Chapter 3. Organisational responses to dealing with tax risk posed by high net worth individuals

Introduction

As discussed in Chapter 2, tax administrations need good information about the high net worth individuals (HNWI) segment and must have processes in place to use this information effectively. This goes beyond understanding the market for aggressive tax planning (ATP) as it must also include an understanding of the particular needs of this segment and the responses that tax administrations can provide to service those needs.

This chapter of the report focuses on the organisational responses available to tax administrations when seeking to meet these objectives with reference to both processes already put in place by focus group countries and comments received as part of the consultation process.

Focusing resources

It is important that tax administrations have regular and continued interaction with the HNWI segment and their advisers on issues such as planning, compliance and service. This can increase the tax administration's understanding[1] of not only specific taxpayers but also its broader understanding of the HNWI population. It will also help the HNWI segment and their advisers gain an understanding of the tax administration.[2] A tax administration will most effectively gather information on the HNWI segment where it tasks certain parts of its organisation with doing so.

The way in which resources are focussed on the HNWI segment can take a number of forms. The most prevalent is that of a dedicated unit. Advisers clearly stated in the consultation process that this was also their preferred method of dealing with the tax administration in relation to their HNWI clients. Such a unit will typically take responsibility for those taxes that have a direct impact on the HNWI's personal tax liabilities. In some countries the coverage extends further to dealing with associated investment and business entities such as trusts, controlled investment companies and other operating entities, and the unit may also take responsibility for family members to enable the administration to take a wider view of the HNWI.

A dedicated unit is not a goal in itself but is a delivery vehicle that serves several functions: it sends a clear message to the non-compliant HNWI that he or she faces a real risk of being pursued by the tax administration, which may in turn reduce aggressive behaviour and improve voluntary compliance; it enables a tax administration to match the level of expertise and knowledge of the HNWI's advisers in addition to developing the commercial awareness of tax administration staff, and it also allows for the concentration of skills, targeted training, the retention of knowledge and thus an improvement over time of the understanding of the HNWI population. A dedicated unit can be monitored, and further improved, more easily than when resources are spread.

Identifying the HNWI segment

Tax administrations have limited resources to dedicate to this taxpayer segment. Managing resources requires an understanding of the segment to establish the thresholds and other limits that are used for identifying those individuals to be included in any focus on the HNWI population.

The countries of the focus group use a range of criteria to define the HNWI population for administrative purposes. These include income and/or wealth thresholds,[3] and criteria indicating complex tax affairs, such as a variety of income sources and international tax issues.[4] Some countries pay particular attention to public company executives and directors or to wealthy individuals with high public profiles. Others are particularly concerned about emerging wealthy taxpayers. Generally there will be a combination of these factors together with others that a particular administration feels are relevant to its own situation.[5]

Wealth may be used as a criterion even by countries that do not have a wealth tax. To acquire wealth an individual generally requires substantial income, whether taxed or not. In addition, wealth as an indicator tends to be relatively stable whereas income can vary substantially from year to year and, as a measure, can also be affected by tax planning. Consequently, a definition of the HNWI population based on income alone may be problematic. Relevant data can be derived from sources such as the tax return (which in some countries includes a statement of assets and liabilities), data held by other government departments, information returns made by financial institutions, media reports, etc.

Particular issues arise on the cut-off point, which needs to be appropriately targeted to ensure the unit includes only those that the tax administration wishes to focus on. There will be issues around those individuals at the margins so there must be sufficient flexibility to ensure that the movement of HNWIs in and out of the unit is managed effectively. For example, one solution may be to consider movement into or out of the unit only if the conditions for inclusion are met or failed for two consecutive years. This may prevent problems with consistency of treatment that might arise if an individual is moved into and out of the unit too frequently. Monetary criteria may need to be revisited at least annually to take into account inflation and the general growth of the HNWI sector to ensure that the available resources are adequately matched to its allocation of taxpayers.

