Coming to the boil

William Ahern urges practitioners to oppose the CRS Mandatory Disclosure Rules while there is still time

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'The Mandatory Disclosure Rules (MDRs) potentially require those of us who advise clients on CRS issues to report our clients and everyone in the relevant structure chain to their local tax departments.'

Many of you (of a certain age) will remember the terrifying 1975 shark attack films by Steven Spielberg and the byline for the Jaws sequel, *Jaws 2*: 'Just when you thought it was safe to go back in the water…'.

Well… just when you thought it was safe to go back into the post-CRS waters, there lurks a new and far more egregious proposal in the form of the Organisation for Economic Co-operation and Development (OECD)'s proposed Mandatory Disclosure Rules (MDRs). The final model rules were published by the OECD on 9 March 2018 and vary little from the original rules released for a one-month 'consultation' on 11 December 2017. These MDRs will, following their almost certain approval by the G7 in June, be distributed by the OECD to governments around the world who will be encouraged to adopt them in their domestic law.

This article examines their nature and import, why private client professionals must oppose them, and how we might do this.

The MDRs potentially require those of us who advise clients on CRS issues to report our clients and everyone in the relevant structure chain (and the advice given) to their local tax departments. This reporting duty has nothing to do with normal tax reporting obligations under local revenue law. Those tax departments will then exchange that information spontaneously with other relevant participating jurisdictions, ie where the subjects of the report are resident for CRS purposes (see further below).

There is a carveout for lawyers who assert that legal professional privilege (LPP) attaches to the advice they gave to their clients but perversely, in this event, the lawyer must inform the client of that claim. The client is then required to report the lawyer to their (the client's) tax authority. The client's tax authority will then spontaneously report that to the lawyer's home tax authority. So, whatever happens, the confidentiality or privilege or 'professional secrecy' (as the OECD calls it) is destroyed.

These MDRs are based on (via BEPS Action 12 Report) the UK's long-established rules called DOTAS (disclosure of tax avoidance schemes) which require similar, but more confined, reporting of widely marketed tax avoidance schemes in the UK. When they were introduced a decade ago and upgraded in the last few years there was hardly a peep from the professional bodies despite their attack on LPP, and client confidentiality more generally, and their introduction of an obligation on advisers and their clients to inform on each other.

The MDRs take this concept further by making the obligations operate cross-border, applying them to any scheme or advice that 'has the effect of circumventing the CRS', making them, in part, operate retrospectively (October 2014) and criminalising non-compliance.

The adage 'the best way to cook a frog is to put it in cold water and boil it slowly' is apposite here.

So, in addition to the CRS itself and its own 'forcefield' in the form of its anti-avoidance rules, we have yet another set of incredibly broad and deeply confusing obligations, this time to report people for doing things which themselves are perfectly legal; see para 4 of the introduction to MDRs on the OECD website. What's next – CRS MDR anti-avoidance rules,

ie anti-avoidance-avoidance rules? Where will this end?

If I, as a Hong Kong-resident trustee, advise my Australia-resident settlor to remove a UK-resident trust protector (to avoid him being reported) of a Canada-resident beneficiary's trust then I must report all of that detail to the Hong Kong Inland Revenue Department. It will then spontaneously (ie if it wants to) share the report it received from the trustee with the Australian, UK and Canadian tax authorities.

On the same facts if I instead advise my settlor (to avoid reporting) to swap reportable financial assets for non-financial ones (like real estate, gold or art), I must report that including full details of what were, under the CRS, non-reportable assets, thus significantly, and craftily, extending the CRS's reporting reach.

However if the trustee, its asset manager, protector, settlor and beneficiaries are all UK residents then no question of reporting should arise because the CRS itself does not operate on such an intra-jurisdictional situation so could hardly be sought to be 'circumvented'. However if I advise someone in my own jurisdiction on how CRS could be circumvented for the benefit of someone resident in another CRS jurisdiction, I am *prima facie* legally required to report that to my home jurisdiction.

There are countless examples of how the most innocent and benign CRS planning, which often will represent no more than exercising choices offered by the CRS, would potentially be reported. Virtually any behaviour other than that motivated to increase a structure's CRS reporting profile is potentially subject to the rules. Paragraphs 4 to 8 of the OECD commentary seek to address this point. I find it largely incomprehensible, but the flavour of it is to target 'bad motive' planning with the motive divined by a purely objective test. In the above example, there is a 'bad motive' ie wanting to avoid reporting.

