoter is required to obtain a tax shelter identification number, provide the number to participants and provide the list of scheme users. Canada has additionally introduced a new Reportable Tax Avoidance Transaction (RTAT) regime that extends disclosure to avoidance schemes that were not caught under the TS regime. However the scheme reference number only applies to tax shelters under the TS regime and does not apply to reportable transactions under RTAT. [100]
- In South Africa client lists are not currently required to be provided.

Considerations

Identification of users is an essential part of a mandatory disclosure regime. It allows a tax administration to improve risk assessment and the targeting of enquiries, it also enables them to better quantify the extent of any tax loss.

- All scheme details are filed per that the scheme reference number, facilitating the easy retrieval of the details at a later date if required.

[97] OECD/G20 2015 Final Report on Action 12 in para 166.
[98] OECD/G20 2015 Final Report on Action 12 in para 167.
[99] OECD/G20 2015 Final Report on Action 12 in para 164.
[100] OECD/G20 2015 Final Report on Action 12 in para 164.

- Requiring that the promoter provide a list also may identify other taxpayers that participated in a scheme but did not disclose.[101]
- The fact that the user knows they will be identified either through a client list or more directly, through entering a number on their tax return, may deter some from undertaking a scheme in the first place.
- There is therefore need for scheme reference number's *and* client lists.[102]

Using a scheme reference number may initially increase both the resource costs for the tax administration and the compliance costs for the promoter/taxpayer user.

- However, once a process has been set up the on-going costs become low.
- Balanced against this a tax administration not only obtains information on the users of a specific scheme, it can also build up a picture of the risk presented by individual taxpayers.
- The use of scheme reference numbers may also improve administrative processes: In South Africa, a scheme reference number is issued as a control measure to indicate the date and the sequence of the reporting.
- There may also be a greater deterrent effect if a taxpayer is personally obliged to include a scheme reference number on their returns. [103]

Client lists are generally received before a tax return so they provide information about the uptake of avoidance schemes much earlier than scheme reference numbers alone.

- This allows compliance plans to be put in place before tax returns are received, sometimes a year in advance.
- Client lists also enable a tax authority to carry out early interventions such as contacting taxpayers who appear on the lists to advise them not to claim the effects of the avoidance scheme on their returns.

These benefits are likely to be more obvious if client lists are automatically provided to the tax administration and the lists are provided sooner rather than later. [104]

OECD recommendations on identifying scheme users

- Where a country places the primary reporting obligation on the promoter it is recommended that they introduce scheme reference numbers and require the preparation of client lists in order to fully identify all users of a scheme, and to enable risk assessment of individual taxpayers. In this context it is recommended that, where domestic law allows, client lists should automatically be provided to the tax administration. [105]

[101] OECD/G20 2015 Final Report on Action 12 in para 168.
[102] OECD/G20 2015 Final Report on Action 12 in para 169.
[103] OECD/G20 2015 Final Report on Action 12 in para 170.
[104] OECD/G20 2015 Final Report on Action 12 in para 171.
[105] OECD/G20 2015 Final Report on Action 12 in para 172.

- Where however a country introduces a dual-reporting obligations where both the promoter and the taxpayer reports, then scheme reference number's and clients lists may not be as essential, but they are likely to aid cross-checking and allow a tax administration to quantify the risk and tax loss from specific schemes.[106]

Recommendation for South Africa

- In line with above advantages it is recommended that South Africa introduces client lists.

5.6.5 CONSEQUENCES OF COMPLIANCE AND NON-COMPLIANCE

(i) Consequences of compliance

The issue of legitimate expectation

Where an obligation to disclose is introduced, taxpayers may believe (or 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. Disclosure does not imply any acceptance of the validity, or tax treatment, of the transaction by the tax authority.[107]

- If such a legitimate expectation were to arise it could impact on a tax authority's ability to subsequently act against a scheme and a requirement to respond to all disclosures would effectively provide a clearance mechanism for such transactions. This would be contrary to the existing practice of many countries who explicitly exclude avoidance transactions from their clearance or rulings process. [108]
- To avoid legitimate expectations from arising it is important for tax authorities to be clear that the disclosure of reportable transactions has nothing to do with the effectiveness of the transactions nor is there any automatic link to obtaining a ruling on the validity of the transaction or to the application of any anti-avoidance rules. In the UK, US, Ireland and Canada the rules make it clear that the mere reporting of any scheme does not have any bearing on whether or not a tax benefit is allowed.
- Similarly the disclosure of a tax arrangement has no effect on the tax position of any person who uses the tax arrangement. Thus, the fact that a transaction is reportable does not necessarily mean that it involves tax avoidance.
- In South Africa (as is the case in UK, the US, Ireland), the disclosure of the scheme does not affect how it is treated and the lack of response from the tax

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106 OECD/G20 2015 Final Report on Action 12 in para 173.
107 OECD/G20 2015 Final Report on Action 12 in para 174.
108 OECD/G20 2015 Final Report on Action 12 in para 175.

authority does not give rise to a legitimate expectation, on the part of the taxpayer, that the scheme is valid or will be accepted. [109]

- Legislation and guidance must make it clear that the disclosure of a transaction does not imply any acceptance of that transaction or any acceptance of the purported tax benefit obtained by any person.

The Issue of self-incrimination

- The information that a taxpayer is required to provide under a mandatory disclosure regime 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 tax planning transactions reported under existing mandatory disclosure regimes should not therefore give rise to any greater concern over self-incrimination than would arise under the exercise of other information collection powers.
- The argument of self-incrimination is also not valid as the types of transactions targeted for disclosure will not generally be the types of transactions that will give rise to criminal liabilities. For countries that impose criminal liabilities on taxpayers for undertaking certain tax avoidance transactions, it may be possible to simply exclude those transactions from the scope of the disclosure regime without substantially curtailing the scope of the regime.
- In addition there should not be an issue with self-incrimination where a promoter is obliged to disclose instead of a taxpayer. [110]

(ii) Consequences of non-compliance

Mandatory disclosure regimes cannot be effective unless promoters and taxpayers fully comply with the reporting requirement. Rules that are precisely articulated and clearly understood will be easier to comply with. Compliance with disclosure requirements can further be enhanced in several ways:

- The usual sanction for non-disclosure is the imposition of penalties. The structure and amount of the penalty may depend on the type of taxpayer (i.e. corporate or individual) and the type of transaction.[111]

<u>Penalties:</u> should either be monetary, non-monetary or include elements of both.
Monetary penalties: The amounts of monetary penalties will generally be an issue for each country to consider. [112] Monetary penalties could arise in a number of situations:

(i) Monetary penalty for non-disclosure of a scheme

[109] OECD/G20 2015 Final Report on Action 12 in paras 175-177.
[110] OECD/G20 2015 Final Report on Action 12 in paras 175-179.
[111] OECD/G20 2015 Final Report on Action 12 in para 180.
[112] OECD/G20 2015 Final Report on Action 12 in para 181.

(ii) Monetary penalty for failure to provide or maintain client lists
(iii) Monetary penalty for failure to provide a scheme reference number
(iv) Monetary penalty for failure to report a scheme reference number [113]

Factors to consider in structuring monetary penalties for non-disclosure:

- In setting penalty levels, jurisdictions may take into account factors such as whether there is negligence or deliberate non-compliance or penalties may be linked to the level of fees or tax benefit.
- The main aim in setting a limit and in fixing a penalty structure is to increase the pressure to comply with the law.
- Penalties should be set at a level that maximises their deterrent value without being overly burdensome or disproportionate.
- Consideration should be given to percentage based penalties based upon transaction size or the extent of any tax savings.[114]

Types of monetary penalties that can be imposed:

- Daily penalties: These put an emphasis on timely disclosure, encouraging the promoter and taxpayer to comply with the disclosure obligation as further daily penalties can be imposed if non-compliance continues (used in UK and Ireland)
- Penalty proportionate to tax savings or promoter's fee: The level of the penalty is based on the amount of the tax benefit achieved by the taxpayer or on the fees/remuneration paid to the advisor or promoter.
  - In South Africa, section 212 of the TAA provides a monthly penalty for non-disclosure of between R50,000 and R100,000 (for up to 12 months) is imposed and the penalty is doubled if the amount of the anticipated tax benefit exceeds R5 million and is tripled if the anticipated tax benefit exceeds R10 million. [115]

Non-monetary penalties

Countries come up with non-monetary penalties for non-disclosure:

- In some countries a failure to disclose could suspend the efficacy of the scheme and taxpayers can be denied any tax benefit arising from the scheme. In other countries, however, non-disclosure itself does not affect the efficacy of a scheme. This is the case in the US, the UK, Portugal, Ireland and South Africa[116].
- In the US, for example, non-disclosure will remove the ability to argue against penalties levied against additional taxes raised in respect of the scheme. It

113 OECD/G20 2015 Final Report on Action 12 in para 182.
114 OECD/G20 2015 Final Report on Action 12 in para 183.
115 OECD/G20 2015 Final Report on Action 12 in para 193.
116 OECD/G20 2015 Final Report on Action 12 in para 195.

can also extend the statute of limitations (time for Government to dispute the taxpayer's treatment).

Penalty initiatives targeting promoters

Promoters have a greater knowledge of a scheme's tax effects and are better placed to know whether a scheme constitutes tax avoidance and to be aware of any risks inherent in that scheme. For this reason tax compliance strategies, including mandatory disclosure rules, are likely to be more effective if they focus on promoters, i.e. improving tax compliance via the supply side, rather than focusing exclusively on the end user, i.e. the taxpayer. For instance under the Mexican tax code (outside the mandatory disclosure rules) a penalty is imposed on a tax advisor who provides an advisory service to a taxpayer in order to reduce or omit some federal contribution. However this penalty is not applicable if the tax advisor provides the taxpayer with a written opinion saying that the tax authority may not agree with the position taken. This type of penalty regime encourages the tax advisor to advise his clients of the risk of undertaking certain transactions and may also, more generally, encourage a tax advisor to be more careful about the advice he provides. [117]

The UK also tackles the behaviour of high-risk promoters in order to increase transparency and it has introduced new rules that make a promoter, who fails to comply with the disclosure regime, vulnerable to further action by the tax authority, including information powers and penalties designed to improve their behaviour. In its latest consultation document entitled 'Strengthening the Tax Avoidance Disclosure Regimes' published in July 2014, the UK tax administration suggests that anyone working with a non-resident promoter (such as a business partner) should be required to disclose reportable arrangements that are promoted by the offshore promoter, to deter the use of offshore promoters to circumvent the UK disclosure requirements. [118] It should also be noted that the UK introduced the Diverted Profits Tax Regime which requires a taxpayer with offshore payments to connected parties to motivate the commerciality of such payments to the HMRC. If not satisfied with this explanation a 25% tax is levied.

OECD recommendations on penalties:

In order to enforce compliance with mandatory disclosure rules, countries should introduce financial penalties that apply if there is failure to comply with any of the obligations introduced. Countries are free to introduce penalty provisions (including

[117] OECD/G20 2015 Final Report on Action 12 in para 197.
[118] OECD/G20 2015 Final Report on Action 12 in para 198.

non-monetary penalties) that are coherent with their general domestic law provisions.[119]

5.6.6 PROCEDURAL/TAX ADMINISTRATION MATTERS

(i) Types of information to be reported

Once a transaction is reportable, the person who is obliged to disclose (promoter or user) must provide the tax authorities with particular information about how the transaction works and how the expected tax benefit arises along with details of the promoter and scheme user.

