International Tax Transparency Is Gaining Momentum

Law360, New York (November 25, 2013, 10:44 AM ET) -- At the St. Petersburg summit on Sept. 5 and 6, 2013, the G20 leaders drove forward the initiative for a global model of automatic exchange of tax information. In addition, they endorsed the action items of the action plan on base erosion and profit shifting issued by the Organization for Economic Co-operation and Development (OECD) on July 19, 2013 (BEPS Action Plan).

Parallel to the BEPS Action Plan, the OECD worked on proposals for a global und uniform system of an automatic exchange of information which has been released on Sept. 5 and 6, 2013 (OECD Report). The G20 fully endorsed the proposals and underscored their commitment to automatic exchange of information as the new global standard.

Background

The aspect of international tax transparency has recently gained momentum. Already on April 19, 2013, the G20 Finance Ministers and Central Bank Governors endorsed automatic exchange as the expected new standard. They called upon the OECD to report on progress in developing a new multilateral standard on automatic exchange of information, taking into account country-specific characteristics. The G20 decision followed earlier announcements by a number of European countries of their intention to develop a multilateral tax information exchange model based on a model agreement in relation to the U.S. Foreign Account Tax Compliance Act, developed between these countries and the United States.

On April 9, 2013, the Ministers of Finance of France, Germany, Italy, Spain and the U.K. announced their intention to exchange FATCA-type information amongst themselves in addition to exchanging information with the United States. Since then, numerous other countries have expressed interest in this approach and have made commitments to join the pilot project.

At the G8 meeting in Lough Erne on June 18, 2013, the G8 issued a communiqué, which also addressed tax transparency. It called for a "country-by-country reporting" to tax authorities by major multinationals. Such reporting shall include information on beneficial ownership and basic information at the national level. In this context, a central registration of beneficial ownership has been proposed.

Proposed Key Factors and Scope

The OECD Report sets out the following key factors for an effective model of automatic exchange of financial information:

- Focus on tax compliance — The model should specifically be designed to tax compliance issues. It should not be a mere by-product of domestic reporting.

- Standardized approach — The model needs to be standardized. This shall improve the process simplification and thereby increase the effectiveness.

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

The OECD Report proposes a comprehensive scope of the information to be reported by domestic financial institutions and to be exchanged with residence jurisdictions:

- Scope of entities required to report — Not only banks, but also other financial institutions, such as brokers, collective investment vehicles and insurance companies, shall become subject to the reporting duties.

- Scope of information to be reported — The reporting shall include different types of investment income, such as interest, dividends and similar types of income, including capital that represents income or assets on which tax has been evaded (e.g., information on account balances).

- Scope of account holders subject to reporting — 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, shall be covered.

However, the consequences of noncompliance were not addressed in the OECD Report. Equally, the issues how to deal with banking secrecy rules have been left open.

Legal Implementation

The OECD Report proposes to use primarily the FATCA-related agreements as a legal basis at the multinational level. Key developments are already under way. France, Germany, Italy, Spain and the United Kingdom, developed with the United States the Model Intergovernmental Agreement to Improve International Tax Compliance and to Implement FATCA (Model 1 IGA).

The Model 1 IGA provides for 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 jurisdiction (for further details on the Model 1 IGA, see Insights dated Jan. 25, 2013).

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.

Context of BEPS — Country-by-Country Reporting

The proposed model for an automatic exchange of information fits in the broader context of the BEPS Action Plan. On June 18, 2013, the G8 member states released a communiqué that endorses the multilateral exchange of tax information and the promotion of greater transparency in order to discourage tax evasion. The communiqué proposes the information to be provided in a standardized format focusing on high level information of the global allocation of profits and taxes paid. The G8 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 shall 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 shall also become required to report and document their "beneficial ownership and basic information." This shall be achieved through central registries at national or state level. Finally, it was recommended that proportionate and dissuasive sanctions shall be imposed on those that do not comply with their obligations.

Conclusion

While the exchange of information could be an efficient tool to fight tax evasion, the concrete steps need to be carefully tailored. At the present stage, the concrete steps remain open. 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 in order 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 account holders and reporting financial institutions. At the same time, confidentiality and the adequate use of information would need to be safeguarded. Finally, the sanctions for noncompliance need to be addressed. It remains to be seen whether such issues could be moved forward into a global standard which is agreeable to the wide range of diverse countries which shall participate. Other projects on tax harmonization show that the level of disagreement amongst states increases with the level of specificity.

In any event, the proposed tax reporting obligations could impose significant costs on businesses of multinational enterprises, in particular financial institutions. Consequently, the further development in this area needs to be carefully monitored, since responses may require significant preparation in advance.

—By Johannes Frey, Skadden Arps Slate Meagher & Flom LLP

Johannes Frey is a partner in Skadden's Frankfurt office.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.