Resource organisation

There are a number of factors that may have an impact on an administration's ability or willingness to organise specialised teams to deal with HNWIs. Specialised teams can take the form of a single centralised unit or a number of regional units. In some countries a specialised HNWI unit may not align with a tax administration's existing organisational structure, for example, where a HNWI's tax affairs are already dealt with by a number of specialised units. In such circumstances, it may be more appropriate to establish support units (for example special competence centres) to provide expert advice on issues particular to HNWIs,[6] without taking responsibility for the taxpayer's affairs themselves. Constitutional restrictions may also prevent a 'national' unit and thus regional units may be more appropriate. In addition, regional units may be more suitable where tax administrations perceive regional diversity within their HNWI population.

The perception of the wider public is an important consideration in dedicating resources to this taxpayer segment. Tax administrations will need to be seen to be acting impartially, applying a consistent treatment to all taxpayers. Australia has published a guide, *Wealthy and Wise: a tax guide for Australia's wealthiest people*, which contains information on what a taxpayer can expect when dealt with by the unit, suggestions to help taxpayers manage their tax obligations, and details of information and support services to help with compliance with tax obligations. Additionally the ATO maintains on-line guidance that features a range of up-to-date information tailored for wealthy individuals.[7]

Of the fourteen counties in the study group, eight have established formal programmes with a direct focus on individuals with high wealth.[8] Each of these tax administrations has gone through a strategic risk assessment and made a decision to focus some of its resources on HNWIs. The various country units have been in existence for differing periods, with France having commenced operation in 1983, followed by Australia in 1996 and most of the other countries between 2002 and 2008. Table 2.1 sets out details of the units, including the number of HNWIs dealt with by the units, the functions carried out in the units and the applicable taxes covered.

Two countries within the focus group (Australia and Canada) have, in addition and subsequent to programmes concentrating on high wealth, established programmes for high income individuals that aim to enhance the tax administration's risk assessing capability for this segment. France and South Africa also use criteria that ensure that high income individuals are included in their specialist programmes.

Table 2.1 Approaches for country HNWI units, their responsibilities and taxes covered by the HNWI units

Country	Estimated. HNWI/HII Population[0]	Year Established	Unit dealing with			Roles and Responsibilities			Taxes Covered	
			HNWI	HII	Controlled entities	Taxpayer Contact Point	Risk Assessment	Audit	Income Tax Only	All Taxes
Australia	1 300 (HNWI)	1996	X		X	X[2]	X	X	X[3]	
	1 700 (HII)	2007		X			X	X	X[3]	
Canada	550 (HNWI)[4]	2006	X		X		X	X		X[5]
	Unknown (HII)	2007		X			X	X	X	
France	10 000[6]	1983	X	X	X			X		X
Ireland	430	2003	X		X[7]	X	X	X		X
Japan[8]	Unknown	2001	X	X	X		X	X		X
Mexico[9]	Unknown							X		X
Netherlands[10]	Unknown	2008	X			X			X	
New Zealand	100	2002 -2006[11]	X		X	X	X	X		X[12]
South Africa	1 000	2006	X	X	X	X	X	X		X
United Kingdom[13]	5 000[14]	2009	X			X	X	X		X[15]
	60 000[16]	2002		X		X	X	X		X

Notes:

1. The criteria used to define the HNWI and HII population may vary between each tax administration and are not necessarily the same as criteria used in wealth reports (see Chapter I Section 1).
2. Contact point for risk assessment, audit and disputes.
3. Unit works with other areas of the office regarding other taxes administered by the ATO.
4. Those with net asset holdings greater than CAD 50 million.
5. At least income tax and GST.
6. This includes entities controlled by the HNWI.
7. Includes all investment related entities but excludes trading entities.

8. Specialist units are located at regional level to examine international taxation issues of HNWIs and small to medium size enterprises (SMEs).

9. Mexico's unit examines the tax affairs of certain public figures (politicians, artists and sportspeople) that may have significant assets. There are no criteria however for determining whether an individual has high wealth.

10. This is currently a pilot initiative.

11. Additional Assistance Team established in 2006 to assist with lower risk individuals / operational matters.

12. At least income tax and GST.

13. Does not include the Professional Partnership Team which predominantly includes non-HNWIs

14. Individuals dealt with by the HNWI unit.

15. Excludes VAT and inheritance tax.

16. Individuals dealt with by the Expatriate Team.

Skills of staff

The overarching principles for the interaction between tax administrations and the HNWI segment are the five revenue body attributes set out in the Intermediaries study: understanding based on commercial awareness; impartiality; proportionality; openness through disclosure and transparency; and responsiveness. To fully understand the supply and demand of ATP by HNWIs together with the complex products used, the staff dedicated to this taxpayer segment should be highly capable and able to display these five attributes.