- The information should include details of the transactions, names and the tax reference number for the promoter and scheme users.
- Sufficient information should be provided to a tax authority to enable it to understand how a scheme operates and how the expected tax advantage arises.[120]

For example:

- *Identification of promoters and scheme users:* This covers details like the full name, address, phone number and tax reference or identification number (if any) of the promoters and scheme users. This is applied in South Africa.[121]
- *Details of the provision that makes the scheme reportable*: Promoters and scheme users are required to identify all hallmarks which the disclosure is being made. This is applied in South Africa.[122]
- *Description of the arrangements and the name by which they are known (if any) – clearly explained and describing steps involved:* This is to enable a tax authority to understand how the expected tax advantage arises. This is applied in South Africa.[123]
- *Statutory provisions on which tax advantage is based:* A full reference to the legislative and regulatory provisions relevant to the tax treatment of the transactions is required. It should explain how the relevant provisions are being applied and how they allow the taxpayer to obtain the desired tax treatment. In the context of international tax schemes such information should include relevant provisions of foreign law. It is recommended that this should be applied in South Africa
- *Description of tax benefit or* advantage generated by the arrangements. This is applied in South Africa[124].
- *List of clients (promoter only).* It is recommended that this should be applied in South Africa

119 OECD/G20 2015 Final Report on Action 12 in para 200.
120 OECD/G20 2015 Final Report on Action 12 in paras 201-202.
121 OECD/G20 2015 Final Report on Action 12 in paras 201-203.
122 OECD/G20 2015 Final Report on Action 12 in paras 201-204.
123 Section 38 of the Tax Administration Act No 28 of 2011 as amended.
124 Ibid.

- *Amount of expected tax benefit:* In South Africa the actual or expected amount of the tax benefit generated by the disclosed scheme has to be reflected on the disclosure form.[125]

(ii) Powers to obtain additional information

A tax administration may need additional legislated powers to enable it to acquire additional information i.e.:

- Enquire into the reasons for a failure to disclose;
- Enquire into the identity of promoters and intermediaries; and
- Request further follow up information in response to a disclosure. [126]

(iii) How to use the information collected

Once a mandatory disclosure regime is introduced there are several ways in which tax authorities can use the information collected to change behaviour and to counteract tax avoidance schemes. These include:

- *Legislative or regulatory change* - Quick legislative change is dependent on a country's legislative system but also requires a country to set up a process that analyses and risk assesses new schemes quickly.[127]
- *Risk assessment* - review of the arrangement plays a role in determining whether further action should be taken in the form of legislative change, audits, or more inquiries, etc. The specific internal procedure varies depending on the administrative structure of countries.
- *Communication strategy* - Tax authorities may issue publications to taxpayers as a way of providing an early warning that they have detected an arrangement in the marketplace and are currently considering its tax implications. In such publications tax authorities describe the arrangement and their concerns with the arrangement so that taxpayers are aware of the risks in undertaking the scheme – this can play an important role in influencing taxpayer's and promoter's behaviour on tax compliance. [128]

In order to use the information from a mandatory disclosure regime effectively it is recommended that tax administrations set up a small unit to risk assess the disclosures received and to co-ordinate action within and across the taxing authorities. [129]

[125] OECD/G20 2015 Final Report on Action 12 in paras 201-209 and s38 of TAA.
[126] OECD/G20 2015 Final Report on Action 12 in paras 220-221.
[127] OECD/G20 2015 Final Report on Action 12 in para 213.
[128] OECD/G20 2015 Final Report on Action 12 in para 217.
[129] OECD/G20 2015 Final Report on Action 12 in para 222.

6 ENSURING MANDATORY DISCLOSURE RULES ARE EFFECTIVE FOR INTERNATIONAL TAX SCHEMES

Action 12 specifically calls for OECD and G20 member countries to formulate recommendations for the mandatory disclosure of international tax schemes. This is intended to give countries an additional tool for tackling BEPS by providing tax administrations with real-time information on cross-border tax planning.

One of the key strengths of mandatory disclosure is its ability to provide tax administrations with current, comprehensive and relevant information on actual taxpayer behaviour. These benefits could prove particularly valuable in the context of cross-border schemes where tax administrations may otherwise find it difficult to obtain information on the facts of a scheme or a complete picture of its overall tax and economic consequences. However there are some key differences between domestic and international schemes that make such schemes more difficult to tackle from a disclosure perspective.

6.1 CHALLENGES TO MANDATORY DISCLOSE RULES IN CROSS-BORDER TRANSACTIONS

The OECD acknowledges that although the current mandatory disclosure regimes can apply to international schemes if it meets required thresholds:

- existing hallmarks used in mandatory disclosure regimes do not generally discriminate between schemes that are wholly-domestic and those that have a cross-border component; and
- Although some jurisdictions have hallmarks that specifically target cross-border schemes or may separately identify an international transaction under their rules, in practice countries receive comparatively fewer disclosures of cross-border schemes. The reason for this lower number of disclosures appears to be a consequence of the way international schemes are structured and the approach taken by these regimes in formulating the requirements for disclosure of a reportable scheme.[130]

(i) Challenges of defining a Reportable Scheme in cross border transactions

- Cross-border schemes typically generate multiple tax benefits for different parties in different jurisdictions. Thus, domestic tax benefits that arise under a cross-border scheme may seem unremarkable when viewed in isolation from the rest of the arrangement as a whole.[131]
- The nature of the tax benefits that arise in respect of cross-border tax planning means that disclosure regimes which focus exclusively on domestic

[130] OECD/G20 2015 Final Report on Action 12 in para 227.
[131] OECD/G20 2015 Final Report on Action 12 in para 228.

tax outcomes for domestic taxpayers, without understanding the global picture, may not capture many types of cross-border tax planning.

- Some disclosure regimes require reportable schemes to meet a formal threshold condition for disclosure (such as the *main benefit* or *tax avoidance* test). This threshold condition can be difficult to apply in the context of cross-border schemes that trigger tax consequences in a number of different jurisdictions.[132]
  - Some cross-border schemes may not meet the disclosure threshold if the taxpayer can demonstrate that the value of any domestic tax benefits was incidental when viewed in light of the commercial and foreign tax benefits of the transaction as a whole.[133]
  - In certain cases the foreign tax benefits of a cross-border scheme may even be returned to the taxpayer in the reporting jurisdiction in the form of a lower cost of capital or higher return. This has the effect of converting a tax benefit for a foreign counterparty in the off-shore jurisdiction into a commercial benefit for the taxpayer in the reporting jurisdiction, thereby further reducing the overall significance of the domestic tax benefits under the transaction.[134]
- Challenges in the application of certain hallmarks: Cross-border tax planning schemes are often incorporated into broader commercial transactions such as acquisitions, refinancing or restructuring. Such schemes tend to be customised so that they are taxpayer - and transaction-specific and may not be widely-promoted in the same way as a domestically marketed scheme. It may therefore be difficult to target these schemes with generic hallmarks that are primarily focussed at promoted schemes that can be easily replicated and sold to a number of different taxpayers.[135]
  - In such situations, specific hallmarks will generally be the most effective method of targeting cross-border tax schemes that raise tax policy or revenue risks in the reporting jurisdiction. Examples include leasing and income conversion schemes which can apply equally in the domestic and cross-border context. South Africa has specific hallmarks which can targeting international transactions.[136]
  - However one of the challenges in the design of specific hallmarks is to come up with a definition that is sufficiently broad to pick up a range of tax planning techniques and narrow enough to avoid over-disclosure. One approach to dealing with this issue is to focus on the kinds of *outcomes* that raise concerns from a tax policy perspective rather than the techniques that are used to achieve them. The US for example

[132] OECD/G20 2015 Final Report on Action 12 in para 229.
[133] OECD/G20 2015 Final Report on Action 12 in para 229.
[134] OECD/G20 2015 Final Report on Action 12 in para 229.
[135] OECD/G20 2015 Final Report on Action 12 in para 230.
[136] OECD/G20 2015 Final Report on Action 12 in para 231.

uses the effects-based approach of extending the disclosure obligations to "substantially similar" transactions (i.e. transactions that are expected to achieve the same or similar consequences to a listed transaction and are based on the same or similar strategy).[137]

(ii) How to deal with identifying who must report in cross border transactions

- A reporting jurisdiction should only require disclosure of an international scheme where the scheme has a substantive connection with the reporting jurisdiction (i.e. the scheme results in a domestic tax consequence for a domestic taxpayer).
- A mandatory disclosure regime should avoid imposing disclosure obligations on persons that are not subject to tax in the reporting jurisdiction or on arrangements that have no connection with the reporting jurisdiction.
- Disclosure regimes should ensure that reporting obligations are not imposed in circumstances where the tax authority would have limited practical ability to enforce them.[138]
- Once the ability to require disclosure is established, further consideration needs to be given to how a taxpayer in the reporting jurisdiction would comply with additional information requirements for international tax schemes. This is because an international scheme that results in domestic consequences for a taxpayer does not necessarily mean that the taxpayer will be aware of the offshore elements of the scheme or be in a position to properly understand its effects.
- At the same time, disclosure obligations should not be framed in such a way as to encourage a taxpayer to deliberately ignore the offshore aspects of a scheme simply to avoid disclosure. [139]

(iii) Issues in describing what must be reported in cross border transactions

Once a disclosure obligation has been triggered there remains the question of what information needs to be disclosed.

- While taxpayers should only be required to disclose information that is within their knowledge, possession or control, they can be expected to obtain information on the operation and effect of an intra-group scheme from other group members.
- Outside of the group context, a reporting taxpayer should not be required to provide any more information than the taxpayer would be expected to have obtained in the course of ordinary commercial due diligence on a transaction of that nature. [140]

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137 OECD/G20 2015 Final Report on Action 12 in para 232.
138 OECD/G20 2015 Final Report on Action 12 in para 233.
139 OECD/G20 2015 Final Report on Action 12 in para 234.
140 OECD/G20 2015 Final Report on Action 12 in para 235.

In light of the above challenges, the OECD sets out a number of recommendations on the design of mandatory disclosure regimes to make them more effective in targeting cross-border tax planning.[141] The challenge is to develop disclosure requirements that appropriately target cross-border transactions and that capture the key information tax administrations need in order to make informed policy decisions, while avoiding over-disclosure or placing undue compliance burdens on taxpayers.[142]

6.2 OECD RECOMMENDATIONS ON AN ALTERNATIVE APPROACH TO THE DESIGN OF A DISCLOSURE REGIME FOR INTERNATIONAL TAX SCHEMES

(i) No threshold requirement

The OECD notes that the function of a threshold requirement is to filter out irrelevant disclosures and reduce the compliance and administration burden by targeting only tax motivated transactions that are likely to pose the greatest tax policy and revenue risks.[143]

Thus the hallmarks for international schemes should target only arrangements that produced cross-border outcomes, which were of particular concern to a tax administration and would only require disclosure of those arrangements in circumstances where they presented a material risk to the reporting jurisdiction from a tax revenue perspective. Provided the new hallmarks give a precise description of the types of tax outcomes that are of concern to the reporting jurisdiction's tax administration and the materiality thresholds are set at level that avoids over-disclosure, there should be no need to apply a threshold requirement to filter-out irrelevant or non-material disclosures.[144]

(ii) Develop new hallmarks based on identification of cross-border tax outcomes

Countries should develop hallmarks that focus on the specific risks posed by cross-border tax planning that give rise to tax policy or revenue concerns for the tax administration in the reporting jurisdiction. These new hallmarks should be wide enough to capture different and innovative tax planning techniques designed to produce those cross-border outcomes, regardless of how those arrangements are structured.[145]

[141] OECD/G20 2015 Final Report on Action 12 in para 8.
[142] OECD/G20 2015 Final Report on Action 12 in para 228.
[143] OECD/G20 2015 Final Report on Action 12 in para 237.
[144] OECD/G20 2015 Final Report on Action 12 in para 238.
[145] OECD/G20 2015 Final Report on Action 12 in para 240.

