

Dealing with foreign revenue authorities

GUIDE

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Those administering offshore structures are increasingly exposed to the consequences of moves to increase the level of cross-border tax assistance. Those moves have seen a marked expansion in the network of Tax Information Exchange Agreements (TIEAs) and the usage of them, pressure on offshore jurisdictions to enter into various multilateral initiatives, and increasing attempts by foreign revenue authorities to flex their muscles in a more direct fashion. Frustrated by perceived delays and the inconvenience of utilising TIEAs, authorities are increasingly bypassing recognised means of assistance and seeking to engage directly with offshore structures. Such approaches can create considerable difficulties for those at the receiving end of them. They inevitably seek information which is confidential, without the protections of a properly formulated TIEA request that would usually relieve the party disclosing it from the consequences of breaching confidentiality. What guidance might be offered to those facing such a conundrum?

An important first consideration is what is sought and for what purpose. This usually goes to the heart of the matter. Is the foreign revenue authority seeking information about the structure itself, or just the interest which a third party may have in it? A related but similarly important question is whether the information is sought because of an intention to take action against the structure itself (such as assess its foreign operations to tax) or against a third party (such as an underlying client). Answering those questions will help to assess whether you are likely to be a sideshow or the main attraction.

It is likely you will want to be able to consult with your underlying client. They are often better placed than you to provide what can be much needed background to the enquiry. Their views will often also be highly relevant as you consider how to respond. Before doing so, you should consider whether there is any prohibition or anything else which should deter you from doing so. Domestic tipping off concerns will rarely be an issue in this context at least, but it is usually prudent to enquire of the foreign revenue authority if there is any prohibition which they are seeking to impose upon you. Having said that, it is important to recognise that it may not be in their interests for you to consult. Relying upon what you are told by a foreign authority is unlikely to be a good defence in the absence of having taken foreign advice.

It is often prudent to seek to engage foreign lawyers at an early stage. How early that stage is, will depend on a number of factors, one of which is often how familiar the foreign jurisdiction is. A Guernsey fiduciary is likely to be more comfortable dealing with a tax investigation taking place in England, than India. In some cases your underlying client may have already engaged foreign lawyers, and they can be a convenient port of call for initial advice. Do not lose sight, though, of the fact that they do not act for you. Even if they are in fact retained by you, it is important to ensure that they are giving fully independent advice, and are not subject to inappropriate influence from your underlying client. A decision to terminate retainer of the lawyers chosen by your underlying client is one not to be taken lightly, but in some cases it is unavoidable.

You will also want to consider what entitlement the foreign authority has to demand what they seek, and what exposure there is if you don't comply.

The former question can often be easily answered, and a view taken that the request is put on no more than a speculative basis.

There are occasions though where the laws of a foreign country provide an expanded basis for that country to bring foreign persons within the tax net of that country. At the very least it is important to properly consider the issue, rather than just consigning the request to the waste paper basket solely on the basis that it emanates from a foreign authority.

Linked to that is what exposure might be faced if the request is not answered. Such exposure can take a number of forms.

First, and most obviously, is the question of what exposure there is for your structure if you do not comply with the request. One of the first things to consider is whether your structure has any assets in the foreign country. More subtle considerations arise where the structure is controlled in the foreign country, either because it is its place of incorporation, or one or more of its directors resides there. All of these represent potential points on which a foreign authority might exert pressure if you do not comply with its wishes. A practical consideration of possible outcomes is necessary.

Second, and related to that, is the question of what exposure there is for your underlying client. That is, what action can the foreign revenue authority take against them if you do not comply. It is not uncommon for a request to arise in conjunction with, or from, an enquiry into the underlying client's personal tax affairs. Whilst that exposure may not be always a direct consideration for you, it is, at the least, important for you to be mindful of it. If the manner in which you respond can have personal repercussions for your underlying client, then that may well influence how they interact with you. In more extreme cases it may well soon place you in a position where those interests positively conflict, which would hasten the need for you to take fully independent foreign advice.

Third, and increasingly, you need to consider what exposure is there for you personally. It is not unknown for foreign authorities to threaten personal consequences, even criminal consequences, if you do not comply with their request. The extent to which those consequences should influence your reaction is discussed below, but you should ensure you fully understand what they are, and how relevant they are to you, your operations (including any foreign operations) and staff (including foreign nationals).

Having turned your mind to the above matters, you might now return to the request itself.

Traditionally there would be no provision in the trust deed or similar corporate documents for a fiduciary or corporate representative to respond to requests for information from foreign revenue authorities if those requests were not directly enforceable. In more recent times there is a move away from such strict provisions to provide that representative with a degree of flexibility. Even if there is provision for you to provide that information, there is still a need to weigh-up the various factors outlined above and form a considered view on whether it can be said to be a proper course to take. Ideally your views and those of your underlying client will be aligned. If they are, and the view is that information should be provided, then you may also consider minimising your exposure by looking to receive indemnities for doing so or – depending upon the nature of the office you hold – bring an application to sanction what is proposed. The latter option is also useful if the views of yourself and your underlying client are at odds. Where analysis reveals that the personal consequences are such as to outweigh all others, then even more difficult considerations can arise. Recent authorities suggest that the Court will, in appropriate circumstances, permit a fiduciary to have regard to its personal interests and disclose confidential information to a foreign revenue authority prior to the wishes of its underlying client. Whether or not to take such a route will require careful consideration. In some circumstances a better view may simply be to provide information on the basis that it would be unreasonable for an office holder to be expected to expose him or herself to personal sanction (particularly criminal sanction) for the sake of their client.

Moreover, it is rarely the case that there is a simple binary decision to be made as to whether to comply or not. Inevitably there will be certain information which is less sensitive than others. You should always try and explore whether the request might be tailored or limited in scope in order to deal with such concerns as there are. Often this is the most productive form of engagement with any revenue authority.

There will also inevitably be other considerations which arise. The mere fact of a tax investigation does not of itself signal the proceeds of crime issue. Nonetheless it is a very clear red flag and you will want to investigate what the underlying circumstances are with a view to considering whether to make a disclosure or not. You should consider whether the fact of the enquiry gives rise to any regulatory obligations. Most jurisdictions have self-reporting requirements where there are suspected breaches of procedures.

There are often also requirements to inform your regulator of matters which may be thought to be a reputational concern for your jurisdiction. Whether or not that is the case will of course depend upon the nature of the enquiry. Increasingly, you should also consider whether there are any public relations aspects with negative exposure which being involved in such enquiries can generate is a tool which foreign authorities are slowly but increasingly willing to deploy; the effectiveness of it is ignored at your peril.

Negotiating such requests does involve a tricky path indeed. Wherever possible, foreign revenue authorities should be encouraged to use more traditional cross border assistance channels. If they cannot be so persuaded it is still nonetheless possible, with a calm approach and considered fashion, to avoid tripping yourself up.

Contacts

Christopher Edwards
Partner, Guernsey
+44 1481 739 320
christopher.edwards@mourant.com

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