These staff need to be able to identify the tax risks in complex structures and arrangements, build professional relationships with HNWIs and their advisers to encourage disclosure and transparency and work efficiently to respond to the HNWI risk in a timely, consistent and clear manner.

The consultation process on the HNWI project indicated that the first of the five attributes – commercial awareness – was a strong requirement for HNWI taxpayers and those advising them. Taxpayers are unlikely to display the behaviours of disclosure and openness if they believe that the subsequent dialogue with the tax administration will be unnecessarily detailed and prolonged as a result of the administration's poor understanding of the commercial background.

The Intermediaries study further described commercial awareness of large corporate taxpayers as including an understanding of the 'business of how to do business', the characteristics of the industry sector and the unique characteristics of the particular taxpayer's business. Whilst an awareness of these business factors will be relevant for those HNWIs with such interests it is important to understand the, different motivations behind arrangements and structures, perhaps based on personal or family rather than business concerns. Commercial awareness is likely to take a broader meaning for HNWIs including those activities giving rise to personal, gift and inheritance taxes. The understanding required will therefore include, but is not restricted to:

- financial arrangements;
- structures used for investment and wealth planning (*e.g.* trusts, stichtung, stifelse, private foundations);
- international tax issues including: tax residence, double taxation agreements, controlled foreign companies, foreign trusts and foreign investment funds;
- succession issues;
- privacy concerns; and
- the HNWI's risk position.

An understanding of these issues should enable the tax administration to produce a more accurate tax profile of the taxpayer and target the risks efficiently with the appropriate resources. For the HNWI, compliance action will be more focused, reducing the cost and administrative burden of dealing with repetitive and unnecessary questions.

It is not surprising given their commercial backgrounds that most HNWIs are accustomed to doing deals and are likely to approach settlements with the tax administration accordingly. Tax administrations will need to appreciate the behavioural drivers to successfully interact with HNWIs and their advisers while ensuring full accountability and good governance.

Commercial awareness develops through regular and continued interaction and can be enhanced by a dedicated unit. This basic awareness can then be built on through training existing staff and by recruiting specialists from outside the tax administration.

The Intermediaries study lists a number of ways in which commercial awareness can be achieved through training. These included:

- development programmes such as mentoring and secondments;
- in-house training and induction;
- partnering with business and representative bodies to deliver specific training requirements; and
- informal networking events (OECD, 2008).

The consultation process indicated that the above examples would be equally appropriate to the HNWI segment. In addition, the consultation process indicated that tax advisers, bankers and even HNWIs may be willing to provide tax administrations with presentations on relevant issues. It is of course important that commercial awareness is kept up to date and therefore training and development must be ongoing.

Employing or seconding staff from private practice and banks offers opportunities to bring fresh commercial awareness into the organisation and a dedicated unit may be more attractive to private sector staff, providing an opportunity to use their current experience in a complementary environment. The ATO operates a panel of both internal and external experts to advise on the application of anti-avoidance provisions, ensuring that decisions reached are “objectively based and consistent” (ATO, 2005). A panel of experts could also enable tax administrations to obtain an insight into complex affairs and distinguish business drivers from ATP. Tax administrations should take appropriate measures to ensure conflicts of interest are managed, confidentiality is preserved and that such measures are fully transparent.[9]

Staff dealing with HNWIs need strong technical tax skills for those taxes dealt with by the unit and in particular knowledge of tax provisions most likely to affect HNWIs (such as residency rules, specified reliefs in Ireland and rules for non-domiciled individuals in the United Kingdom). There also must be a broad awareness of tax issues dealt with by other parts of the administration, and staff need to be able to call on their expertise and possess the coordination skills to draw these strands together to resolve complex issues.

For staff to maintain a higher level of knowledge tax administrations need to equip their staff with adequate initial and ongoing training to ensure that they can deal with the range of taxes and commercial issues they face. For example, the Irish Office of Revenue Commissioners has, in conjunction with a local University, established a diploma course to enable staff to increase their tax knowledge. Further initiatives such as mentoring programmes and secondments to the private sector may also prove useful.