These rules are, after all, an intelligence-gathering measure based on surveillance of professionals and their clients.

As was forcefully pointed out in STEP's submissions to the OECD's consultation on the MDRs, they offend on many levels:

- their retrospectivity;
- their effective destruction of LPP and client confidentiality;
- their conversion of professional advisers and their clients into state informants;
- their timing – when CRS itself is not even close to being put to bed as an international automatic exchange information mechanism, what's the big hurry?

All of us should oppose the MDRs for the following reasons:

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- their breadth and complexity which often border on unintelligibility;
- their creation of criminal offences based upon objective criteria, thus dispensing with mens rea as an element of the offence; and
- because they are wrong in principle for the reasons set out above;
- because they will not achieve what the OECD wants them to achieve, which is presumably to fix what is perceived to be the CRS's inadequacies. How is anyone served by knowing

that a protector was sacked or that trust assets were traded? How will this help the CRS when we all know that the real CRS bad guys, the serial reporting cheats, are, in any event, going to ignore these MDRs? They will cause all sorts of confusion and a tsunami of unintelligible reports that will clog up the system and undermine the whole object of the CRS – to stop cross-border tax cheating;

- because the absence of the US from the regime will not only render it useless but further undermine perfectly legitimate local business that has already been lost to the US through the CRS;

- despite the fact that we were asleep when the UK passed its DOTAS laws – one bad law does not justify another even worse one;

- because they are not subject to the customary 'bottom-up' legislative processes applicable in most rule of law countries which require a proper examination and consultation process which informs lawmakers and the wider community as to precisely what laws are being proposed, why, and what they will mean. As we saw with the CRS itself, laws written in Paris and presented to local legislatures as a *fait accompli* as part of their international convention obligations are not subject to any meaningful scrutiny at the local level. This practice also undoubtedly undermines fundamental notions of national sovereignty – indeed, it is truly 'colonial' in approach;

- because we are the professionals best equipped to oppose these rules and we and our clients are those most likely to suffer if we do not; and

- because the MDRs are the thin end of the wedge being driven between professionals and their clients. Who knows what area of interest the OECD or individual governments will focus on next by broadening the subject matter of the MDRs regime? Immigration planning, all manner of 'regulatory arbitrage' – who knows what is next?

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So, what to do? First, we need to revisit and rediscover the philosophical underpinnings of why we have client confidentiality and LPP and why we find the idea of retrospectivity and of being compelled to inform on each other so repugnant. We have been in the cooking pot too long.

We must create awareness at the national level as to the true nature and effect of these innocently named MDRs. It is there that they will, or will not, come into effect. The OECD statement makes it clear these rules are not (yet) part of the CRS standard or the Convention on Mutual Administrative Assistance so there is actually no legal compulsion on individual countries to pass them. The emphasis should not just be on demonstrating that they are wrong, but also by showing that they will not actually work; they will create far more chaos than useful information. Case studies will be helpful here. We should put the question – why turn long-standing and fundamental convention on its head and add to consumer cost for no result? If the CRS is imperfect, then fix it. The MDRs are not the way to fix the CRS's perceived inadequacies.

Campaigning to oppose these rules as soon as possible will be most effective when done via or in conjunction with other professional bodies such as the law societies, bar associations, trustees' associations and accounting bodies. There is undoubtedly strength in diversity and numbers. This should be organised before the MDRs are handed down from Paris to our local legislatures. This will happen any time now.

The object should be to stop them altogether. There can be no halfway house in such matters. Be wary about being drawn into discussions with governments by first accepting the MDRs' general architecture – and thus their underlying principles – and then engaging in arguments about tweaking their most odious parts. This is not a winning strategy.

Finally, in opposing these proposals we need to be clear-eyed and strategic and use both our shared intellect and our shared passion; this is not merely an intellectual exercise that will be won on the technical strength of the arguments alone.

Those readers who are STEP members will soon learn how STEP proposes to assist STEP branches that choose to lobby against the MDRs in their home jurisdictions. ■

References

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'STEP Response to OECD consultation on Mandatory Disclosure Rules for addressing CRS avoidance arrangements and offshore structures' – download from www.legalease.co.uk/step-oecd