Examples of such new hallmarks include:

- Arrangements that give rise to a conflict in ownership of an asset that results in taxpayers in different jurisdictions claiming tax relief for depreciation or amortisation in respect of the same asset or claiming relief from double taxation in respect of the same item of income.
- Deductible cross-border payments made to members of the same group that are not resident for tax purposes in any jurisdiction or that are resident in a jurisdiction that does not impose tax on income.
- Transactions that give rise to a deduction or equivalent relief resulting from a deemed or actual transfer of value for tax purposes, where that transaction is not treated as giving rise to tax consequences in the jurisdiction of the counterparty.
- Asset transfers where there is a material difference in the amount treated as payable in consideration for the asset. [146]

(iii) Broad definition of "arrangement" that includes offshore tax outcomes

Countries should develop a broad definition of arrangement that would treat any arrangement involving a domestic taxpayer as a reportable scheme where that arrangement includes a cross-border outcome (regardless of the jurisdiction where that outcome arose).

- Domestic taxpayers should be under an obligation to disclose a cross-border arrangement to the reporting jurisdiction even if they are not a direct party to the cross-border outcome.
- If disclosure of an arrangement was only required from taxpayers that were directly involved in engineering the cross-border outcome then tax planners could simply use intermediaries and back-to-back structures to avoid triggering domestic disclosure requirements. Equally, however, a reporting jurisdiction should not require disclosure of cross-border arrangements that have no substantive connection with the reporting jurisdiction and that do not give rise to any tax revenue risks. Accordingly an arrangement that gives rise to a specified cross-border outcome should only be reportable if it involves a transaction or payment that has a material tax impact on the reporting jurisdiction. [147]
- A domestic taxpayer should be treated as involved in a cross-border arrangement where the arrangement includes a transaction with a domestic taxpayer that has material economic consequences for that taxpayer or material tax consequences for one of the parties to that transaction.[148]

(iv) Limitations on disclosure

146 OECD/G20 2015 Final Report on Action 12 in para 239.
147 OECD/G20 2015 Final Report on Action 12 in para 241.
148 OECD/G20 2015 Final Report on Action 12 in para 243.

In order to prevent mandatory disclosure imposing an undue burden on taxpayers, disclosure in the reporting jurisdiction should only be required where the taxpayer could reasonably have been expected to be aware of the cross-border outcome under the arrangement. [149]

A person can reasonably be expected to be aware of a cross-border outcome where the person has sufficient information about the arrangement to understand its design and to appreciate its tax effects. This will include any information obtained by a taxpayer under the obligation to make reasonable enquiries (described below) but, in the context of transactions with unrelated parties, the test should not be taken as requiring a person to gather more information than it could have been expected to obtain in the course of ordinary commercial due diligence on a transaction of that nature. [150]

(v) Enquiry and notification requirements

A taxpayer can only be expected to provide the tax administration with information that is within that person's knowledge, possession or control. Information that is within a person's control includes information held by agents and controlled entities. As is the case for domestic schemes, mandatory disclosure should not require any person to provide information that is subject to a non-disclosure or confidentiality obligation owed to a third party. [151]

Where a taxpayer enters into a transaction with a group member that has a material tax impact, then that taxpayer can be expected, at the time that arrangement is entered into, to make reasonable enquiries of those group members as to whether that transaction is part of an arrangement that includes, or will include, a cross-border outcome. In certain cases information about the scheme may be subject to confidentiality or other restrictions that prevent it from being made available to the reporting taxpayer. In these cases, where group members are unable or unwilling to provide this information within a reasonable period of time then the taxpayer should notify the tax administration of the fact that:

- It has entered into an intra-group transaction with a material tax impact.
- After making reasonable enquiries, has been unable to obtain information on whether the transaction is part of an arrangement that incorporates a cross-border outcome.

The notification should include any relevant information the domestic taxpayer has on the intra-group transaction and circumstances giving rise to the transaction. Tax administrations would be able to use this information as the basis for an information

[149] OECD/G20 2015 Final Report on Action 12 in para 249.
[150] OECD/G20 2015 Final Report on Action 12 in para 250.
[151] OECD/G20 2015 Final Report on Action 12 in para 251.

request under their existing exchange agreements with other jurisdictions (for example under a double tax treaty which contains an information exchange provision; the multilateral convention on mutual administrative assistance or a tax information exchange agreement).[152]

(vi) Disclosure obligation material adviser and/or taxpayer

In the case of domestic tax schemes, disclosure is normally required from the taxpayer involved in the arrangement as well as any person who is a "promoter" in relation to that taxpayer and arrangement.

- The rules that apply to domestic schemes for identifying the promoter or material adviser and for determining who has the primary disclosure obligation should also apply in the international context.
- It will, however, be important that the definition captures those who could reasonably be expected to have knowledge of the tax consequences of the arrangement, and excludes advisors or intermediaries who could not be expected to these.[153]

(vii) Information required

The information that should be required to be disclosed in respect of international tax schemes will generally be the same as the information required for domestic schemes. Such information should include information about the operation of the scheme including key provisions of foreign law relevant to the elements of the disclosed transaction.[154]

As part of the work on monitoring the outputs from the BEPS project, the OECD recommends that countries may consider whether the information required for international schemes could be standardised, in order to minimise the compliance costs that may arise from overlapping disclosure obligations imposed by different jurisdictions in respect of the same scheme.[155]

7 DISCLOSURE OF AGGRESSING TAX PLANNING IN SOUTH AFRICA

South Africa is far ahead of many countries in implementing regulations dealing with disclosing aggressive tax planning. In line with international trends, South Africa came up with reportable arrangements legislation under s 76A of the Income Tax Act 58 of 1962, introduced by the Revenue Law Amendment Act 45 of 2003. Section

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[152] OECD/G20 2015 Final Report on Action 12 in para 252.
[153] OECD/G20 2015 Final Report on Action 12 in para 249.
[154] OECD/G20 2015 Final Report on Action 12 in para 253.
[155] OECD/G20 2015 Final Report on Action 12 in para 255.

76A (now repealed) was effective from 1 April 2005. The Explanatory Memorandum to the Revenue Laws Amendment Bill 2003[156] explained that it was necessary to introduce special reporting provisions for transactions that contain indicators of potential tax avoidance. Furthermore, that the purpose of this reporting system was to uncover "innovative" corporate tax products that effectively cost the tax system hundreds of millions (and perhaps even billions) of Rand annually. The Explanatory Memorandum noted that most of these innovative products stem from the Banks and other sophisticated financial institutions.[157] Essentially the rules were intended to give the SARS early warning of arrangements that were potentially tax driven. SARS would then be in a position to take appropriate action to counter abuse more quickly than would otherwise have been the case.

The then s 76A provided for the reporting of two classes of arrangement. The first class of reportable arrangement related to those that resulted in a tax benefit and were subject to an agreement that provided for the variation of, for example, interest or fees, if their actual tax benefits differed from the anticipated tax benefits. The second class of reportable arrangement related to certain hybrid debt and equity instruments. Section 76A required a company or a trust, which derived or will derive any tax benefits in terms of a reportable arrangement, to report that arrangement to the Commissioner within 60 days after the date that an amount was received by or accrued to any person or was paid or actually incurred by any person in terms of that arrangement. In terms of the provisions, the duty to report and to furnish information and documents lay on the taxpayer which derived tax benefits under the arrangement. On 1 March 2005, SARS issued a Guide on reportable arrangements.[158] Unfortunately, the number and nature of the transactions disclosed to SARS proved disappointing. Fewer than 150 transactions, most of them involving well known hybrid instruments, were reported in the 25 months in which the legislation was in force. Some taxpayers raised technical points to avoid reporting, or restructured their transactions to avoid the triggers for reporting. And some taxpayers indicated they had encountered fewer transactions that they believed would require reporting.[159]

When the General anti-avoidance rules (GAAR) under ss 80A–80L (discussed in chapter 4) were enacted in 2006, the reportable arrangements legislation was revised and linked to the factors that are indicative of a lack of commercial substance for GAAR purposes.[160] Sections 80M–80T of the Income Tax Act (now repealed) set

156 Clause 69 of the Explanatory Memorandum to the Revenue Laws Amendment Bill 2003 at 76.
157 Ibid.
158 SARS 'Reportable Arrangements Guide' (March 2005).
159 South African Institute of Chartered Accountants (SAICA) 'Tech Talk' Issue 50 (23 February 2009). Available at https://www.saica.co.za/TechnicalInformation/Publications/TechTalk/tabid/711/itemid/1211/pageid/4/language/en-ZA/language/en-ZA/Default.aspx (accessed on 13 May 2012).
160 Ibid.

out special reporting rules for transactions containing indicators of tax avoidance. In terms of the then s 80M(1) an arrangement was reportable if it qualified as a "hybrid equity instrument" as defined in s 8E and s 8F of the Income Tax Act, or if the arrangement was identified by the Minister by notice in the *Gazette* as one likely to result in any undue tax benefit. Subject to certain exclusions, the then s 80M(2) set out specific arrangements that had to be reported. Such reportable arrangements included tax benefits that would be derived by any participant with regard to 'interest' as defined in s 24J, finance costs, fees or any other charges, avoidance arrangements indicative of a lack of commercial substance, such as round trip financing, and arrangements involving an accommodating or tax indifferent party.

In terms of the provisions the duty to report an arrangement was on a "participant", defined in the provisions to include a company or a trust, which derived any tax benefits in terms of a reportable arrangement as well as a "promoter" (any person who is principally responsible for organising, designing, selling, financing or managing that reportable arrangement). On 31 March 2010, SARS issued a revised Draft Guide to Reportable Arrangements requesting public comment by 14 May 2010. The Draft Guide contained a flow chart to provide guidance in the application of the provisions. However the Draft Guide was criticised for its numerous ambiguities and discrepancies from the provisions in the Act, and it was never finalised.[161] The legislature, when drafting the reportable arrangements rules under s 80M-80T, aimed for a wide ambit, as it was felt that the previous reportable arrangement regime was toothless. This ultimately presented a problem, as the root cause of the problem with the regime under s 80M-80T was lack of precision. [162]

When the TAA was enacted in 2011, the provisions relating to "reportable arrangements" in the Income Tax Act were repealed and, instead became part of Part B of the TAA. In terms of s 34 of the Act, an "arrangement" means any transaction, operation, scheme, agreement or understanding (whether enforceable or not). This definition is the same as that in s 80L of the Income Tax Act, which deals with the GAAR. Since a number of concepts used in the reportable arrangements rules are the same as those applied in the GAAR, the meanings of those terms also apply to the Reportable arrangements, and the cases used in interpreting similar concepts under the GAAR would, thus, also apply to these rules. Thus the word "transaction" as used in the phrase "transaction, operation, scheme, agreement or understanding" refers to, for instance, a sales transaction or a leasing transaction. In *Meyerowitz v CIR*[163] the court ruled that the word "scheme" is sufficiently wide to cover a series of transactions. The word "understanding"

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[161] L Steenkamp & P Cramer 'A Critical Analysis of the Current SARS Model for the Disclosure of Reportable Arrangements and a Proposed Alternative' (2012) 5(2) *Journal of Economic and Financial Sciences* at 392.

[162] I Louw & B Simpson (Cliffe Dekker Hofmeyer) 'The Simple Life Before Reportable Arrangement' *Tax Matters* (2010) at 3.

[163] 1963 (3) SA 863;25 SATC 299-300.

suggests that regardless of whether an agreement is a written or verbal understanding of proposed future conduct (such as a dealing between two or more parties), it will constitute an arrangement.[164]

8 THE FRAMEWORK OF SOUTH AFRICA'S REPORTABLE ARRANGEMENTS PROVISIONS

8.1 MEANING OF RELEVANT TERMS

In terms of s 34 of the TAA (as amended by the Taxation Laws Amendment Act 43 of 2014), a "reportable arrangement" means an "arrangement" referred to in s 35(1) or 35(2) that is not an excluded "arrangement" referred to in section 36. In terms of s 35 of the TAA, an arrangement is reportable if a "tax benefit" is or will be derived, or is assumed to be derived by any "participant".