Roles and responsibilities

While established HNWI units in focus group countries focus predominantly on personal taxes[10] few cover all of them.[11] There are, however, a number of benefits to be realised where the broader range of personal taxes, including gift and estate taxes, are dealt with by a specialist team, including:

- certain transactions have implications on more than one tax: where these taxes are dealt with by the same team, information requests can be minimised and intelligence gathered more efficiently; and
- a single point of contact for the taxpayer offers a more consistent and efficient response from the tax administration.

Where HNWIs operate businesses further taxes need to be considered, for example corporation taxes, payroll taxes and consumption taxes. Coverage of all these taxes would require very broad tax knowledge by those employed within the unit and may preclude a more in-depth knowledge of, and focus on, the more common and interlinked personal taxes.

In some countries there are limits to the range of taxes that can be dealt with by a dedicated unit. For example, it could not deal with both federal and regional taxes in countries where both of these exist. However, where the responsibility for dealing with taxes lies elsewhere in the tax administration, a coordinated response can ensure that the benefits described above can still be realised.

A separate but related issue arises where a HNWI operates through separate legal entities or other arrangements. One approach is that the unit deals with the HNWI together with all entities under his or her control. There are advantages to this approach, such as better security for the sensitive data held by the unit, a more considered risk assessment process and a co-ordinated approach to audits.[12] Australia, for instance, has reported that its success with HNWI audits is due to the fact that the whole of the effectively controlled group is considered irrespective of whether a particular entity in the group was traditionally managed by a different area of the ATO. The ATO takes a holistic approach to understanding the HNWIs' compliance behaviour, bringing all associated entities, both business and private (including the personal affairs of a highly wealthy individual's family), into the analysis.

Placing too much emphasis on the sector that a particular entity falls into may miss the important links with the HNWI who controls them. Canada advised that the Agency's approach of dividing its compliance programme into taxpayer categories (*e.g.* Small and Medium Business, Large Business and Specialty Audit) meant that it was easy to overlook high-risk transactions involving HNWIs that crossed over various business lines. This was due to the fact that the various audit programmes would select files for audit that met their programme-specific work plans without having a global view of the overall structure of large HNWI groups. The knowledge of other related transactions and economic entities gained by a HNWI focus enables auditors to ascertain whether a series of transactions may be potentially abusive.

The range of tax and commercial knowledge required may, however, prevent the unit from adequately and expertly addressing all tax issues raised. For example, some private companies are of such a size that a very high level of corporate tax specialisation is required. Such an approach may also cause problems of consistency where, for example, an administration organises its response to companies by grouping them in industrial or business sectors.

In some cases it may not be appropriate to include controlled entities within the HNWI unit. There may also be some debate as to whether in fact the HNWI actually controls the entity. Some entities may operate completely independently of the HNWI, with their own management and reporting and financial structures, and are separate taxpayers in their own right. Entities may also have minority equity holders whose affairs are not dealt with by the dedicated unit. Here again, good lines of communication within the tax administration and, a co-ordinated response can ensure that a unit can operate well by restricting its coverage to the HNWI's personal and non-trading activities.[13]

A HNWI unit that does not undertake compliance initiatives (including audits) is likely to miss a valuable opportunity to increase its understanding of the taxpayer segment. Furthermore, it is unlikely to be able to influence taxpayer behaviour. Units which combine audit activity with a single point of contact, research capability and risk assessment are likely to make a significant contribution to the gathering and sharing of intelligence resulting in audits that are better targeted and more efficiently carried out.

The consultation process indicated that there may be advantages in separating the service and compliance aspects of the HNWI relationship. Indeed, Ireland is currently considering such an approach. Such a demarcation of responsibilities would protect the integrity of the unit (and thus the wider tax system) and ensure that audit activity does not impinge on building a productive relationship with the HNWI.

