Ensuring Tax Compliance in a Globalized World: the International Automatic Exchange of Tax Information

By

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April 2015

A thesis submitted to McGill University

in partial fulfilment of the requirements of the degree of

Doctor of Civil Law

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Abstract

Paying taxes is a statutory obligation and this obligation is often constitutionally stipulated. It is rooted in the Hobbesian social contract theory according to which individuals have consented, either explicitly or tacitly, to surrender some their resources along with some of their natural rights to the authority of state in exchange for protection of their remaining rights and resources. The state is then expected to dedicate these collective resources for the pursuit of peace, public security, healthcare, education, economic prosperity, and for many other shared goals. However, if one taxpayer shirks her or his tax obligation, the cost of providing these public goods would fall unjustly on others. This may ultimately jeopardize the collective project. Therefore, it has been important that every beneficiary of the society complies with the tax obligation properly and in harmony with others and it has been the state's responsibility to ensure the compliance.

Tax information has been central for the operation of this tax system. It is a type of information that is collected and analysed by tax authorities to determine, assess, and collect income taxes from taxpayers. Tax information normally determines the taxpayer, verifies her or his residence, income, and expenses, and establishes links between the taxpayer and these items. This information is generally collected from taxpayers as annual self-assessment tax declarations (i.e. tax returns) or from third parties through third party tax information reports (i.e. information returns). This allows tax authorities to determine who ought to pay, how much tax, and to whom (e.g. to which country). Without having access to such information, tax authorities would face great difficulty in the proper enforcement of income tax laws.

However, there is a fundamental challenge associated with obtaining such information from taxpayers. By nature, people disclose their information to others only when they perceive it to be in their own interest to do so, or at least where the outcome of the disclosure would be neutral to their interest; otherwise, they generally tend to hold it back. It is also naïve to believe that people like to pay taxes and give away their hard-earned money. In their attempt to understand the roots of tax evasion, economics Professors Slemrod and Bakija noted "it is not anyone individual's interest to contribute voluntarily to government's coffers. Each citizen has a very strong incentive to ride free on the contributions of other, since one's own individual contribution is just a drop in the bucket and does not materially affect what one gets from government".[1] Hence, it is not at peoples' immediate selfish interest to voluntary comply with tax laws. After all, tax system requires enforcement, a sound enforcement mechanism that ensures reasonable visibility of people's tax-relevant information to tax administration.

My aim in this project is to introduce a new way of exploring this old but extremely important issue of income taxation: tax compliance, more specifically, tax compliance on the foreign-source income of resident taxpayers. I study the development of proper channels for exchanges of tax information between national tax authorities to ensure that taxpayers who are involved in cross-border dealings are paying their right share of taxes to the right governments. I explore automatic exchange of tax information between governments as a potential mechanism to address this issue and attempt to provide much needed historical exploration, conceptual clarification, and theoretical support for this system. I also analyse the need for a fair international legal framework for automatic exchange of

[1] See Joel Slemrod & Jon Bakija, *Taxing Ourselves: a Citizen's Guide to the Debate Over Taxes* (Cambridge: Mit Press, 2004), at 145.

tax information between states, and address the particularities and challenges associated with establishing such a framework.

Overall, I believe the contribution of this research to knowledge are threefold: it (a) provides a comprehensive exploration of the evolution of the concept and system of automatic exchange of tax information; (b) introduces a basic theoretical framework in support of the automatic exchange of tax information system; and finally (c) the research puts together and comparatively analyses the existing international legal frameworks that have the elements and attributes of automatic exchange of tax information.

Résumé

Les renseignements fiscaux sont essentiels à la mise en application de l'impôt sur le revenu. Ces renseignements sont recueillis et utilisés par les autorités fiscales afin de fixer, évaluer et récolter de l'impôt. Les renseignements fiscaux permettent d'identifier les contribuables, de vérifier leur lieu de résidence, leurs revenus et leurs dépenses, et permettent d'identifier les liens entre les contribuables et ces items. Sans ces renseignements, les autorités fiscales seraient à court de moyens pour mettre en application les lois sur le revenu.

Cependant, l'obtention de ce type de renseignements de la part des contribuables constitue un défi de taille. La nature humaine veut que les individus ne divulguent leurs renseignements à autrui que s'ils croient que cela peut servir leurs intérêts, ou lorsque l'effet de la divulgation est perçu comme étant neutre; autrement, ils ont généralement tendance à retenir leurs renseignements. Il est également naïf de penser que les individus paient leurs impôts de façon volontaire sur un revenu durement gagné. Le fait de se conformer aux lois fiscales n'est pas dans l'intérêt égoïste immédiat des citoyens. En tentant de comprendre les sources de l'évasion fiscale, les professeurs Slemrod et Bakija, économistes, ont noté qu' "il n'est dans l'intérêt individuel de personne de contribuer volontairement à renflouer les coffres du gouvernement. Chaque citoyen a un incitatif très fort à profiter gratuitement des contributions des autres, étant donné que la contribution d'un seul individu ne représente qu'une goutte d'eau dans l'océan et n'a pas d'effet significatif sur les services que cet individu reçoit du gouvernement".[2] Après tout, il est nécessaire dans un regime fiscal que des mécanismes d'application de la loi efficaces soient en place afin de permettre à l'administration fiscale d'avoir un accès raisonnable aux renseignement fiscaux des contribuables.