The term "tax benefit" as used in s 35, is defined in s 34 of the TAA, to mean the avoidance, postponement, reduction or evasion of a liability for tax. This definition is the same as in s 1 of the Income Tax Act. With respect to the GAAR, it was held in *ITC* 1625[165] that the test to be applied in determining whether a transaction has had the effect of avoiding tax was to ask whether "the taxpayer would have suffered tax but for the transaction".[166] It is important to note that the definition of "tax benefit" not only refers to an actual benefit that is derived, but also a tax benefit that may be derived in future, or is assumed to be derived. In other words, even if no tax benefit is derived in the end, the transaction may still be reportable). The requirement is thus not if a tax benefit is derived in a transaction, but if it is entered into in order to avoid, escape, or prevent the tax liability. [167]

The term "participant" in relation to an "arrangement" as used in s 35, is defined in s 34 (as amended by the Taxation Laws Amendment Act 23 of 2015) to mean:

(a) a 'promoter';
(b) a person who directly or indirectly will derive or assumes that the person will derive a 'tax benefit' or 'financial benefit' by virtue of an 'arrangement'; or
(c) any other person who is party to an 'arrangement' listed in a public notice referred to in section 35(2).

164 A De Koker & RC Williams Silke on South African Income Tax: Being an Exposition of the Law, Practice and Incidence of Income Tax in South Africa (2014) in para 19.36.

165 (1966) 59 SATC 383.

166 This meaning of avoiding liability was also upheld in other cases such as *Hicklin v CIR* 1964 (1) SA 324(A) and *Ovenstone v SIR* 1980(1) SA 481(A).

167 Louw & Simpson 'The Simple Life Before Reportable Arrangement' at 3.

A “promoter”, in relation to an arrangement, means a person who is principally responsible for organising, designing, selling, financing or managing the ‘arrangement’.

A “financial benefit” is in term defined in s 34 to mean a reduction in the cost of finance, including interest, finance charges, costs, fees and discounts on a redemption amount.

8.2 CIRCUMSTANCES UNDER WHICH AN “ARRANGEMENT” WOULD QUALIFY AS A “REPORTABLE ARRANGEMENT”

Section 35 provides for two circumstances under which an “arrangement” would qualify as a “reportable arrangement”:

8.2.1 SPECIFIC REPORTABLE ARRANGEMENTS

Section 35(1) lists 5 categories of reportable arrangements. In terms of this section, an arrangement is reportable if a “tax benefit” is or will be derived or is assumed to be derived by any “participant” under the following circumstances.

(a) An arrangement is reportable if “it contains provisions in terms of which the calculation of ‘interest’ as defined in s 24J of the Income Tax Act, finance costs, fees or any other charges is wholly or partly dependent on the assumptions relating to the tax treatment of that “arrangement” (otherwise than by reason of any change in the provisions of a tax Act).”[168] In terms of s 24J, interest is defined as including:
  - the gross amount of any interest or related finance charges, discount or premium payable or receivable in terms of a financial arrangement;
  - the amount (or portion thereof) payable by a borrower to the lender in terms of any lending agreement as compensation for any amount to which the lender would have been entitled, but for such lending arrangement;
- the value of the difference between all amounts receivable and payable by a person in terms of a sale and lease back arrangement as contemplated in s 23G for the full terms of such arrangement.

The above is irrespective of whether such amount is calculated with reference to a fixed rate of interest or a variable rate of interest, or if it is receivable as a lump sum or in unequal instalments during the term of the financial arrangement. For purposes of the reportable arrangements provisions, the implications of the above are that if the calculation of interest is wholly or partly dependent on the assumptions relating to the tax treatment of that arrangement, other than the way that interest ought to be calculated in terms of a tax Act, then that arrangement is reportable. A typical

[168] Section 35(1)(a) of the Tax Administration Act.

example is where a financial model determines the funding cost of a transaction based on the assumed tax benefits in the hands of the participants.[169]

(b) An arrangement is reportable if "it has any of the characteristics contemplated in s 80C(2)*(b)* of the Income Tax Act, or substantially similar characteristics".[170]

Section 80C(2)(b) is a provision in the GAAR in the Income Tax Act which refers to arrangements that lack commercial substance. In terms of s 80C(1) of the Income Tax Act, an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party but does not have a significant effect upon either the business risks or the net cash flows of that party, apart from any effect attributable to the tax benefit that would be obtained in the absence of the GAAR. The word "significant" is however not defined in s 80C.

An objective meaning of the word would require taking into account the specific circumstances of each arrangement, since what is significant differs from person to person. In terms of s 80C(2)(b), the characteristics of an avoidance arrangement that indicates lack of commercial substance include, but are not limited to, the inclusion or presence of:

(i) round trip financing as described in s 80D; or
(ii) an accommodating or tax indifferent party as described in s 80E; or
(iii) elements that have the effect of offsetting or cancelling each other.

These elements are explained below.

<u>Round tripping:</u> In terms of s 80C(2)(b)(i) the characteristics of avoidance arrangements that indicate lack of commercial substance could include the presence or inclusion of round tripping. Section 80D(1) defines "round trip financing" to include any avoidance arrangement in which funds are transferred between or among the parties which would result, directly or indirectly, in a tax benefit and significantly reduce, offset or eliminate any business risk incurred by any party in connection with the avoidance arrangement. The Explanatory Memorandum to the Revenue Amendment Bill 2005 notes that the concept "round tripping" is analogous to the concept of "round robin financing" in Australia and "circular cash flows" in the United States.[171] In term of s 80D(2), the round tripping provisions apply to any round-tripped funds without regard to whether the round tripped amounts can be traced back, and ignoring the timing, sequence, means, or manner in which the round tripped amounts are transferred or received. Thus the fact that the flow of funds

[169] Louw & Simpson 'The Simple Life Before Reportable Arrangement' at 4.
[170] Section 35(1)(b) of the Tax Administration Act.

[171] The Explanatory Memorandum to the Revenue Amendment Bill 2006 at 64.

takes place during different years of assessment is irrelevant.[172] In terms of s 80D(3), the term "funds" includes any cash, cash equivalents or any right or obligation to receive or pay the same.

<u>Accommodating or tax indifferent party:</u> Section 80C(2)(b)(iii) provides that the characteristics of avoidance arrangements that indicate lack of commercial substance include the presence or inclusion of an accommodating or tax indifferent party. The first part of the provision covers a wide a range of possible mechanisms for achieving this status, while the second part focuses upon the ways in which these parties are typically used in impermissible avoidance arrangements. Section 80E(1) provides that a party to an avoidance arrangement is an accommodating or tax-indifferent party if:

- Any amount derived by the party in connection with the avoidance arrangement is not subject to normal tax or is significantly offset either by any expenditure or loss incurred by the party in connection with that avoidance arrangement or any assessed loss; and
- Either:
- due to the participation of accommodating party:
  - an amount that would have been included in gross income of another party is now included in the gross income of the accommodating party as capital in nature;
  - a non-deductible expenditure or loss in the hands of another party would be treated as a deductible expenditure by the accommodating party;
  - an amount that would have constituted revenue in the hands of another party would be treated as capital by the accommodating party;
  - or
- The participation of that party directly or indirectly involves a prepayment by any other party.

In terms of s 80L the term "party" means "any person; permanent establishment in the Republic of a person who is not a resident; a permanent establishment outside the Republic of a person who is a resident; a partnership; or a joint venture, who participates or takes part in an arrangement".

Thus the definition extends to parties in cross-border transactions. Section 80E(2) provides that a person may be an accommodating or tax-indifferent party whether or not that person is a connected person in relation to any party. Section 80F explains that connected persons and accommodating or tax indifferent parties are often used to give the illusion of commercial substance in a specific entity, so as to circumvent anti-avoidance rules. Accordingly, the Commissioner is empowered to combine connected persons, and disregard an accommodating or tax indifferent party or

[172] Stiglingh *et all* at 815.

combine it with another party for the purposes of determining whether an avoidance arrangement lacks commercial substance or whether a tax benefit exists.

Clearly the definition of an accommodating or tax indifferent party is extremely wide as it covers any party who is not subject to tax in South Africa. This would in principle cover all cross border transactions with non-residents[173] and any transaction in a tax-haven unless the taxpayer can prove that the sole or main purpose of the transaction was not to obtain a tax benefit.[174]

To exclude ordinary business transactions from the provisions, s 80E(3) provides two exclusions to the provisions. The first one is where income tax actually paid in other jurisdictions amounts to more than two-thirds of the income tax that would have been paid in the Republic. The second one relates to ongoing active business operations in connection with the avoidance arrangement, that is carried out through a substantial business establishment in the Republic or outside the Republic. Section 80E(4) provides that for purposes of s 80E(3)(a), the amount of tax imposed by another country must be determined after taking into account any applicable double taxation treaty and any assessed loss, credit or rebate to which the party in question may be entitled or any other right of recovery to which that party or any connected person in relation to that party may be entitled.

Inclusion or presence of elements that have the effect of offsetting or cancelling each other*:* This indicator of lack of commercial substance, targets schemes involving complex financial derivatives that seek to exploit perceived loopholes in the law through transactions in which one leg generates a significant tax benefit while another leg effectively neutralises the first leg for non-tax purposes.[175]

(c) An arrangement is reportable if "it gives rise to an amount that is or will be disclosed by any 'participant' in any year of assessment or over the term of the 'arrangement' as:
    (i) a deduction for purposes of the Income Tax Act but not as an expense for purposes of 'financial reporting standards'; or
    (ii) revenue for purposes of 'financial reporting standards' but not as gross income for purposes of the Income Tax Act".[176]

Section 34 states that the term "financial reporting standards" means in the case of a company required to submit financial statements in terms of the Companies Act 71 of 2008, financial reporting standards prescribed by the standards that provide a fair presentation of the financial results and position of the taxpayer.

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173 L Oliver & M Honiball International Tax: A South African Perspective (2011) at 533.
174 Stiglingh *et all* at 816.
175 De Koker & Williams in para 19.39.
176 Section 35(1)(c) of the Tax Administration Act.

(d) An arrangement is reportable if "it does not result in a reasonable expectation of a 'pre-tax profit' for any 'participant'".[177]

In terms of s 34, the term "pre-tax profit" in relation to an arrangement means the profit of a participant resulting from the arrangement before deducting normal tax, which profit must be determined in accordance with "financial reporting standards" (defined above) after taking into account all costs and expenditures incurred by the participant in connection with the arrangement, and after deducting any foreign tax paid or payable by the participant in connection with the arrangement.

(e) An arrangement is reportable if "it results in a reasonable expectation of a pre-tax profit for any 'participant' that is less than the value of that tax benefit to that 'participant' if both are discounted to a present value at the end of the first year of assessment when that tax benefit is or will be derived or is assumed to be derived, using consistent assumptions and a reasonable discount rate for that participant".[178]

8.2.2 ARRANGEMENTS LISTED BY THE COMMISSIONER BY PUBLIC NOTICE

Section 35(2) refers to arrangements which may be listed by the Commissioner for the South African Revenue Service ("the Commissioner") as "reportable arrangements" by public notice*,* if the Commissioner is satisfied that the "arrangement" may lead to an undue "tax benefit".

In April 2014, the Commissioner published a Draft Public Notice listing arrangements for purposes of section 35(2) for public comment. The draft notice set out a list of additional reportable arrangements that have certain characteristics that may lead to an undue tax benefit. On 16 March 2015, the Commissioner issued a finalised public notice in Government Gazette No. 38569 on 16 March 2015,[179] listing reportable arrangements and excluded arrangements for purposes of the reportable arrangement provisions of the TAA. This was followed by SARS published notice No 140 in the Government Gazette No. 39650 issued on 3 February 2016, in terms of sections 35(2) and 36(4) of the TAA, which replaces all previous notices. Paragraph 2 of the Notice lists the following arrangements that are reportable:
Paragraph 2.1: This paragraph requires the reporting of hybrid equity instrument if the prescribed period in section 8E of the Income Tax Act ('ITA') had been 10 years. The paragraph states that:

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177 Section 35(1)(d) of the Tax Administration Act.
178 Section 35(1)(e) of the Tax Administration Act.
179 SARS "Public Notice Listing Arrangements for Purposes of Sections 35(2) and 36(4) of The Tax Administration Act, 2011" Government Gazette No. 38569 16 March 2015. Available at http://www.gov.za/sites/www.gov.za/files/38569_gon212.pdf accessed 23 July 2015.

