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IFAC Small and Medium Practices Advisory Group Response to IESBAs Exposure Draft of Proposed Revisions to the Code Addressing Tax Planning and Related Services

INTRODUCTION

The IFAC SMP Advisory Group (SMPAG) is pleased to respond to the IESBA Exposure Draft Proposed Revisions to the Code Addressing Tax Planning and Related Services. The SMPAG is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small- and medium-sized entities (SMEs). The constituents of the SMPAG are small- and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members and Technical Advisers serving the SMPAG are drawn from IFAC member bodies representing 25 countries from all regions of the world.

GENERAL COMMENTS

As the IESBA will be aware, the SMPAG has engaged with the Board on multiple occasions as this project has progressed, including encouraging a reconsideration of the approach to focus on guidance outside the Code because tax planning can be complex and highly dependent on the local jurisdiction's legislation. On the basis that the project will continue, the SMPAG generally supports the proposed revisions to the Code. However, some areas have been identified where we propose specific changes or suggest greater clarity, which would help to avoid practical issues in implementation, and others where there may be unintended consequences resulting from these proposed revisions.

The SMPAG agrees that PAs should behave ethically in all their work and acknowledges that the fundamental principles of the IESBA Code already apply to taxation related services or activities. However, the definition of services or activities that fall into the scope of the IESBA's project on tax planning and related services as described is broad. For example, 280.5 A3 identifies preparation of a tax return that reflects the position in a tax planning arrangement to be an activity within scope. This creates a concern that under the proposals as drafted, routine arrangements may be subject to additional considerations (i.e., considerations designed to address so-called gray areas or aggressive tax minimization), or further documentation, both of which will have an impact on the competitiveness of professional accountants (PAs) providing these services in comparison to other providers, such as lawyers, tax advisors or – in some cases, multiple – others, including individuals who are not part of a profession and who may provide tax advisory services including promoting more "aggressive" schemes. This issue is likely to have a disproportionate impact on SMPs, as generally the nature of services provided and the arrangements in question would be routine. A challenge in scalability may therefore exist for some of the proposed revisions.

Specifically, the 'stand-back test' requirement in Para R380.12 may be problematical. The requirement to consider stakeholder perspective will be challenging from a practical perspective due to its subjectivity, and this test would add little value where the arrangement being looked at is routine in nature and not expected to reveal significant risks. It would be useful if application of this test was limited to arrangements where there are specific risks, for example those that have potential to be in the 'gray zone'. Practically, the test may be more suited for high-profile and Public Interest Entities (PIEs) and is likely to be less relevant to many SMEs.

In addition, because the PA's decision not to recommend a particular tax planning arrangement even though there is a credible basis depends on the outcome of this stand back test it needs to be clear that the relative significance of any consequences (i.e., associated risks affecting the client on the one hand and the PA or the profession on the other) are taken into account. Ultimately, when the PA is satisfied that there is a credible basis and has appraised the client of potential associated risks, it is solely for the client to decide whether or not to pursue a specific tax arrangement, so the PA should reflect primarily on risks impacting the PAs and the profession in considering whether further action is appropriate in the specific case. We therefore also suggest the IESBA revise the requirements in paras. R380.19, 20 and 21 to clarify that where there is no credible basis for a specific tax arrangement the PA shall disassociate from that arrangement. When under R380.12 and 13 the PA identifies risks that would impact the PA's reputation and that of the profession, the PA shall consider whether it is appropriate to withdraw from the engagement or to end the client relationship. Risks the PA has informed the client of, but which the client decides are "worth taking" may not all fall within this category so it needs to be clear that a more careful consideration is needed in this context.

It is also unclear how a PA addresses related services such as assisting a client to resolve disputes etc. that result due to past decisions on a tax arrangement. We suggest this aspect be made clearer.

The explanatory memorandum clarifies why no attempt was made to define or describe the 'public interest' and identifies the challenges in determining 'credible basis,' as both are very subjective in nature and would be impacted by jurisdictional circumstances. However, the lack of guidance around definitions will create practical problems for PAs who will need to make their own determination of what these concepts entail. There is also potential for ethical dilemmas to be created through the proposed revisions. The guidance may create a threat that PAs withdraw from some services in the gray zone, but this is arguably not always in the public interest – especially if there are "others" who will step in to fill a perceived void. Furthermore, the 'encouragement' of documentation outlined in 380.23 A1 and the guidance to encourage clients to consider reporting arrangements which have been assessed not to have a credible basis to tax authorities in R380.20 could also give rise to issues with client confidentiality and protection and add costs to PA's services thus potentially resulting in clients moving away from PAs in this space. Further detail on these issues will be provided in the detailed comments that follow.