In a number of focus group countries the dedicated unit currently provides a single point of contact in addition to undertaking compliance activities,[14] an approach which is largely supported by HNWIs and their advisers. The extent to which the relationship with the HNWI and his or her advisers is managed can vary, from simply a named contact at the dedicated unit to an individual who takes sole responsibility for the whole of the administration of the tax affairs of the HNWI. Feedback from those involved in initiatives whereby large corporate taxpayers are provided with a dedicated contact within the tax administration report that such a facility has worked well. The benefits include:

- accountability for a consistent and timely response from the tax administration;
- enhancing the relationship between advisers to HNWIs and the tax administration; and
- certainty and consistency for the HNWI.

As has been discussed effective relationship management requires a general knowledge of all relevant taxes to respond to queries in the first instance and to identify any further resources that may be required to address the issues presented. To get the full benefit of such an approach the relationship manager should assume responsibility for seeking necessary input from staff within the unit and from other specialists within the tax administration and have the authority and interpersonal skills to bring resolution to complex situations.

To retain knowledge and experience administrations should take measures to reduce staff turnover while at the same time preventing over-familiarity or a loss of impartiality.

Staff dealing with the affairs of HNWIs on a day-to-day basis are ideally placed to monitor the impact and success of new legislation and procedures and can act as a useful feedback tool for the legislator and policy colleagues. This is likely to be most successful where there is an effective interaction between unit staff and the HNWI's advisers. Those responding to the consultation paper suggested that staff specialising in HNWI issues should also be involved in the preparation and improvement of relevant tax legislation and associated guidance material. This would enable the unit to better respond to issues that arise subsequently as a result of the application of the legislation.

Interaction with the HNWI segment can also take a more formal approach. In the United Kingdom, senior members of the HNWI unit meet regularly with tax advisers from the larger accounting firms for the purpose of improving voluntary compliance. In addition, the unit operates two external forums: *The Wealthy Forum* which discusses risk, customer service issues and enables consultation on proposed policy changes (the notes of which are published on the HMRC internet site), and *The Expatriate Forum* which deals with issues in relation to foreign national employees. In Australia, the ATO has set up a consultative committee for HNWIs that comprises representatives of legal and accounting firms known to represent a significant number of HNWIs.

Formal dialogue may also take the form of consultation events where such interaction would not only facilitate better legislation and administration practices, but would also give the tax administration greater insight into the issues faced by the HNWI segment and those advising them.

Conclusions

Dedicating resources to the HNWI segment can greatly assist in understanding the products and supply and demand for ATP, which in turn can result in increased tax yield and assist in understanding the commercial and personal drivers that inform the HNWI's appetite for tax planning. These benefits can be optimised by taking into consideration the HNWI's broader tax profile, encompassing the range of taxes as well as entities under the HNWI's control.

A number of countries have reported increased taxpayer satisfaction as a result of establishing HNWI units (whether centralised or regional), largely because of dedicated contact points. In addition these units generally attract higher calibre staff. In France, for example, the good dialogue between the dedicated unit (DNVSF), the headquarters of the Ministry of Finance and HNWIs has resulted in a greater willingness to exchange information. This has encouraged a better understanding of each party's environment and led to a reduction in the amount of litigation.

Focusing on the HNWI segment can produce an increase in tax revenue. Whilst countries were not specifically surveyed about the return on their investment in a dedicated HNWI unit (and for countries whose units have only been in operation for a short period it is too early for any revenue results), there is some publicly available information to suggest that the focus on this group of taxpayers has produced positive results, both in terms of additional revenue and disallowed losses. In Ireland, there is some evidence that the activities of the unit have had an impact on the approach of HNWI advisers to tax related items such as asset valuations where greater care is now being taken with the valuations presented to the Irish tax administration.

Australia reported in March 2008 that in the period 1997-2008 an additional AUD 2 115 million in revenue had been collected and AUD 1 752 million in losses had been disallowed as a result of active compliance activities (such as audits) of HNWIs and their associated entities. The following table sets out the adjustments made by the unit (ATO, 2008a).

