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The global harmonisation of exchange of information

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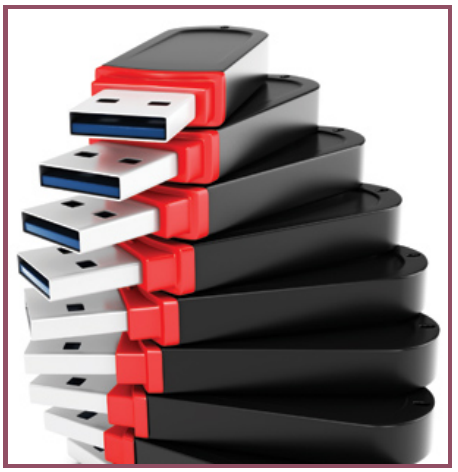
Corporate tax reporting in an era of exchange of information is still uncertain, but, as Samantha Merle, Sumeet Hemkar and Katrina Dautrich-Reynolds, of Taxand explain, taxpayers can still take steps to prepare for the introduction of new regulations.

Since 2008, the reinforcement of international tax cooperation has been one of the major concerns of governments worldwide. As a result of the growing international pressure, the financial industry is also moving towards a global and automatic system of exchange of information (EOI). Increasing efficiency in the fight against tax is, of course, one of the motivations, but the aim is also to reduce domestic budget deficits by increasing tax collection after the financial crisis.



Tax authorities could soon be sharing masses of taxpayer information with each other

The Foreign Account Tax Compliance Act (FATCA) and the EU Directive on Administrative Cooperation are two of the existing tools reflecting an international trend to make automatic EOI the new international standard. Exchange of information exists in various forms: upon request; spontaneous; and automatic and is regulated at many levels:

- bilaterally under FATCA
- based on EOI provisions in (DTTs) or specific EOI agreements
- within a specific region such as the EU under the EU Directive on Administrative Cooperation or the or globally with the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

And the work at OECD level to avoid base erosion and profit shifting (BEPS) will bring additional changes in automatic EOI rules and procedures applicable globally.

This diversity makes it difficult for multinationals with a presence in several countries to get clear guidance on which information may or will be communicated. Multinationals are now faced with a multitude of rules and a rapidly evolving environment, including:

- the implementation of automatic EOI in the EU member states (effective as of 2015 based on the Administrative Cooperation Directive)
- upcoming changes to broaden the scope of the EU Savings Directive
- the various FATCA agreements that more and more countries in the world sign with the US

This confusion is compounded when each country may have its own EOI sharing protocols, such as in the case of India, where this is largely modelled in its DTTs or (TIEAs). To encourage global tax harmonisation, the OECD has recently released a global standard on EOI between tax authorities worldwide.

But what is EOI and what will be its potential impact on multinationals in the future?

EOI upon request

So far, EOI upon request has been the most common EOI standard. Exchange of information between tax authorities generally occurs based on the EOI provision of DTTs, based on bilateral EOI agreements or based on the EU Administrative Cooperation Directive.

Following the work of the Global Forum on Transparency and Tax Information Exchange, the OECD Model Tax Convention and the UN Model Tax Convention were updated to ensure that a contracting state cannot refuse to exchange information solely because the information is held by a bank or a financial institution. In 2009, after unprecedented political pressure by the G20, most countries, including Switzerland, Luxembourg, Austria and Belgium agreed to adopt this provision and amended their banking secrecy rules, allowing local banks holding information to provide it to their local tax authorities.

These countries also started to amend existing DTTs or conclude several new tax treaties and EOI protocols in line with the OECD standards on international tax cooperation. Today, Luxembourg exchanges information upon request with 37 countries in a DTT context and several additional DTTs and protocols will soon enter into force to increase this number.

India is continually looking to amend its DTTs that do not contain an EOI article and to execute specific TIEAs with other countries, including some tax havens. Due to a growing pressure for the reinforcement of international tax cooperation and the fact that the Global Forum performs regular country reviews, the number of EOI agreements concluded in line with the OECD standards has also increased significantly. The US shares taxpayer information with more than 60 countries and globally, the number of EOI agreements in line with the OECD standards has increased from 44 in 2008 to more than 700 today.