DETAILED COMMENTS

We have outlined our responses to each question (in italics) in the ED below.

Proposed New Sections 380 and 280

1. *Do you agree with the IESBA's approach to addressing TP by creating two new Sections 380 and 280 in the Code as described in Section VI of this memorandum?*

The SMPAG generally agrees with the approach of creating two new sections. It is important that the proposals minimize prescriptive areas and allow PAs to exercise judgement, as the proposed guidance is currently all applicable equally regardless of size of entity or practice. In this case, PAs, but SMPs in particular, must be allowed some freedom to determine whether application of some areas is appropriate to the nature and circumstances of the arrangement in question. At the same time, we note there will be challenges to applying judgment in some areas, which we will detail later in this response.

A challenge may also be posed where PAs are engaged to provide corrective advice to resolve past problems caused by inappropriate tax advice or guidance taken by clients. While the arrangements in question may lack a 'credible basis,' it would appear neither to be in the public interest nor appropriate to disassociate with the client under such circumstances, as this would deny access to all PAs who may be best placed to assist in resolution of the matter. It may be useful to consider such a scenario explicitly either through revised wording or examples.

Description of Tax Planning and Related Services

2. *Do you agree with IESBA's description of TP as detailed in Section VII.A above?*

The SMPAG disagrees with part of the proposed description. As noted above, the scope of arrangements that fall under the description of tax planning and related services is broad, and goes far beyond targeting aggressive tax minimization, which is where the most pressing issues are. This broad definition has the potential to create onerous requirements in relation to many simple services and is not helped by the proposed definition of tax planning in 380.5 A1 and 280.5 A1. The definition includes arrangements where affairs are structured in a "tax-efficient" manner, which effectively means any arrangements providing an economic benefit to the client would be in scope. The use of this wording compounds with the existing broad scope and potentially creates extra work for simple schemes that are clearly legal but seek to be tax efficient and are not thus comparable with the sort of contentious aggressive, tax-minimization arrangements this project is aimed at addressing. While there is merit in having limited examples, it is challenging to understand the boundary using the examples in 380.5 A2. We believe that further consideration should be given to examples that limit the scope and focus on providing clarity over the contentious kind of arrangements where it would be most important to apply the revised guidance.

The proposed Code revisions are also silent on how the guidance will impact PAs fulfilling voluntary positions, for example by providing support to their government, small private clubs or charities. This is a feature in many jurisdictions, and PAs may have roles on resolution committees or other boards where they are required to consider tax planning arrangements. It would be useful to add some examples to highlight that such voluntary services provided are also covered by the proposed revisions to the Code.

Role of the PA in Acting in the Public Interest

3. Do you agree with IESBA's proposals as explained in Section VII.B above regarding the role of the PA in acting in the public interest in the context of TP?

We note the reasons why it has not been attempted to define or describe the public interest, although an example of how this is relevant for tax planning is given in 380.4 A1. However, in practice, leaving this for PAs to determine could be problematic. Many arrangements will be concerned with cross-border operations, and the public interest may differ from jurisdiction to jurisdiction. In many jurisdictions, there are also multiple regulators that could operate in this area, so it would be a challenge to determine who decides what the public interest is. Additionally, where legislature is unclear, decisions about the appropriateness of tax planning schemes are often made in hindsight – sometimes with considerable time delay involving more than one institution and different interpretations until a final decision is reached. Considering these challenges, it may be useful to give additional relevant examples of what constitutes public interest in the context of tax planning, this could save PAs time and effort in trying to establish what this is.

The existence of other actors providing services in this space, such as lawyers, tax advisers or unregulated individuals providing tax planning advice, must also be considered. Non-PAs operating in this area could create a challenge in implementation as the proposed guidance would fail to apply to them. The proposed guidance and additional considerations will add cost to the provision of these services, potentially making PAs less efficient than others in carrying out this activity, especially where the schemes in question are not risky or aggressive. As such, there is potential for the proposed guidance to be to the detriment of PAs.

While we note the explanatory memorandum confirms that the provisions do not address tax morality, there does appear to be some focus on the moral tone when considerations of the public interest are examined. Therefore, we suggest the explanation in the 2nd and 3rd sentences of para. 65 of the explanatory memorandum be added as explanatory material within the Code. The overarching aim of the PA should be to give the client credible tax advice, outlining all legally permissible options, including those that will be most advantageous to the client. It would not be acceptable to withdraw some options from client consideration due to issues with perceptions on public interest, as this would be failing to meet this overarching aim. Withholding the most advantageous options from a client may also leave the PA exposed to legal challenge.