> "An arrangement that would have qualified as a "hybrid equity instrument" in terms of section 8E of the Income Tax Act, 1962, if the prescribed period in that section had been 10 years, but does not include any instrument listed on an exchange regulated in terms of the Financial Markets Act, 2012 (Act No. 19 of 2012)".

Paragraph 2.2: This paragraph requires reporting where a company buys back shares for an amount in excess of R10 million and the company issued or is required to issue any shares within 12 months of the date of entering into the arrangement or of the buyback. The paragraph states that:

> "An arrangement in terms of which—
> (a) a company buys back shares on or after the date of publication of this notice from one or more shareholders for an aggregate amount exceeding R10 million; and
> (b) that company issued or is required to issue any shares within 12 months of entering into that arrangement or of the date of any buy-back in terms of that arrangement".

Paragraph 2.3: This paragraph requires reporting where a resident makes a contribution to a non-resident trust that acquires a beneficial interest in that trust and the sum of all contributions before or after that date or the value of the beneficial interest exceeds or is expected to exceed R10 million is a reportable arrangement. The paragraph states:

> "An arrangement in terms of which—
> (a) a person that is a resident makes any contribution or payment on or after 16 March 2015 to a trust that is not a resident and has or acquires a beneficial interest in that trust; and
> (b) the amount of all contributions or payments, whether made before or after 16 March 2015, or the value of that interest exceeds or is reasonably expected to exceed R10 million, excluding any contributions or payments made to or beneficial interest acquired in any—
> (i) portfolio comprised in any investment scheme contemplated in paragraph *(e)*(ii) of the definition of "company" in section 1(1) of the Income Tax Act, 1962; or
> (ii) foreign investment entity as defined in section 1(1) of the Income Tax Act, 1962."

There has however been uncertainty as to whether the use of the phrase "contribution or payment" in the above provision extends to a loan – which is the common vehicle for the transfer of cash or assets from a resident to a non-resident trust. The concern is that the terms "contribution" and "payment" are not defined in the TAA; which make it unclear as to what would qualify as a "contribution or payment". The word "contribution" is defined in the Oxford Dictionary to *inter alia* mean "a gift or payment to a common fund or collection" and the word "payment" is defined as "the action or process of paying someone or something or of being paid; an amount paid or payable". The word "pay" is defined as *inter alia* to "give someone money owed to them for work". The word "loan" is defined in the Oxford dictionary as "a thing that is borrowed, especially a sum of money that is expected to be paid back with interest; the action of lending something." Since the word "contribution" entails a gift or a payment and the word "payment" entails giving money owned; one could argue that a loan is not covered in the meaning of these words as repayment is expected. It is therefore arguable that a loan to a non-resident trust is not a reportable arrangement.[180]

- The DTC recommends that SARS clarifies the wording of this paragraph to ensure that loans are categorically covered.

The other concern is that the paragraph makes use of term "beneficial interest", which is not defined in the TAA.[181] Even if courts could refer to the Income Tax Act (ITA) for the meaning of the term – there is no definition of the term there. Section 1 of the ITA defines the term "beneficiary" in relation to a trust to mean a person who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust. However qualifying as a "beneficiary" as defined in the ITA, does not automatically infer a "beneficial interest". An interest in a trust is usually described either as a vested interest/right, or a discretionary interest/right (a contingent right). The phrase "beneficial interest" is thus not a recognised concept in the legislation; and it is not clear if the legislator intended to refer to some other interest altogether.

If one refers to the Oxford dictionary, to determine what "beneficial interest" would imply, the dictionary defines the word "beneficial" as "having a good effect; favourable," and the word "benefit" to *inter alia* mean an "advantage or profit gained from something". The combination of these two definitions implies that a "beneficial interest" must be an interest of which it can be said with certainty that it is favourable, that an advantage or profit is gained. It is therefore uncertain whether a beneficiary of a discretionary trust in terms of which it is completely within the discretion of the trustees whether or not any distribution will be made to a specific beneficiary, has a beneficial interest. Unless the trustees have decided to vest any capital or income in the beneficiary, that beneficiary only has a contingent right, which is no more than a *spes* - a hope or an expectation.[182]

- It is therefore recommended that to ensure that the term "beneficial interest" is not open to an interpretation that an interest in a discretionary trust is not reportable, SARS should clearly explain what it intended by the term and whether or not it also includes any beneficial interest in a discretionary trust.[183]

The other concern about the paragraph is that the value of all contributions or payments, or the value of the beneficial interest, must exceed or be reasonably expected to exceed R10 million. Even if it is established that a person holds a beneficial interest in a discretionary trust, it is almost impossible to attribute a value

[180] Technical Report submitted by STEP Cape Town to the DTC BEPS-Subcommittee (June 2016).
[181] Technical Report submitted by STEP Cape Town to the DTC BEPS-Subcommittee (June 2016).
[182] *Commissioner for Inland Revenue v Estate Merensky* 1959 22 SATC 343.
[183] *Reportable Arrangements - 2446. Extended to foreign trusts*, Cliffe Dekker Hofmeyer, Saica Integritax Newsletter, September 2015, Issue 192, p 23 – 26, accessed 2nd June 2016: https://www.saica.co.za/integritax/Archive/Integritax_Sep_2015_Issue_192.pdf.

to that interest, as the substance of that interest is no more than a hope, and totally dependent on the discretion of the trustees. This was confirmed by the Supreme Court of Appeal in the case of *Welch v Commissioner for the South African Revenue Service*,[184] that a mere *spes* has no present inherent value.[185]

- It is therefore recommended that SARS clarifies how the value of the "beneficial' interest to be in the context of a discretionary trust will be determined.

Where reporting in the case of a trust applies, if "the value of that interest exceeds or is reasonably expected to exceed R10 million" with respect to the contributions or payments of the beneficial interest, there are also some uncertainties as to how this value is to be determined. One may not be sure when the value of such contributions or payments is likely to exceed R10 million at any point in the future, so that it becomes reportable.[186] Even if the value of the interest of a beneficiary can be established, and even if can be expected to exceed the threshold, there are numerous factors which could influence the value such as changes in the exchange rate, a decrease, decrease or crash in the markets, a discretionary distribution made to another beneficiary, *etcetera*.

- The DTC recommends that SARS provides more concrete, rather than very broad ways, of determining the value.

Paragraph 2.4: This paragraph requires reporting in the case of the direct or indirect acquisition of a controlling interest in a company with assessed losses in excess of R50 million from the year of assessment preceding the transaction, or during which the transaction is concluded is reportable. The paragraph states:

> "An arrangement in terms of which one or more persons acquire the controlling interest in a company on or after the date of publication of this notice, including by means of acquiring shares, voting rights or a combination of both, that—
> (a) (i) has carried forward or reasonably expects to carry forward a balance of assessed loss exceeding R50 million from the year of assessment immediately preceding the year of assessment in which the controlling interest is acquired; or
> (ii) has or reasonably expects to have an assessed loss exceeding R50 million in respect of the year of assessment during which the controlling interest is acquired; or
> (b) directly or indirectly holds a controlling interest in a company referred to in paragraph *(a)."*

Paragraph 2.5: This paragraph requires the reporting of arrangements between residents and foreign insurers if amounts that exceed or are expected to exceed R5 million have been paid or will become payable to the foreign insurer and any amount

184 2004 2 All SA 586.
185 Supra, para 50 and para 62.
186 *SARS gazettes new list of arrangements deemed reportable,* News & Press: Tax Talk (22 September 2015). Available at http://www.thesait.org.za/news/251710/SARS-gazettes-new-list-of-arrangements-deemed-reportable-.htm accessed 9 June 2016.

payable to beneficiaries is determined mainly with reference to the value of particular assets or categories of assets held by the foreign insurer. The paragraph states:

> "An arrangement between a person that is a resident and a person that qualifies as an insurer in terms of any law of any country other than the Republic (hereinafter referred to as the foreign insurer) in terms of which—
>
> (a) an aggregate amount that exceeds or is reasonably expected to exceed R5 million has been paid or becomes payable by the resident to the foreign insurer; and
>
> (b) any amount payable on or after 16 March 2016, in cash or otherwise, to any beneficiary in terms of that arrangement is to be determined mainly by reference to the value of particular assets or categories of assets that are held by or on behalf of the foreign insurer or by another person for purposes of that arrangement."

Paragraph 2.6: This paragraph requires the reporting of services comprising consultancy, construction, engineering, installation, logistical, managerial, supervisory, technical, or training services rendered to a resident person or to a permanent establishment of a non-resident person in South Africa under certain circumstances. The paragraph states:

> "An arrangement for the rendering to a person—
>
> (a) that is a resident; or
>
> (b) that is not a resident that has a permanent establishment in the Republic to which that arrangement relates, of consultancy, construction, engineering, installation, logistical, managerial, supervisory, technical or training services, in terms of which—
>
> (i) a person that is not a resident or an employee, agent or representative of that person—
>
> (aa) was or is physically present in the Republic; or
>
> (bb) is anticipated to be physically present in the Republic, in connection with or for purposes of rendering those services; and
>
> (ii) the expenditure in respect of those services under that arrangement—
>
> (aa) incurred or to be incurred, on or after the date of publication of this notice, exceeds or is anticipated to exceed R10 million in aggregate; and
>
> (bb) does not qualify as remuneration for purposes of the Fourth Schedule to the Income Tax Act, 1962."

The above provision appears to be largely aimed at non-resident service providers who physically provide services in South Africa to residents (which may create permanent establishments of non-residents) via individual non-residents sent to South Africa. This could be the case where a foreign consulting firm sends its employees to South Africa to render consulting services. It could also be the case where a multinational corporation that has a resident subsidiary or a permanent establishment in South Africa, sends non-resident employees or agents to South Africa (e.g. managers or experts) to provide services to the resident subsidiary or permanent establishment.

Generally, a non-resident service provider would be liable to account for income tax in South Africa in respect of all income derived from a South African source. Where an international tax treaty applies, the non-resident would generally be liable to account for income tax in South Africa only to the extent that it has created a permanent establishment in South Africa and the relevant income is attributable to such permanent establishment.

Where a non-resident service provider sends non-resident employees or agents to South Africa in connection with, or for purposes of, rendering services to South African residents (or permanent establishments of non-residents in South Africa), the relevant income derived by the non-resident service provider is very likely to be taxable in South Africa.

In practice, the risk for SARS is that such non-resident service providers could fail to register as taxpayers in South Africa (whether as a permanent establishment or not), and not declare their income that is taxable in South Africa. The fiscus may then be compromised as the local recipient of the services would likely claim a tax deduction for the expenditure incurred. The non-resident service provider could potentially also become liable to register for value-added tax in South Africa to the extent that it conducts an enterprise in South Africa and makes taxable supplies of services.

Where such non-resident service providers maintain a light footprint in South Africa, SARS may find it difficult to enforce compliance. Thus, the above provision is intended to be a detection mechanism, which ensures that resident recipients of services from non-resident service providers, are forced to declare their payments to those service providers and thus give an indication of the non-resident's South African income.

The withholding tax on service fees provided for in s51A-s51H of the Income Tax Act, No 58 of 1962 was originally expected to commence on 1 January 2017. In this regard the local recipient of services would generally have to withhold 15% of the fee payable to the non-resident service provider (subject to the application of a relevant international tax treaty). However, in the 2016 Budget review it was announced that the services withholding tax is to be removed. Thus, it appears that the reporting obligation will replaced the withholding tax as a mechanism for SARS to identify where tax should be paid in South Africa by non-residents.

8.3 EXCLUDED ARRANGEMENTS

Section 36 of the TAA provides for certain arrangements that are excluded from the provisions. The excluded arrangements fall under two main categories: specifically excluded arrangements (subject to certain exceptions) and arrangements excluded by the Commissioner by public notice.

