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October 14, 2013

G20 Leaders Endorse Greater International Tax Transparency

At last month's summit in St. Petersburg, Russia, G20 leaders backed two ambitious proposals issued by the Organization for Economic Co-operation and Development (OECD), including the establishment of a global model for the automatic exchange of tax information between multinational entities and taxing authorities (OECD Report), and an action plan on base erosion and profit shifting (BEPS Action Plan).[1]

The G20 endorsements are the latest developments in the ongoing global effort for greater tax transparency that has gained significant momentum in 2013 and should continue to do so over the next two years. However, there are questions surrounding how OECD's recommendations can be implemented.

Background

Since the U.S. government issued comprehensive final regulations implementing the U.S. Foreign Account Tax Compliance Act (FATCA) in January 2013, there has been a wave of global activity, including:

Model 1 IGA. In April 2013, the ministers of finance of France, Germany, Italy, Spain and the U.K. announced their intention to exchange FATCA-type information among themselves in addition to exchanging information with the United States. To achieve this, these countries developed with the U.S. the Model Intergovernmental Agreement to Improve International Tax Compliance and to Implement FATCA (Model 1 IGA). Model 1 IGA requires reporting by financial institutions to their local tax authorities, which then exchange the information on an automatic basis with the tax authorities in the respective residence jurisdictions of the account holders. Since April 2013, numerous other countries have expressed interest in this approach and have made commitments to join the Model 1 IGA project.

G20 and G8 Backing. Also in April this year, the G20 finance ministers and central bank governors endorsed automatic exchange as the expected new standard, calling upon the OECD to report on progress in developing a new multilateral standard for the automatic exchange of tax information, taking into account country-specific characteristics. At their meeting in Lough Erne, Ireland, in June, the G8 issued a communiqué that also addressed tax transparency, calling for country-by-country reporting to tax authorities by major multinationals. Such reporting would include information on beneficial ownership and basic information at the national level. In this context, the G8 proposed a central registration of beneficial ownership.

The OECD Report

Key Factors. According to the OECD Report, an effective model of automatic exchange of tax information should include:

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1 *See* "International Taxation – OECD Reboot for the 21st Century," *Skadden Insights* (July 19, 2013), *available at* http://www.skadden.com/insights/international-taxation-oecd-reboot-21st-century.

- *Focus on tax compliance*. The model should be designed specifically for tax compliance issues and not be a mere byproduct of domestic reporting.

- *Standardized approach*. The model needs to be standardized, which will simplify the process and increase its effectiveness.

- *Global reach***.** The model should have a global reach. Otherwise, it may only lead to a relocation of income streams and would not resolve the issues of offshore tax evasion.

Scope. The OECD Report proposes a comprehensive scope of the entities required to report, the account holders and the information required to be exchanged with residence jurisdictions:

- *Required entities.* Not only banks, but also other financial institutions, such as brokers, collective investment vehicles and insurance companies, will be required to report.

- *Required accountholders.* Both individuals and "interposed legal entities or arrangements", such as shell companies, trusts or similar arrangements as well as the persons behind such interposed entities, will be covered.

- *Required information.* Different types of investment income — such as interest, dividends and capital that represents income or assets on which tax has been evaded (*e.g.*, information on account balances) — will be required.

Omissions. Neither the consequences of noncompliance nor guidance for dealing with bank secrecy rules were addressed in the OECD Report.

Legal Implementation. The OECD Report proposes to use primarily the FATCA-related agreements, such as Model 1 IGA, as a legal basis at the multinational level.

The Bigger Picture: The OECD Report and the BEPS Action Plan

The OECD Report's proposal fits into the broader context of the BEPS Action Plan. The G8's June communiqué endorsing a multilateral exchange of tax information and greater transparency suggests the information be provided in a standardized format focusing on high-level details about the global allocation of profits and taxes paid.

The G8 also called on the OECD to develop a common template for country-by-country reporting to tax authorities by major multinational enterprises. Pursuant to the G8, this would improve the flow of information between multinational enterprises and tax authorities in the countries in which the multinationals operate in order to enhance transparency and improve risk assessment. Companies and trusts also would be required to report and document their "beneficial ownership and basic information." This would be achieved through central registries at a national or state level. Finally, it was recommended that proportionate and dissuasive sanctions will be imposed on those that do not comply with their obligations.

Next Steps

The OECD aims to present a new single global standard for automatic exchange of information by February 2014 and to finalize the technical modalities of effective automatic exchange by mid-2014. In parallel, the G20 intend to begin to exchange information automatically on tax matters among G20 members by the end of 2015.

Observations

While the exchange of information could be an efficient tool to fight tax evasion, the concrete steps for implementing OECD's proposals need to be carefully tailored. In the meantime, some of these steps remain ambiguous:

Model 1 IGA Refinement. The advantage of using Model 1 IGA as a basis of the global automatic exchange model is that financial institutions already invest in FATCA compliance. However, the model agreement focused on FATCA would need to be refined to be efficient for a global reach. In particular, U.S. specificities may need to be amended or removed, such as the identification requirements associated with citizenship, existing threshold amounts, or exceptions for reportable accountholders and reporting financial institutions. At the same time, confidentiality and the adequate use of information would need to be safeguarded.

Noncompliance Issues. The sanctions for noncompliance need to be addressed. It remains to be seen whether a global standard that is agreeable to the wide range of participating countries can be created. Other projects on tax harmonization show that the level of disagreement among states increases with the level of specificity.

Costs. The proposed tax reporting obligations could impose significant costs on businesses of multinational enterprises, in particular financial institutions. Consequently, further developments in this area needs to be carefully monitored because responses may require significant advance preparation.