Basis for Recommending or Otherwise Advising on a Tax Planning Arrangement
4. Do you agree with the IESBA's proposals regarding the thought process for PAs to determine that there is a credible basis in laws and regulations for recommending or otherwise advising on a TP arrangement to a client or an employing organization, as described in Section VII.E above?

The SMPAG agrees with the concept of establishing a 'credible basis in laws and regulations' (R380.11), but notes that this would be highly subjective and could pose practical problems for a PA to determine without further clarity or examples to support them, as they would not always be best placed to do this . From the point of view of Professional Accountancy Organizations (PAOs) to the extent that they may perform oversight over members' activities, much like public interest considerations, it would also be very difficult to assess if PAs were complying.

As mentioned in the cover letter, R380.12 is potentially also problematical, in that even when a PA has established a credible basis for a particular tax planning arrangement, the PA is required to go further and consider reputational, commercial and wider economic consequences using professional judgement about stakeholders' possible views on the specific arrangement. We suggest this applies only when the PA encounters so-called "grey zone issues" and not to all tax planning arrangements. We are also concerned that this consideration may prove impossible in some cases. The results of this test (i.e., the PAs identification of consequences and related risks) are ultimately decisive for the PA's determination not to recommend a or otherwise advise on a tax planning arrangement in R380.13. As explained in our general comments above, we suggest the IESBA clarify that the relative significance of the identified consequences will factor into the PA's action in regard to whether to disassociate from the arrangement, withdraw from the engagement, or even from the relationship with the client, since at this stage the PA has already established that a credible basis exists for the tax planning arrangement and due to the subjectivity involved in complying with R380.12.

A further issue is in relation to the apparent disconnect between 'credible basis in laws and regulations' (e.g., 380.11 A1, R280.11), including the uncertainty referred to in 380.15 A1 and the notion that arrangements may not be prohibited by tax laws and regulations and yet may still be problematic (e.g., 280.4 A2). Perhaps some alignment is needed for these two concepts as they could be the source of some confusion.

Basis for Recommending or Otherwise Advising on a Tax Planning Arrangement
5. Are you aware of any other considerations, including jurisdiction-specific considerations, that may impact the proper application of the proposed provisions?

Our comments elsewhere in this section have flagged some jurisdiction specific issues, generally, guidance that is principles based rather than detailed guidelines make it easier for SMPs to adopt and minimize the likelihood of jurisdiction specific challenges.

Consideration of the Overall Tax Planning Recommendation or Advice
6. Do you agree with the proposals regarding the stand-back test, as described in Section VII.F above?

The SMPAG disagrees with the proposal to require all PAs to conduct a stand-back test in every case when there is a credible basis and raises several concerns. It is not clear that performing this test, which could be time-consuming, would add any value in relation to simple and routine arrangements or activities that are clearly not in a so-called gray zone. Further, the test requires PAs to make a consideration from the point of view of stakeholders (R380.12). This would create multiple practical difficulties, first in identifying relevant stakeholders and then in judging what their respective potential positions could be, and – to the extent that they could be opposing – decide which are more compelling. It is also especially difficult for PAs working on SME clients to consider "wider economic consequences" (R380.12) resulting from arrangements. Factors such as whether an arrangement is clearly not in a so-called gray zone, as well as the relative severity and materiality to the client (and in total where applicable) should influence where this consideration is relevant and should be required.

The test may also give rise to some political challenges. A PA could perceive a particular interpretation of a tax law to be detrimental to the wider economic consequences, which then creates a challenge in applying the test. Additionally, the legislative intent of tax laws is not always matched by the final enactment, and it is not clear how the PA should navigate such situations with regards to the test. Ultimately, the test appears idealistic and would be dependent upon the lens and background of the PA making the determination and perceptions as to the views of a range of potentially divergent stakeholders. The test could penalize certain political stances or economic evaluations of benefits. When a treatment is legal and has a credible basis, in some cultures it would be difficult to avoid recommending this, and avoidance may amount to challenges for practitioners aiming at "doing the right thing" in uncertain environments. There is a resulting argument that it may be appropriate to incorporate consideration of what is in the client's best interest into this test, but we acknowledge this would be the prerogative of the client and may add even greater complexity and subjectivity into this test.