8.3.1 SPECIFICALLY EXCLUDED ARRANGEMENTS (SUBJECT TO CERTAIN EXCEPTIONS)

In terms of s 36(1) excluded arrangements fall under 4 main categories discussed below:

(a) An “arrangement” is excluded if it is a loan, advance or debt in terms of which:
- (i) the borrower receives or will receive an amount of cash and agrees to repay at least the same amount of cash to the lender at a determinable future date; or
- (ii) the borrower receives or will receive a fungible asset and agrees to return an asset of the same kind and of the same or equivalent quantity and quality to the lender at a determinable future date.

An example of this exclusion is vanilla type loans (advances or debt).

(b) An “arrangement” is excluded if it is a lease:
The term ‘lease’ (not defined in the ITA or TAA) can be defined as a contract in terms of which an owner of an asset or equipment, normally referred to as the lessor, who lets the asset or equipment to be used by another person, normally referred to as the lessee.[187] Thus, the leasing contract is based on the separation of the ownership of an asset and its usage.[188] Section 23A(1) of the ITA, does however define an “operating lease” as a lease of movable property concluded by a lessor in the ordinary course of a business (not being a banking, financial services or insurance business) of letting such property to members of the general public for a period of less than a year, whereby the cost of maintaining and repairing the property are borne by the lessor and the risk of loss or destruction to the asset is not assumed by the lessee.

(c) An “arrangement” is excluded if it is a transaction undertaken through an exchange regulated in terms of the Securities Services Act 36 of 2004:

The term “transaction” is defined in s 1 of the Securities Services Act, to mean a contract of purchase and sale of securities. Section 1 of the same Act defines an “exchange” as a person who constitutes, maintains and provides an infrastructure:
- for bringing together buyers and sellers of securities;
- for matching the orders for securities of multiple buyers and sellers; and
- whereby a matched order for securities constitutes a transaction.

In terms of sections 5 and 6 of the Securities Services Act, exchange transactions are regulated by Registrar or Deputy Registrar of Securities Services in terms of Financial Services Board Act 97 of 1990. Since any person who deals in securities has to apply to the registrar for an exchange licence in respect of their securities transactions,[189] such transactions are regulated and so they are excluded from the

187 Oxford English Dictionary.
188 OECD “The Taxation of Income Derived from Leasing of Industrial, Commercial and Scientific Equipment” op cit note 1 in para 9.
189 Section 7 of the Securities Services Act 36 of 2004.

reportable arrangements provisions. This implies that preference shares traded on the JSE Securities Exchange are excluded arrangements.[190]

(d) An "arrangement" is excluded if it is a transaction in participatory interests in a scheme regulated in terms of the Collective Investment Schemes Control Act 45 of 2002:

In terms of section 1 of the Collective Investment Schemes Control Act, a "collective investment scheme" means "a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which:

(i) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and
(ii) the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined, in the collective investment scheme as authorised by any other Act.

Section 1 of the Collective Investment Schemes Control Act defines a 'participatory interest' in a collective investment scheme as "'any interest, undivided share or share whether called a participatory interest, unit or by any other name, and whether the value of such interest, unit, undivided share or share remains constant or varies from time to time, which may be acquired by an investor in a portfolio."

In terms of section 7 of the Collective Investment Schemes Control Act, transactions in participatory interests in Collective Investment Schemes are regulated by the registrar or the deputy registrar of collective investments in terms of Financial Services Board Act 97 of 1990. Since these transactions are duly regulated, they are excluded from the reportable arrangements provisions.

8.3.2 EXCEPTIONS FROM EXCLUDED ARRANGEMENTS

The above excluded arrangements are subject to certain exceptions. In terms of s 36(2), an arrangement is excluded in terms of s 36(1) only if that arrangement:

(a) is undertaken on a stand-alone basis and is not directly or indirectly connected to any other "arrangement" (whether entered into between the same or different parties); or
(b) would have qualified as having been undertaken on a stand-alone basis, were it not for a connected "arrangement" that is entered into for the sole

[190] SARS 'Reportable Arrangements Guide' (1 March 2005) at 6.

purpose of providing security and if no “tax benefit” is obtained or enhanced by virtue of the security “arrangement”.

Many loans are linked to an event that the taxpayer will undertake, or anticipates to undertake. To the extent that the loan is linked to the acquisition of an asset, the arrangement would no longer be excluded, and may need to be reported.[191]

Section 36(4) provides that the excluded arrangements set out in s 36(1) do not apply if the “arrangement” is entered into:

(a) with the main purpose or one of its main purposes of obtaining or enhancing a “tax benefit”; or
(b) in a specific manner or form that enhances or will enhance a “tax benefit”.

The meaning of the phrase “main purpose of obtaining a tax benefit” can be gleaned from the meaning of the same phrase as used in s 80G(1) of the Income Tax Act, which deals with the GAAR. In terms of this GAAR provision, the word “purpose”, as used in the context of section 80G does not refer to the intention of the taxpayer but the purpose of the arrangement. In the context of reportable arrangements, this would imply the objective effect that the arrangement is sought to achieve – the end accomplished or achieved.[192] Thus the burden of proof lies on the Commissioner to show that the main purpose or one of the main purposes of the arrangement is to obtain or enhance a tax benefit. The use of the word “or” between s 36(3)(a) and (b) seems to imply a taxpayer cannot reason that the arrangement is excluded, merely because its main *purposes* was not to obtain a tax benefit. As long as the arrangement is entered into in a specific manner that enhances or will enhance a tax benefit, it will also not fall under the excluded arrangements.

8.3.3 ARRANGEMENTS EXCLUDED BY THE COMMISSIONER BY PUBLIC NOTICE

In terms of s 36(4), the Commissioner may determine an “arrangement” to be an “excluded arrangement” by public notice, if satisfied that it is not likely to lead to an undue “tax benefit”.

As noted above, the Commissioner for SARS issued a public notice No 140 in Government Gazette (No 39650) on 3 February 2016 listing reportable arrangements and excluded arrangements for purposes of the reportable

[191] Louw & Simpson ‘The Simple Life Before Reportable Arrangement’ at 4.
[192] De Koker & Williams op cit note 5 in para 19.6.

arrangement provisions of the TAA that replaces all previous notices. In terms of this Notice the excluded arrangements are set out in paragraph 3.

Paragraph 3.1: "An arrangement referred to in section 35(1) of the Tax Administration Act, 2011, is an excluded arrangement if the aggregate tax benefit which is or may be derived from that arrangement by all participants to that arrangement does not exceed R5 million.

Paragraph 3.2: "An arrangement referred to in section 35(1)*(c)* of the Tax Administration Act, 2011, is an excluded arrangement if the tax benefit which is or will be derived or is assumed to be derived from that arrangement is not the main or one of the main benefits of that arrangement."

8.4 DISCLOSURE OBLIGATIONS

The TAA has provisions that deal with disclosure obligations with regard to reportable arrangements. Section 37(1) thereof provides that the information in referred to in section 38 (below) in respect of a reportable arrangement must be disclosed by a person who:

(d) is a "participant" in an "arrangement" on the date on which it qualifies as a "reportable arrangement" within 45 business days after that date; or
(e) becomes a "participant" in an "arrangement" after the date on which it qualifies as a "reportable arrangement", within 45 business days after becoming a "participant"

Section 37(3) provides that a "participant" need not disclose the information if the "participant" obtains a written statement from any other "participant" that the other "participant" has disclosed the "reportable arrangement". :

Section 37(5) provides that SARS may grant extension for disclosure for a further 45 business days, if reasonable grounds exist for the extension.

Thus the reporting obligation is in the first instance on the promoter (who in terms of section 34 of the TAA is the person who is responsible for organising, designing, selling, financing or managing the reportable arrangement) as this is the person most likely to have insight into the whole transaction. For example, if a corporate finance firm designs a transaction, it has to report the transaction. If there is no promoter, or the promoter is a non-resident, the participants to the transaction (which only include companies and trusts) must report. [193] Essentially this provision covers reporting by participants in cross-border transactions.

Since any participant is obliged to report the relevant arrangement it follows that in terms of paragraph 2.6 of Government Gazette No. 39650 issued on 3 February

[193] Louw & Simpson 'The Simple Life Before Reportable Arrangement' at 3.

2016, South African residents (or non-residents having a South African permanent establishment) who conclude contracts with non-resident service providers for the provision of services, would very likely have to report the arrangement where the non-resident service provider will be sending non-resident employees, agents or representatives to South Africa in relation to the services, and the overall monetary threshold of R10 million non-remuneration income is to be exceeded.

Section 38 of the TAA provides for the information that must be submitted. The section states that:

> "The 'promoter' or 'participant' must submit, in relation to a reportable arrangement, in the prescribed form and manner and by the date specified:
> (a) a detailed description of all its steps and key features, including, in the case of an 'arrangement' that is a step or part of a larger 'arrangement', all the steps and key features of the larger 'arrangement';
> (b) a detailed description of the assumed 'tax benefits' for all 'participants', including, but not limited to, tax deductions and deferred income;
> (c) the names, registration numbers, and registered addresses of all 'participants';
> (d) a list of all its agreements; and
> (e) any financial model that embodies its projected tax treatment".

In terms of s 39 of the TAA, after SARS has received the information contemplated in s 38 of the same Act, it must issue a reportable arrangement reference number to each "participant" for administrative purposes only.

8.5 PENALTIES FOR NON-DISCLOSURE

Section 38 of the TAA provides that the arrangement must be disclosed in the prescribed form. Disclosing the arrangement in any other manner than with the prescribed form would therefore not constitute compliance to the TAA, and without a prescribed form it is impossible to disclose an arrangement, as it can only be done with the prescribed form.

However, the only form that can be found on SARS's website is the RA-01 form, which expressly stipulates that it is the form in which to report arrangements in terms of sections 80M – 80T of the ITA. Sections 80M – 80T were repealed by the TAA in 2011. No form exists in terms of the TAA with which to disclose reportable arrangements.

Since a reportable arrangement can only be disclosed with the prescribed form – any other manner or form of disclosure would not constitute proper disclosure or compliance with the Act. Without a prescribed form, it is therefore impossible to comply with the provisions.

Bearing in mind that the deadline for reporting any existing arrangements which became reportable on the publication date of the Notice would have expired on 15th June 2016 (calculated with an extension included), this is a major concern.[194]

- It is recommended, by the DTC, that SARS urgently provides a valid prescribed form to negate any arguments from taxpayers that the unavailability of such a form precludes their ability to comply with the Act.

8.6 PENALTIES FOR NON-DISCLOSURE

Where a person fails to disclose the information in respect of a reportable arrangement, s 212 of the TAA as amended by the Tax Administration Amendment Laws 23 of 2015 sets out penalties. The section states that:

> "(1) A person referred to in paragraph (*a*) or (*b*) of the definition of 'participant' who fails to disclose the information in respect of a 'reportable arrangement' as required by section 37 is liable to a 'penalty', for each month that the failure continues (up to 12 months), in the amount of—
> (*a*) R50 000, in the case of a 'participant' other than the 'promoter'; or
> (*b*) R100 000, in the case of the 'promoter'.
>
> (2) The amount of 'penalty' determined under subsection (1) is doubled if the amount of anticipated 'tax benefit' for the 'participant' by reason of the arrangement (within the meaning of section 35) exceeds R5 000 000, and is tripled if the benefit exceeds R10 000 000.
>
> (3) A person referred to in paragraph (*c*) of the definition of 'participant' who fails to disclose the information in respect of a 'reportable arrangement' as required by section 37 is liable to a 'penalty' in the amount of R50 000".

As indicated above, the term "participant" in relation to an "arrangement" is defined in s 34 (as to mean:

(a) a 'promoter';
(b) a person who directly or indirectly will derive or assumes that the person will derive a 'tax benefit' or 'financial benefit' by virtue of an 'arrangement'; or
(c) any other person who is party to an 'arrangement' listed in a public notice referred to in section 35(2).

