Tax disclosure regime - unseen implications?

PATRICK MCCLAFFERTY & PJ HENEHAN, partners at FS taxation, contemplate some hidden issues behind the introduction of the Mandatory Tax Disclosure Rules and comment on a number of general risk management considerations for both taxpayers and advisors.

The obligation, risk and costs of ensuring compliance with tax rules now largely fall upon the taxpayer – similar to any efficient system. The new mandatory disclosure regime, which came into effect on 17 January 2011, represents a major and potentially onerous and unchartered leap forward from this position. Over recent months there have been a number of articles and publications addressing the technical rules and finer details of the disclosure regime, so there is no need to focus on this here. In this article we aim to examine some of the non-technical issues which the new rules throw up for taxpayers and their advisors alike.

(L-R) Launching the new financial services consultancy firm, FS taxation, are its founding partners P.J. Henehan and Patrick McClafferty; with Minister for Jobs, Enterprise and Innovation, Richard Bruton TD who said 'The specialist financial services sector has long been a source of strength in Ireland, and if we are to see the recovery we need, we must build on that and support the growth of indigenous businesses in the area."

Brief recap of the rules

The disclosure regime obliges advisors to provide details of certain tax planning 'transactions' to Revenue, whether implemented or not. Essentially, they must also explain to Revenue how the transaction works and who has availed of it. The regime applies where one of the main benefits of the transaction is that it gives rise to a 'tax advantage', which is very broadly defined. The rules can also apply to introducers/marketers of transactions and users of transactions i.e. the taxpayer where the transaction may be developed in-house or where a non-Irish adviser is used.

Why have these measures been introduced?

The purpose of the disclosure regime is clear – to gain real time information and close down, as soon as possible, transactions viewed by Revenue as 'aggressive'. This objective has been openly expressed by politicians and officials. In announcing the Regulations linked to the mandatory disclosure legislation in January 2011, the then Minister for Finance, the late Brian Lenihan, TD, said, "This new regime complements the existing range of anti-avoidance measures….it is not the intention of the disclosure rules to stop tax advisors advising clients in the normal way… ". Very reassuring I hear you say. However, the Revenue Guidance Notes, also issued in January 2011, note that the "regime is such that the "net it casts" is much wider, and it may, therefore, result in the disclosure of some schemes that would not be considered as avoidance".

This is both contradictory and confusing. The above is just one phrase from the 50 odd pages of the Revenue Guidance Notes. However, it gives us a sense of another possible use for these new rules. Not only will they be used to discourage and attack aggressive tax planning (arguably a legitimate practice for a tax authority!) but they may also be used to keep Revenue up to date with general tax developments in the market with minimal use of their own internal resources.

Could the Disclosure Rules bring benefits?

If the new rules work as Finance and Revenue intend and they do provide an "early warning" system on tax planning schemes, surely this can only be of benefit to taxpayers as a whole. The logical outcome, if Revenue has better knowledge of the goings on in tax market, should be a reduction in the level of Revenue Audits and queries raised on tax returns. Equally, it should follow that the ever growing administrative burden being placed upon businesses by Revenue should also be reduced. This would then leave the vast majority of fully compliant taxpayers to get on with more important things, such as running their businesses and, in this climate, trying to survive.

But logic very seldom enters the equation and this may be just wishful thinking. It is also worth noting that some may view a 'disclosed' transaction as providing greater comfort to the taxpayer, notwithstanding the inevitable attention it would draw. Further, given that Ireland does not have an official tax ruling regime this may be an attractive option for some taxpayers. Also there is a sense that ruling systems (which exist in some of Ireland's competitor jurisdictions such as Luxembourg) may have a finite life as they could be viewed as unacceptable State Aid under EU law, while our disclosure regime should not. Thus if used correctly the disclosure regime may give us competitive advantage in the medium term.

What are the issues for promoters?

The new regime raises a number of interesting questions in terms of the independence of advisors. In many cases businesses like to keep their various advisors (audit, tax, corporate finance etc) separate from one another. This may be due to internal policy, as a result of regulatory restrictions (e.g. those part of an SEC registrant group) or simply for perceived best practice. Independence is also prerequisite for professionals who are required under professional standards to avoid conflicts of interest.

The new disclosure rules may create a strange new dynamic in this area. For example, an advisor who promotes a tax structure to a client may be inherently conflicted from the very outset. The advisor, at their sole discretion, determines whether or not a transaction which they are promoting is disclosable to Revenue or not. This in turn may give rise to potential disagreement for example between an in-house tax person and the external advisor.

Because of this, taxpayers may be forced to consider seeking a second opinion from another advisor. This would apply equally to the transaction itself and whether or not it should be a discloseable transaction under the mandatory disclosure rules.

From a risk management perspective, advisors may well ask themselves whether they want to pitch or advise upon a discloseable transaction in the first place. Since, if they are involved in such a case, they must be prepared for the inevitable second opinion or peer review.

When could the taxpayer be obliged to disclose?

Something all businesses, particularly those who develop in-house tax planning structures or have a tax function, should be aware of is that in certain circumstances the rules may also apply directly to taxpayers. This may be relevant also where the promoter of the transaction is offshore or where the promoter claims legal privilege. Given the tight timeframe in which disclosures are required to be made (as low as 5 working days) and the potentially significant penalties, taxpayers may be well advised to seek guidance from an independent advisor where they have any uncertainty over whether or not a transaction may be discloseable.

Speaking of uncertainty, Irish subsidiaries of groups reporting under US GAAP should bear in mind potential implications of the disclosure regime on accounting recognition. The FASB interpretation number 48 (an interpretation of FASB statement number 109, commonly referred to as “FIN 48”) deals with accounting for uncertain tax positions, including recognition and measurement.

It is not beyond possibility that transactions disclosed under the Irish Mandatory Disclosure Regime could fall foul of the recognition threshold. The tax provisions under local GAAP/IFRS are not as onerous in terms of recognition as US GAAP, however, a discloseable transaction may at the very least warrant a discussion with the auditors.

It is hoped that the rules will be used in a sensible manner and not impact upon most taxpayers in any way. Indeed, they may have some unintended benefits if used correctly. However, it would be prudent to bear in mind the possibility of scope creep by Revenue in the future. These new rules should also be reflected in internal tax risk management policies and procedures.

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