Describing the Gray Zone and Applying the Conceptual Framework to Navigate the Gray Zone
7. Do you agree with the IESBA's proposals as outlined in Section VII.G above describing the gray zone of uncertainty and its relationship to determining that there is a credible basis for the TP arrangement?

We agree that it is reasonable to discuss the nature of uncertainty with the client where such uncertainties exist. The current definition and guidance in R380.16 and R280.16 along with the explanatory memorandum imply that the gray zone would be a current or future consideration. The proposed revisions fail to acknowledge that the past may be relevant for gray zone considerations too. For example, past advice may place a client within an arrangement that is in the gray zone and subsequently becomes subject to challenge by the tax authorities, a PA may then subsequently be assisting that client to navigate the situation. It would be counterintuitive for a PA to step away from such activity in these circumstances, engagement would be a more appropriate solution for all parties.

Describing the Gray Zone and Applying the Conceptual Framework to Navigate the Gray Zone
8. In relation to the application of the CF as outlined in Section VII.H above, is the proposed guidance on:
(a) The types of threats that might be created in the gray zone;
(b) The factors that are relevant in evaluating the level of such threats;
(c) The examples of actions that might eliminate threats created by circumstances of uncertainty; and
(d) The examples of actions that might be safeguards to address such threats
sufficiently clear and appropriate?

There is likely to be limited exposure to cases where these considerations will be relevant for SMPs, but we note that generally the guidance in relation to the gray zone could be made more useful through reinforcing the link between the gray zone and the concept of "credible basis in laws and regulation". The drafting of 380.17 A2 and A4 may raise some questions for practitioners. It would be useful to make explicitly clear who 'ultimate beneficiaries' in the context of these sections refers to and why it is important that their identity is established.

Disagreement with Management
9. Do you agree with the proposals outlined in Section VII.I above which set out the various actions PAs should take in the case of disagreement with the client or with the PA's immediate superior or other responsible individual within the employing organization regarding a TP arrangement?

We agree with the requirement in R380.13 that the client shall be fully informed as to a PA's reasons for not recommending a specific course of action even when the PA believes there is a credible basis when the PAs considerations required under R380.12 flag potential consequences. We also agree that uncertainties as to whether there is a credible a basis must be discussed with a client (R 380.16). However, given the subjectivities involved in both cases, we believe that the issues such as severity and materiality must feature in driving a PA's reaction to the client's decision to pursue a particular tax treatment that the PA has not recommended despite there being a credible basis, so it is not reasonable that both cases should automatically lead to a requirement for a need to dissociate fully from the engagement as proposed in R380.20 (in R380.13 there is a credible basis and in R380.16 it is not sufficiently certain). In any case, this proposal is not in line with the requirement of R380.21 which requires the PA consider the need to withdraw from the engagement. In our view, it is appropriate to require disassociation only when the PA determines there is no credible basis. Consequently, we contend that generally it is appropriate to require only consideration of disassociation, withdrawal from the engagement and cessation of the client relationship based on the consequences identified under R380.12. We therefore suggest that IESBA require a consideration by the PA in both R380.20 and 21 and also provide guidance as to factors that should be considered. R380.21 may not result in termination of the professional relationship and so it could be clearer that the PA may also assist in related services (e.g., assisting the client further in regard to a tax planning arrangement which has been challenged).

The wording of paragraphs R380.20 and R280.20 is further problematic as the advice also appears contradictory. These paragraphs note a PA should take steps to dissociate from the client if a tax planning approach is adopted despite the PA's advice to the contrary; presumably based on a decision required under R380.13 (although whether or not the intent is to also refer to disagreements about the existence of a credible basis is unclear). However, actions such as advising the client to make disclosure to tax authorities or the external auditor would be contrary to disassociation. While these paragraphs require the PA to consider advising the client to make full disclosure of the arrangement to the relevant tax authorities or the external auditor in the event of a disagreement about pursuing a tax planning arrangement, there is no clarity on what a PA should do if the client refuses to make such disclosure. This could create an underlying expectation for the PA to violate client confidential information in such a case. It should be made clear that the scope of arrangements entered into and permissibility of actions in jurisdictional legislation would need to be considered as a factor before advising a client to make a disclosure. The guidance should explicitly remind a PA of their obligations in relation to client confidentiality, and it would also be beneficial for the guidance to include a reminder that it would be extreme for a PA to suggest escalation through the client reporting to a tax authority where there is a good faith difference in view and a credible basis. This approach should only be limited to situations where a treatment would be unquestionably incorrect or problematic.