From the above, there seem to be uncertainties about how the penalties apply.

- Section 212(1) stipulates that a person will be liable for penalties for non-disclosure of the arrangement. However, the conjunction "or" used between subsections 1(a) and 1(b) makes it unclear whether only one person will be held liable for the penalty, in the corresponding amount, or whether all persons will be held liable simultaneously, in the amount applicable to their role in the arrangement. It is not clear whether SARS imposes a penalty on each of the promoters or if the penalty will be imposed jointly and severally. It is suggested that the legislation be made clearer.

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[194] Technical Report submitted by STEP Cape Town to the DTC BEPS-Subcommittee (June 2016).

- There are also concerns that the heavy penalties may be unfair to innocent participants. Section 34(c) of the definition of participant provides that "any other person who is a party to an arrangement" is a participant. However the TAA does not explain who is included or excluded in the term "party to an arrangement". It is for instance not clear whether it includes beneficiaries of discretionary trusts. If the phrase "a party to an arrangement" is interpreted so widely SARS, may impose unfair and unjust penalties on innocent persons i.e. those who have no knowledge of the actions of the trust. As explained above, Action 12 of the OECD BEPS Report recommends that in structuring monetary penalties for non-disclosure:
    - Jurisdictions should take into account factors such as whether negligence, deliberate non-compliance or the tax benefit may be linked to the level of the penalty.
    - Penalties should be set at a level that maximises their deterrent value without being overly burdensome or disproportionate.
    - Consideration should be given to percentage based penalties based upon transaction size or the extent of any tax savings.[195]

  In South Africa, under section 217 of the TAA, SARS does apply discretion in the way the section 212 reportable arrangements penalties are levied. Section 217(2) provides that SARS may "remit the 'penalty' or a portion thereof if appropriate, up to an amount of R2000 if SARS is satisfied that:

  (iii) reasonable grounds for non-compliance exist; and

  (iv) the non-compliance in issue has been remedied".

- The penalties in section 212(1) are: R100 000 per month of non-disclosure by the promoter, or R50 000 per month in the case of a participant other than the promoter, limited to 12 months. It would appear that "a participant" other than a promoter would include both the person falling into category (b) and the person in category (c) of the definition of participant in section 34. However section 212(3) of the penalties provision contains a separate penalty for participants in category (c) of the definition of participant. A strict reading, of the provision indicates a duplication of the penalty imposed on the person falling into category (c) of the definition of participant. Although one can through the rules of interpretation deduce that the intention was to separate all three parts of the definition of a participant, making them liable to R100 000 per month in the case of promoters in category (a), R50 000 per month in the case if participants category (b), and a once-off R50 000 in the case of participants category (c), the provision does not explicitly state so. It is recommended that the wording of this provision is made clearer.[196]

[195] OECD/G20 2015 Final Report on Action 12 in para 183.
[196] Technical Report submitted by STEP Cape Town to the DTC BEPS-Subcommittee (June 2016).

- The penalties have serious economic implications for participants and promoters. For example non-disclosure by a promoter for 12 months could amount to penalties of 1.2million (100, 000 per month). It is possible that amount could even be higher if a promoter is involved in more than one arrangement that must be reported. With such hefty penalties, it is important that SARS ensures that the provisions are well worded and clear, so that taxpayers are not left to their own devices to interpret what was meant. It is also important that SARS raises more awareness to taxpayers about the reportable arrangements provisions especially regarding the penalties for not complying with the provisions.

9 OBSERVATIONS AND RECOMMENDATIONS ON ENSURING THE EFFECTIVENESS OF SOUTH AFRICA'S REPORTABLE ARRANGEMENTS PROVISIONS

9.1 OBSERVATIONS ON ENSURING AN EFFECTIVE EARLY WARNING SYSTEM

The reportable arrangements provisions are supposed to work as an "early warning system" for SARS, allowing it to identify potentially aggressive transactions when they are entered into. This could lead to SARS countering innovative transactions as they are devised, instead of them attempting to play catch up a number of years down the line.[197]

With respect to obtaining early information about aggressive tax avoidance schemes**,** in South Africa any preference share that is redeemable within 10 years of issue is listed as a reportable arrangement. These arrangements make up the majority of transactions currently reported, and the data collected has provided an insight into how preference share funding is utilised. This understanding has informed the design of the new hybrid equity tax rules that have been recently introduced.[198]

9.2 RECOMMENDATION TO ENSURE EFFECTIVE DETERRENCE OF AGGRESSIVE TAX AVOIDANCE

The Table below from SARS[199] shows the statistics on Reportable Arrangements in South Africa for which the "Tax Avoidance and Reportable Arrangements Unit" at SARS has issued receipts since 2009. The 2016 statistics relate to the 1st quarter of the year.

197 Louw & Simpson 'The Simple Life Before Reportable Arrangement' at 3.
198 OECD May 2015 Public Discussion Draft on Action 12 in para 42.
199 Statistics adopted from SARS "Tax Avoidance and Reportable Arrangements Unit". Refer to reportable@sars.gov.za.

Year	Number
2009	151
2010	76
2011	154
2012	70
2013	91
2014	87
2015	155
2016	54
Total	**838**

The above shows that 838 arrangements have been reported to SARS since 2009 to date. This success can be ascribed to the fact that SARS has carried out successful audits where significant amounts of tax have been collected; and also to the fact that changes were made to the legislation on a more proactive basis rather than on relying on discovering arrangements through the audit process only. A further benefit of the system is that the Tax Avoidance and Reportable Arrangement Unit is able to tailor the training of its auditors for risk profilers based on its experience of reports received, thus keeping these its auditors more abreast with trends in the market.

In the majority of cases the disclosures have been made by several large companies. The majority of reports under the generic hallmarks were made during 2009 and the number of arrangements disclosed annually under those hallmarks has reduced significantly. South Africa has since extended the scope of its mandatory disclosure regime with the addition of specific hallmarks targeting transactions that are of particular concern to the South African tax administration. [200]

There were previously concerns that the reportable arrangements legislation was largely aimed at structured financial arrangements facilitated by banks; such as preference share arrangements which are legitimate. In this regard, SARS mainly received reports of vanilla type preference share arrangements which are legitimate. This left out the so-called funnel funding schemes.

Over the last two years the SARS Unit responsible for Reportable Arrangements started managing the listed Reportable Arrangements in a more proactive manner which enabled it to list five additional arrangements that are now required to be reported. This has resulted in an increase in the number of arrangements reported in line with SARS expectations, although preference share deals remain the predominant item reported. The evidence collected through reports on arrangements listed as recently as March 2015 helped to inform policy considerations on certain

[200] OECD May 2015 Public Discussion Draft on Action 12 in para 54.

issues. Thus the Government Gazette No. 39650 issued on 3 February 2016 extended the scope of reportable arrangements which is hoped to make the provisions more effective in exposing tax abuses.

It appears from s 38 of the TAA that the success of the reportable arrangements rules depends on pro-active reporting[201] and the ability of the participants to fully disclose the information regarding such arrangement. Although taxpayers have in the past been able structure their affairs to avoid falling under the reportable arrangements provisions, the latest Gazette shows that much more reporting will be required of taxpayers.

9.3 COMMENT ON EFFECTIVE TIME OF DISCLOSURE

In the UK, a scheme is regarded as "made available for implementation" at the point when all the elements necessary for implementation of the scheme are in place and a communication is made to a client suggesting that the client might consider entering into transactions forming part of the scheme, it does not matter whether full details of the scheme are communicated at that time.[202] A UK a promoter must disclose a scheme within 5 working days of making a scheme available for implementation by another person. In Portugal promoters must disclose a scheme within 20 days following the end of the month in which the scheme was made available.[203]

Section 37(1) of the TAA provides that an arrangement must be disclosed by a "participant" within 45 from the date on which it qualifies as a "reportable arrangement". Further that SARS may grant extension for disclosure for a further 45 business days, if reasonable grounds exist for the extension. This time period for disclosure obligation is triggered where there is receipt or payment of money, for a transaction forming part of a reportable arrangement. This disclosure be is reasonable and in line with the OECD recommendation on the time of disclosure.

9.4 RECOMMENDATION ON EFFECTIVE IDENTIFICATION OF SCHEME USERS

The method applied to identify scheme users in South Africa is by SARS issuing a reportable arrangement reference number to each "participant" for administrative purposes in terms of s 39.

Requiring promoters to submit client lists is not a requirement in South Africa. In countries such as the USA, the UK and Canada taxpayers must include the scheme

201 Ibid.
202 OECD/G20 2015 Final Report on Action 12 in para 141.
203 OECD/G20 2015 Final Report on Action 12 in para 141.

reference number on their tax returns and lists of clients must be furnished.[204] The OECD notes that requiring the promoter to provide a client list may identify other taxpayers that participated in a scheme, but did not disclose.[205] Although this may increase compliance costs for the promoter, the fact that the user knows they will be identified either through a client list or more directly, through entering a number on their tax return, may deter some from undertaking a scheme in the first place.[206] The OECD recommends that client lists should be received by tax administrations before a tax return is submitted so they provide information about the uptake of avoidance schemes much earlier than scheme reference numbers alone. This allows compliance plans to be put in place before tax returns are received, sometimes a year in advance. Client lists also enable tax authorities to carry out early interventions such as contacting taxpayers who appear on the lists to advise them not to claim the effects of the avoidance scheme on their returns.[207]

OECD recommends that where a country places the primary reporting obligation on the promoter, they should introduce scheme reference numbers and require the preparation of client lists in order to fully identify all users of a scheme and to enable risk assessment of individual taxpayers.[208] Where however, a country has a dual-reporting obligations where both the promoter and the taxpayer reports, then scheme reference numbers and clients lists may not be as essential but they are likely to aid cross-checking and allow a tax administration to quantify the risk and tax loss from specific schemes.[209] South Africa has a dual reporting system, in term of section 38 of the TAA, the "promoter" has the primary obligation to report. If there is no promoter in relation to the "arrangement" or if the promoter is not a resident, all other "participants' must disclose the information.

- ➢ In light of the dual reporting mechanism in South Africa and in the interest of not placing administrative burdens on taxpayers to submit clients lists it is recommended that clients lists should not be introduced in South Africa. Such information could be easily accessed from the disclosures submitted by the participants in terms of section 38 of the TAA. It should also be noted that SARS Form RA 01 for Reporting Reportable Arrangements contains detailed aspects of what must be disclosed by a participate or a promoter – the information that would be provided on completion of these From is broad enough to capture what could be required from client lists. Nevertheless the Form is outdated as it is based the repealed reportable arrangements provisions under the Income Tax Act. It is important that the form is updated urgently.

204 OECD/G20 2015 Final Report on Action 12 in para 164.
205 OECD/G20 2015 Final Report on Action 12 in para 168.
206 OECD/G20 2015 Final Report on Action 12 in para 169.
207 OECD/G20 2015 Final Report on Action 12 in para 171.
208 OECD/G20 2015 Final Report on Action 12 in para 172.
209 OECD/G20 2015 Final Report on Action 12 in para 173.

9.5 RECOMMENDATION TO ENSURE THE RULES ARE EFFECTIVE TO DETERRING BEPS IN A CROSS BORDER CONTEXT

Government Gazette No. 39650 issued on 3 February 2016 which has extended the scope of reportable arrangements has the potential of making the rules more appropriate from a BEPS angle, as much of what BEPS is concerned with relates to commercial arrangements. For example, paragraph 2.3 of the Gazetted list covers any arrangement in terms of which a person that is a resident makes any contribution or payment on or after the date of publication of this notice to a trust that is not a resident and has or acquires a beneficial interest in that trust.

The reportable arrangements provisions clearly apply in a cross border context as section 37 clearly provides that if the promoter of a scheme is not a resident, all other "participants" (whether resident or non-resident) must disclose the information regarding to the arrangement to SARS. Nevertheless more needs to be done to ensure the provisions are more effective in preventing BEPS.