Exchange of information upon request based on DTTs is neither limited to the taxes covered in the DTT nor to tax residents within the meaning of the DTT, which makes its scope broad. Upon request of a DTT partner, tax authorities can provide information that is considered as foreseeably relevant for the purpose of taxation in the country of the DTT partner. So-called fishing expeditions are therefore excluded. This applies in the same way to EOI upon request based on the EU Administrative Cooperation Directive, which covers all taxes except VAT and compulsory social security contributions. Still, the concept of foreseeable relevance is broad and difficult to define precisely, though there are some OECD guidelines designed to clarify the concept.

In recent years, countries such as Luxembourg have faced increasing EOI requests and more proceedings initiated by information holders arguing about the violation of domestic law. The Luxembourg courts have issued a significant number of decisions and clarified the conditions of application of the domestic procedural rules. In several cases, the courts considered the request as invalid, resulting in the OECD Global Forum criticising Luxembourg for having an unduly restrictive interpretation of the concept of foreseeably relevant information. Probably in response to this criticism, the Luxembourg tax authorities released a circular in December 2013 which reiterated the rules they need to comply with when handling an EOI request within a DTT context. This recent circular should accelerate the process of exchanging information upon request in future.

In practice, EOI upon request is typically initiated when an authorised foreign tax authority makes a formal request to local tax authorities. The local tax authorities then request the information from the information holder, often a bank, or directly from the taxpayer, and transmit to the foreign requesting authorities the information received. So, each time taxpayers invest in a foreign country, they will be subject to the EOI rules applicable in the foreign country of investment. The information available for exchange is typically agreed upon by the respective countries, but the concept of foreseeable relevance is generally defined in most countries based on the OECD guidelines so that EOI upon request is in practice more or less harmonised. The process of EOI exchange, the timeline for communicating information and the penalties in case of default may still vary from one country to another, however.

Spontaneous EOI

Spontaneous EOI is defined as the provision of information to another contracting party that is foreseeably relevant to that other party and that has not been previously requested. The scope is the same as EOI upon request, but the process is different: as the OECD manual on the implementation of EOI explains, spontaneous EOI relies on the active participation and cooperation of local tax officials, for example, tax auditors. Information provided spontaneously is usually effective since it concerns particulars detected and selected by tax officials of the sending country during or after an audit or other type of tax investigation.

In principle, there are no restrictions regarding the origin of the information which may be exchanged spontaneously and tax authorities can exchange any foreseeably relevant information they become aware of. Taxpayers should therefore be aware that any information they provide to the tax authorities either on a voluntary basis, for example, in a tax filing or advance tax clearance request, or unintentionally, for example, in a tax audit, may be exchanged spontaneously to the tax authorities of the residence country. So, though corporate tax departments play no official role in the international EOI network, the information they provide in their tax filings is crucial to the information tax authorities transmit to foreign governments. This is not only true for the purposes of exchanging information spontaneously but it is also true for exchanging information automatically.

Automatic EOI

All EU countries will soon exchange information automatically within the EU based on the automatic EOI provisions of the Administrative Cooperation Directive. Automatic EOI is defined by the OECD as the systematic and periodic transmission of bulk taxpayer information by the source country to the residence country concerning various categories of income. Under these rules, the tax authorities of EU countries will be required to communicate automatically to the tax authorities of any other EU member state information regarding specific categories of income, which is available and concerns residents of that other member state. Since only available information can be exchanged automatically and not all categories listed in the directive are available, each EU country confirms, when implementing the directive in internal law, the categories of income to which automatic EOI will apply. As far as Luxembourg is concerned, its tax authorities will communicate automatically, that is, systematically, only information regarding professional income, director fees and pensions.

Information on savings income is exchanged automatically under the EU Savings Directive, the scope of which is intended to be extended. Countries such as Luxembourg which did not exchange information automatically under this directive but levied a withholding tax instead will move to automatic EOI from 2015.

Automatic EOI occurs also under FATCA, which is designed for the US Internal Revenue Service (IRS) to collect information about foreign accounts of US taxpayers. Under this system, foreign financial institutions (FFIs) have to report the account information of US taxpayers, including the income received by such persons. To implement this system, the US is concluding bilateral intergovernmental agreements (IGAs) with various countries around the world. Under a Model 1 IGA, the information transits from the FFI to the IRS via its domestic authorities, while under a Model 2 IGA, the FFI communicates the information directly to the IRS. Most countries may enter into a Model 1 IGA as direct communication to the IRS often requires bigger changes in internal law so is more difficult to implement. The US has concluded IGAs with 22 countries and several are under negotiation.