The wording of R380.21 notes that the PA "shall" consider the need to withdraw from the engagement and professional relationship. The wording seems quite strong and, without guidance to explain matters that factor in such a decision, may be taken as an implication that this is generally the course of action to follow in such circumstances. Perhaps explaining the factors driving such consideration would be helpful to show there is genuine judgment to be applied in making this decision and that PA would take the possible further action(s) in severe but not necessarily all cases.

Documentation

10. Do you agree with the IESBA's proposals regarding documentation as outlined in Section VII.J above?

In principle, we do prefer "encouraging" documentation rather than requiring it. However, the simple and unproblematic nature of many of the arrangements that are included in the scope means that the cost-benefit value of documentation many times will be low. As such, if the wording that encourages documentation remains, and considering the broad scope of the arrangements that would fall subject to the guidance, we encourage the IESBA to include in the application material that risk and significance should be considered as factors in determining whether documentation is appropriate.

Tax Planning Products or Arrangements Developed by a Third Party

11. Do you agree with the IESBA's proposals as detailed in Section VII.K above addressing TP products or arrangements developed by a third party provider?

Paragraph 88 of the explanatory memorandum states “where a PA is referring a client to a provider of TP products or arrangements to meet the client’s needs, the PA would need to inform the client of the PA’s relationship with the external provider. In addition, the PA should ascertain the provider's competence in developing the TP product or arrangement.” These issues do not seem to be covered in the exposure draft and, in any case, a distinction should be drawn between a situation in which a PA is recommending a particular TP provider or TP arrangement, and one in which the PA is just being asked for second opinion by the client.

Multi-jurisdictional Tax Benefit

12. Do you agree with the IESBA’s proposals regarding a multi-jurisdiction tax benefit as described in Section VII.L above?

The proposed guidance in this area may again be problematic. If the treatments under question are lawful, the consideration would fall on a public interest argument, meaning the challenges in establishing public interest would again be relevant. As noted earlier, this would be even harder to interpret in multi-jurisdictional cases as political leanings and other considerations from each jurisdiction could be very different. There is also some ambiguity as to whether the guidance in this area is intended to cover only deliberate cases obtaining tax benefits from multiple jurisdictions, or whether unintended or consequential cases would also be relevant for consideration. It would be useful to provide some explicit clarification on this point.

There may also be some ambiguity in paragraph R380.14 A2 that would be useful to provide clarity on. The first bullet includes the “significance of the tax benefits in the relevant jurisdiction” being a consideration in determining whether to advise the client to make a disclosure. It is not clear what this means nor how significance would be assessed in this respect. It is also unclear if the assessment should be on monetary, or other terms (e.g., type of tax benefit claimed). Some further clarity may be useful on this point.

Proposed Consequential and Conforming Amendments

13. Do you agree with the proposed consequential and conforming amendments to Section 321 as described in Section VII.M above?

We have no comments in relation to this question.

Other Comments

Paragraphs 380.8 A1 and 280.8 A1 refer to the responsibilities of management and Those Charged With Governance (TCWG). The reality for many SMEs will be that TCWGs are unlikely to be familiar with tax

and would not necessarily have the sophistication to carry out some of the responsibilities listed. As such, the guidance in this area may be harder to adopt for SMEs and would appear less relevant.

Generally, it seems as if PIE engagements or grey-zone situations have been in focus when drafting many of the proposals in the new sections. Given the broad scope of possible tax arrangements subject to this initiative, the requirements might not be as relevant and suited for simple, non-complex engagements which are often provided to SMEs by SMPs. Therefore, we would encourage the IESBA to consider whether certain requirements (e.g., R380.12) must apply in every case and also whether sufficient guidance is provided to ensure that the requirements are relevant and proportionate to the broad scope of arrangements that they should be applied to.

CONCLUDING COMMENTS

If the approach to proceed with revisions to the Code has been decided, the SMPAG generally supports the proposed revisions, but urges IESBA to take steps to make the application of the guidance more targeted to cases where there are significant risks as the current scope is too broad. It would also be useful to clarify the applicability of certain of the proposed requirements due to this broad scope and more generally some clarity should be added in areas where PAs and especially SMPs may struggle in practical application.

The SMPAG strongly suggests that further steps such as dissociation should only be considered when there is no credible basis and that more extreme measures such as withdrawal from the engagement or cessation of a relationship with the client should only be considered when the assumed potential impact of a specific tax arrangement (which has a credible basis) is sufficiently severe.

Please do not hesitate to contact me should you wish to discuss matters raised in this submission. Sincerely,

Monica Foerster
Chair, IFAC SMP Advisory Group