The OECD notes that many countries have lower numbers of disclosures of international schemes because the way international schemes are structured and the formulation of some countries' disclosure regimes may not be effective in curtailing BEPS in a cross-border context, since such structures typically generate multiple tax benefits for different parties in different jurisdictions.[210] There is therefore need to ensure that the generic hallmarks for disclosure discriminate between schemes that are wholly-domestic and those that have a cross-border component.[211] The OECD specifically points out the ineffectiveness (in a cross-border context) of disclosure regimes that require reportable schemes to meet a formal threshold condition for disclosure (such as the *main benefit* or *tax avoidance* test) since some cross-border schemes may not meet this threshold if the taxpayer can demonstrate that the value of any domestic tax benefits was incidental when viewed in light of the commercial and foreign tax benefits of the transaction as a whole.[212]

In South Africa section 35(1) of the TAA set out a list of five specific reportable arrangements and section 35(2) sets out arrangements that are reportable if the Commissioner lists the same in a public notice. Section 36(3)(a) and (b) makes it clear that an arrangement is reportable if the main purpose or one of the main purposes of entering into the same is to obtain a tax benefit (i.e. the intention of the taxpayer); or if the arrangement is entered into in a specific manner or form that enhances or will enhance a tax benefit (i.e. even if there is no intention but the result is a tax benefit).

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210 OECD/G20 2015 Final Report on Action 12 in para 227.
211 OECD/G20 2015 Final Report on Action 12 in para 227.
212 OECD/G20 2015 Final Report on Action 12 in para 229.

- Thus both the intention to gain a tax benefit and the result of a tax benefit without intention are taken into consideration; the South African rules are not dependent on the “main purpose to obtain a tax benefit” as the l threshold condition for disclosure. Thus even though a taxpayer can reason that the value of any domestic tax benefits was incidental (not main purpose) when viewed in light of the commercial and foreign tax benefits of the transaction as a whole, the arrangement is still reportable, in light of section 36(b) if it is entered into in a specific manner or form that enhances or will enhance a tax benefit.

The OECD notes that cross-border tax planning schemes are often incorporated into broader commercial transactions such as acquisitions, refinancing or restructuring and they tend to be customised so that they are taxpayer and transaction specific and may not be widely-promoted in the same way as a domestically marketed scheme. Thus generic hallmarks that are primarily focussed at promoted schemes that can be easily replicated and sold to a number of different taxpayers may not be effective in curtailing BEPS.[213] In this regard, the OECD recommends the use of specific hallmarks to target cross-border tax schemes to address particular tax policy or revenue risks in the country. Examples include leasing and income conversion schemes which can apply equally in the domestic and cross-border context.

- Although South Africa has specific hallmarks in section 35(1) of the TAA as well as arrangements listed by the Commissioner by public notice in section 35(2) of the TAA, more international schemes need to be targeted that could cause potential loss of revenue – for example conversion, restructuring, acquisition schemes and other innovative tax planning techniques.
- In targeting more international schemes, cognisance could be taken of the challenge the OECD points out of ensuring that in the design of specific hallmarks, the relevant definition is sufficiently broad to pick up a range of tax planning techniques and narrow enough to avoid over-disclosure. To effectively deal with this challenge the OECD suggests that focus should be placed on *outcomes* that raise concerns from a tax policy perspective rather than the techniques that are used to achieve them (e.g. using the effects-based, approach of the USA that extends the disclosure obligations to “substantially similar” transactions).[214]

The OECD recommends that countries should have a broad definition of “arrangement” that includes offshore tax outcomes. The definition of “arrangement” in section 34 of the TAA states that it “means any transaction, operation, schemes, agreement or understanding (whether enforceable or not”. Although this definition does not specifically refer to offshore arrangements, the use of the word “any”

[213] OECD/G20 2015 Final Report on Action 12 in para 230.
[214] OECD/G20 2015 Final Report on Action 12 in para 232.

implies that both domestic and offshore arrangements. Reference to offshore outcomes is also indicated in section 37, which provide that if there is no promoter in relation to the “arrangement” or if the promoter is not a resident, all other “participants’ must disclose the information.

- Perhaps to make this offshore implication much more clearly, the legislations should consider re-drafting the definition of an arrangement to specifically state that the word “any” covers both domestic and offshore outcomes.
- The rules that apply to domestic schemes for identifying the promoter and for determining who has the primary disclosure obligation should also apply in the international context.

To ensure there are no undue administrative burdens on domestic taxpayers, disclosure obligations should not be placed on persons that are not subject to tax in the South Africa or on arrangements that have no connection with South Africa. At the same time, disclosure obligations should not be framed in such a way as to encourage a taxpayer to deliberately ignore the offshore aspects of a scheme simply to avoid disclosure. [215]

- Taxpayers should only be required to disclose information that is within their knowledge, possession or control. They can however be expected to obtain information on the operation and effect of an intra-group scheme from other group members. Outside of the group context, a reporting taxpayer should not be required to provide any more information than the taxpayer would be expected to have obtained in the course of ordinary commercial due diligence on a transaction of that nature. [216]

The OECD recommends that information that should be required to be disclosed in respect of domestic schemes should be the same as the information required for cross-border schemes. Such information should include information about the operation of the scheme including key provisions of foreign law relevant to the elements of the disclosed transaction. [217] Where information about the scheme is held offshore and may be subject to confidentiality or other restrictions that prevent it from being made available to the person required to make disclosure then:

- Domestic taxpayers, advisors and intermediaries should only be required to disclose the material information about the scheme that is within their knowledge, possession or control.
- In the case where the person holds only incomplete information about the scheme or is unable to disclose such information, that person should be required to the extent permitted by domestic law to:
    - identify the persons with possession or control of that information; and

215 OECD/G20 2015 Final Report on Action 12 in para 234.
216 OECD/G20 2015 Final Report on Action 12 in para 235.
217 OECD/G20 2015 Final Report on Action 12 in para 253.

- certify that a written request for that information has been sent to such persons. [218]
- SARS can then use this certificate as the basis of an exchange of information request under the relevant double tax treaty or under a Tax Information Exchange Agreement (TIEA) that may have been signed with a country.

The OECD does recommend the use of monetary thresholds set at levels that avoids over-disclosure to filter-out irrelevant or non-material disclosures. [219] In South Africa, Government Gazette No. 39650 issued on 3 February 2016, which lists reportable arrangements and excluded arrangements excludes from the rules any arrangement referred to in s 35(1) of the if the aggregate tax benefit which is or may be derived from that arrangement by all participants to that arrangement does not exceed R5 million.

- ➢ It is important that this limit is reviewed regularly taking into consideration cross-border perspectives.

9.6 UNCERTAINTY CONCERNS FOR TAXPAYERS

One of the concerns that taxpayers have had with regard to the reportable arrangements provisions is that one is not always clear when a transaction should be considered reportable.[220] However section 36(3)(a) and (b) makes it clear that an arrangement is reportable if the main purpose or one of the main purposes of entering into the same is to obtain a tax benefit (i.e. the intention of the taxpayer); or if the arrangement is entered into in a specific manner or form that enhances or will enhance a tax benefit (i.e.. even if there is no intention but the result is a tax benefit). Thus both the intention to gain a tax benefit and the result of a tax benefit without intention are taken into consideration.

9.7 CONCERNS ABOUT PROTECTION OF LEGAL PROFESSIONAL PRIVILEGE

In terms of reportable arrangements provisions, the duty to report the arrangement is on a "participant". As explained in above, a "participant" is defined in s 34 of the TAA to mean:

- a "promoter" (a person who is principally responsible for organising, designing, selling, financing or managing the reportable arrangement;
- or a company or a trust which directly or indirectly derives or assumes that a "tax benefit" or "financial benefit" by virtue of an arrangement.

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218 OECD/G20 2015 Final Report on Action 12 in para 236.

219 OECD/G20 2015 Final Report on Action 12 in para 244.

220 Louw & Simpson 'The Simple Life Before Reportable Arrangement' at 4.

It is common cause that many "arrangements" that could result in a "tax benefit" are designed by professionals in accounting firms and law firms who devote a lot of effort to generating complex tax shelter products.[221] However, not all tax practitioners are involved in engineering tax-avoidance schemes, many tax advisers participate in mainstream, high profile tax practice.[222] The disclosure provisions in s 37 of the reportable arrangements rules, may require a tax advisor of a taxpayer, who designs an "arrangement" to furnish information and documents in relation to the arrangement to the Commissioner, failure of which may result into penalties under s 212 of the TAA. The concern is that the reportable arrangements rules do not provide for the protection of "legal professional privilege" which is a fundamental common law principle of South Africa's judicial system.[223] In *S v Safatsa and others,*[224] Botha AJ approved the following views expressed in the Australian case of *Baker v Campbell:*[225]

> "The law came to recognise 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.... it is now established that its justification is to be found in the fact that the proper functioning of our legal system depends upon a freedom of communication between legal advisors and their clients which would not exist if either could be compelled to disclose what passed between them for the purpose of giving or receiving advice.... The restriction of the privilege to the legal profession serves to emphasise that the relationship between a client and his legal advisor has a special significance because it is part of the functioning of the law itself.... The privilege extends beyond communications made for the purpose of litigation to all communications made for the purpose of giving or receiving advice and this extension of the principle makes it inappropriate to regard the doctrine as a mere rule of evidence. It is a doctrine which is based upon the view that confidentiality is necessary for proper functioning of the legal system and not merely the proper conduct of particular litigation.... "

Zeffert [226] notes 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". Furthermore that: "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."[227] It is worth noting that that the Financial Intelligence Centre Act 38 of 2001 (FICA) also

221 PC Canellos 'A Tax Practitioner's Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters' (2001) 54 *SMU Law Review* at 48.

222 Canellos at 55.

223 Edward Nathan Sonnenbergs Inc 'Reportable arrangements and legal professional privilege' *Intergritax* Issue 102 (February 2008). Available at https://www.saica.co.za/Integritax/2008/1602_Reportable_arrangements_and_legal_professional_privilege.htm accessed 6 June 2014.

224 1988(1) SA 938 (A).

225 [1983] HCA 39; (1983) 153 CLR 52.

226 H Zeffert *The South African Law of Evidence* (1988) at 257.

227 Zeffert at 248.

places duties and obligations on accountable institutions (for example an attorney as defined in the Attorney's Act) to furnish certain information and documents to the Centre, however it protects attorney and client privilege. In terms of s 37(2) of the FICA, the restrictions on the duty of secrecy or confidentiality do not apply to the common law right to legal professional privilege between an attorney and the attorney's client in respect of communications made in confidence between:

(a) the attorney and the attorney's client for the purposes of legal advice or litigation which is pending or contemplated or which has commenced; or
(b) a third party and an attorney for the purposes of litigation which is pending or contemplated or has commenced.

In line with the FICA which protects legal professional privilege as between an attorney and the attorney's client,[228] it is recommended that a provision on protection of "legal professional privilege" between a legal advisor and his or her client, should be included in the reportable arrangement's rules. This provision should however not be limited to attorneys and their clients as is the case in the FICA but it should be extended to all legal professionals and their clients. In *Mohamed v President of the Republic of South Africa and others*[229], the court held that legal professional privilege should not be limited to legal practitioners in private practice and their clients but that it should also extend to communications by "in house legal advisors" in their capacities as such. And in *Kommissaris van Binnelandse Inkomste v Van der Heever*[230] the Supreme Court of Appeal confirmed that legal professional privilege also applies where an advocate in the employ of a firm of auditors, gave legal advice to a client.

10 CONCLUSION

Although South Africa appears to be ahead of many G20 countries on mandatory disclosure rules as discussed above, more needs to be done to make these provisions more effective especially in a cross border context.

228 Edward Nathan Sonnenbergs Inc 'Reportable arrangements and legal professional privilege' *Intergritax* Issue 102.
229 (2001) (2) SA 1145 (C).
230 1999) (3) SA 1051 (SCA)