The EU Administrative Cooperation Directive includes a so-called most favoured nation clause according to which member states have to provide any EU partner with the same level of information as they provide to third countries. Since the FATCA agreements signed by some of the EU member states with the US generally provide a scope of automatic EOI which is broader than under this directive, some EU member states will now have to exchange information on all categories of financial income to all other EU member states. So, even if not formalised yet, an EU FATCA may exist in practice already due to the IGAs concluded by some EU member states with the US and because of the most favoured nation clause included in the EU directive.

Outside the EU, India has been a supporter of automatic exchange of information and greater transparency. The Central Board of Direct Taxes (CBDT), which is the highest body for tax administration in India, has, in its Manual on Exchange of Information, expressed support for the OECD initiatives on automatic exchange. This is demonstrated by the fact that India transmitted about two million pieces of information to more than 50 of its DTT partners between 2009 and 2012, and received more than 40,000 pieces of information from 2011 to 2012 on an automatic basis.

The last international source of automatic EOI is the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. Even if this convention has a wide scope and provides extensive forms of cooperation on all types of taxes, each party to the convention still remains free, when implementing the convention into internal law, to limit its scope of application, so in the end, the scope of EOI under the Convention will vary from country to country.

Automatic EOI is the EOI standard governments want to see applied globally and the OECD has now taken some steps to harmonise automatic EOI rules worldwide to apply it effectively.

New reporting standard

The OECD has acted quickly regarding a new standard for financial institutions as exemplified by the recent publishing of a Common Reporting Standard (CRS): the Standard for Automatic Exchange of Financial Account Information between tax authorities worldwide, which was presented for the endorsement of G20 finance ministers during their meeting in Sydney on February 22 and 23.

Under the standard, jurisdictions will obtain financial information from their financial institutions and exchange that information automatically with other jurisdictions on an annual basis. Financial institutions will undergo due diligence procedures to share reportable account information, including investment income, account balances and sales proceeds from financial assets, with their local tax authorities. Under the new standard, financial institutions would include banks, brokers, certain collective investment vehicles and certain insurance companies. Not surprisingly, a lot of the provisions embodied under the new standard shadow the provisions found under the FATCA rules and the IGAs.

As well as the CRS, the OECD has also released a model competent authority agreement that jurisdictions can use for setting the rules of automatic EOI which will apply to them. The CRS released by the OECD has no legal force, however, and will have to be implemented into domestic law. Before entering into a reciprocal agreement to exchange information automatically with another country, the receiving country will need to have the legal framework, administrative capacity and processes in place to ensure the confidentiality of the information during and after the exchange of information process. The implementation of this new standard may therefore take some time.

From a US perspective, because a significant amount of information is already exchanged under its existing rules, with more to come through the imminent implementation of FATCA, the new guidelines outlined by the OECD do not result in a material change for US taxpayers. For countries such as Luxembourg, on the other hand, the implementation of the new OECD standards will mean significant changes in the future. With India's ratification of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and given the country's stated position on transparency and automatic exchange of information, taxpayers should, in the future, expect a heightened focus on the furnishing of information to the Indian Revenue.

Too early

It is too early to determine what additional reporting will be required from corporate tax departments to make the information available in line with the new OECD standard for automatic EOI. However, tax departments should already be considering how they should streamline their procedures to avoid any pitfalls in the future if new requirements are enacted. Action plans may include:

- Actively monitoring new developments in this area;
- Creating sample questionnaires;
- Summarising taxpayer information as required by the OECD;

- Creating information queries within internal software to group taxpayer information by country of origin; and
- Creating a system of checks and balances that improve quality control and avoid taxpayer information escaping transmission.

In this very rapidly evolving tax environment, foreign investors should remain prudent and seek the advice of their tax adviser for any new investment or change in their existing investment structures.

Samantha Merle (samantha.merle@atoz.lu)
Sumeet Hemkar (Sumeet.Hemkar@bmradvisors.com)
Katrina Dautrich-Reynolds (kdautrichreynolds@alvarezandmarsal.com)

www.taxand.com

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