Table 3.2 Australia HNWI unit performance data 1996-2007

Year of collection /adjustment	Direct Revenue (AUD M)	Reduction in Revenue Losses (AUD M)	Reduction in Capital Losses (AUD M)
1996-97	37.8		
1997-98	23.0	196.1	56.9
1998-99	63.9	243.8	382.5
1999-00	73.5	24.5	24.1
2000-01	185.5	91.6	155.2
2001-02	128.4	146.5	12.8
2002-03	325.9	17.6	16.2
2003-04	400.6	195.3	55.8
2004-05	116.8	0.0	19.2
2005-06	186.8	12.5	47.8
2006-07	224.0	6.8	8.1
2007-08	348.5	3.6	36.0
Total	**2 114.7**	**938.3**	**813.6**

Source: ATO (2008a).

As is evidenced by the Australian figures above, whilst identifying potential cases for review and resolving the issues presented is time consuming, the potential results are substantial.

The Australian experience provides further evidence that focussing on the HNWI segment can improve compliance. Initial research carried out by the ATO into growth of tax paid by HNWIs as compared to growth of household income of a comparable demographic segment shows a marked acceleration of tax paid compared to income in the 1990s, corresponding with the creation of the taskforce and the initial injection of resources into the ATO's activities. This clear improvement in voluntary compliance appears to have been maintained in all subsequent years. Regular and continued interaction with HNWIs and their advisers can encourage a flow of information and mutual awareness of current issues.

Notes

1 . Such as a familiarity with long-held structures and the tax risks these can present, together with a better understanding of the HNWI's overall tax strategy.

2 . For example, structures frequently used for investment, business and succession planning and the non-tax drivers that contribute to their proliferation.

3 . In Australia and Canada, high wealth and high income individuals are separately defined with the two groups being managed by separate units and processes. In Australia the focus of the High Income Individuals team in its first year of operation (2007-08) was on public company executives and directors with total remuneration of more than AUD 1 million who appeared to have underreported their income. This is being expanded in 2008-09 to include senior executives of private companies and foreign-owned companies. See ATO (2008b).

4 . Japan's unit focuses on the international tax avoidance schemes used by small to medium enterprises (SMEs) and HNWIs. The reason for this focus is the recognition that the issue of international tax avoidance has been spreading amongst these segments of taxpayers.

5 . The United Kingdom, for example, separately defines two other categories of wealthy individuals - expatriate employees and professional partnerships - and looks at particular issues relevant to those sub-populations.

6 . For example, the treatment of foreign asset holding vehicles and trusts for domestic tax purposes.

7 . See *www.ato.gov.au/individuals*.

8 . Australia, Canada, France, Ireland, Japan, New Zealand, South Africa and the United Kingdom.

9. For the wider benefits of hiring from the private sector to understand supply, demand and the schemes, see Chapter 2: Hiring staff from the private sector.

10. In this context, personal taxes is taken to include income, capital gains, inheritance / estate and gift taxes.

11. See Table 2.1 above.

12. In France, for example the DNVSF carries out audits covering both the individual's personal tax affairs and those of their controlled entities (unless that entity is to be audited by a specialist unit in the French tax administration, for example, units dealing with companies in a particular industry). The review is also extended to include the remuneration arrangements for the senior managers of the HNWI-controlled entities. Audits into controlled entities amount to around 40% of those carried out by the HNWI unit. Audit teams specialise in certain areas such as international operations (international fraud, globalisation of economic activities and tax havens), financial operations (focussing on leveraged buy-outs and the valuation

of assets), and stocks and shares. In addition, back up teams provide specialist technical advice and support whilst a further team plans the largest cases and offers advice on tactical issues to the audit teams.

13. This may include trusts.

14. See Table 2.1 above. Australia's unit does not provide this single point of contact. However, in the initial contact letter taxpayers are provided with a contact officer who will most likely be involved in any risk assessment, audit or dispute work.

References

ATO (Australian Taxation Office) (2005), "Guide: Part IVA: the general anti-avoidance rule for income tax: Basic principles about how and when it applies", ATO, Canberra, p. 8.

ATO (2008a) *Wealthy and Wise: a tax guide for Australia's wealthiest people*, ATO, Canberra, pp. 7, 12. The booklet was officially released on 31 March 2008.

ATO (2008b), *Compliance Program 2008-09*, ATO, Canberra, p. 17.

OECD (2008), *Study into the Role of Tax Intermediaries*, OECD Publishing, Paris, pp. 11, 13, 33 ff, 39 ff, 41-42, 69, Annex 8.1.