Mon objectif dans ce projet est de proposer une nouvelle façon d'explorer une problématique de l'impôt sur le revenu qui quoiqu'ancienne, demeure très importante: l'accès du gouvernement aux renseignements fiscaux, plus particulièrement aux renseignements fiscaux sur les revenus de sources étrangères de ses contribuables ayant le statut de résident. J'étudie le développement de canaux appropriés pour l'échange de renseignement fiscaux entre autorités fiscales nationales afin d'assurer

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[2] See Joel Slemrod & Jon Bakija, *Taxing Ourselves: a Citizen's Guide to the Debate Over Taxes* (Cambridge: Mit Press, 2004), at 145.

que les contribuables impliqués dans des transactions transfrontalières paient leur juste part d'impôts aux gouvernements auxquels ils sont dus; j'explore l'échange automatique de renseignements fiscaux entre gouvernements comme mécanisme potentiel pour répondre à la problématique posée. J'analyse également la nécessité que soit mis en place un régime juridique international équitable afin d'encadrer l'échange automatique de renseignements fiscaux, et j'aborde les spécificités et defies associés à la mise en place d'un tel régime.

Acknowledgement

I would like to express my deepest appreciation to Professor Allison Christians for motivating me to explore this extremely interesting topic and for her valuable guidance and constructive comments in developing this thesis. Her unwavering enthusiasm for the topic and for the field of tax law kept me engaged with my research. You have been my tremendous motivation and mentor.

I would also like to thank my thesis committee members, Professor Richard Janda and Professor Fabien Gélinas for serving as my committee members even at hardship and for reading through the several drafts of this project. Their comments and suggestions during the early stages of my research greatly influenced the outcome. I also would like to thank Professor Rosalie Jukier, Professor Angela Campbell, Robert Raizenne, and all of my doctoral fellow colleagues for their extensive support. All of you have been there to support me when I needed.

I also express my deep appreciation and gratitude for McGill University, Faculty of Law for giving me the opportunity, remarkable resources, and the necessary material supports to undertake doctoral study and to make my humble contribution to the knowledge in the field. Without you this would not have been possible.

Last but not least, I am grateful to my family. Words cannot express how thankful I am to my mother, Mavsuma, and father, Valijon, for their support of my decision to pursue a doctoral study and for my wife, Shakhnoza and two beautiful and innocent children, Shokh and Madina, for all of the sacrifices that they have made on my behalf in the course of writing this dissertation.

Abbreviations

CAA	Competent Authority Agreement
CoE	Council of Europe
CRS	Common Standard on Reporting and Due Diligence for Financial Account Information
CTPA	OECD Centre for Tax Policy and Administration
ECOFIN	United Nations Economic and Financial Affairs Council
EU	European Union
FATCA	Foreign Account Tax Compliance Act
IGA	FATCA Intergovernmental Agreement
OECD	Organization for Economic Co-operation and Development
TC	Double Tax Convention
TIEA	Agreement on Exchange of Information on Tax Matters
TIN	Taxpayer Identification Number
TJN	Tax Justice Network
UN	United Nations

Introduction

Law plays a significant role in society. One of the most basic roles of law is to ensure a safe, respectful, and adequately progressive society in which every person lives her or his life happily and in harmony with others.[3] Non-compliance with law jeopardizes this collective project. Therefore, in order to promote adherence to law, government has always had certain mechanisms of observance, detection, and sanctioning for the breach of law, all of which are collectively known as law enforcement mechanisms. The existence of these mechanisms has been critical to ensure a sufficiently high degree of rule of law.[4] This very existence of enforcement mechanisms is also what distinguishes law from other social norms (e.g. customs, traditions, morality, or other rules of conduct), for without it the law is no more than a moral obligation.[5]

Modern income tax laws have had a significant problem in this regard. There has been a clear mismatch between what these laws state and their enforceability. The basic premise of modern income taxation since early 20th century has been that the state's jurisdiction to tax its residents does not effectively stop at its territorial borders.[6] Generally, a state has jurisdiction to tax the income of its residents from all sources, including those income sourced from inside and outside its territory.[7] This tax theory also suggests that, for tax purposes, a state treat the foreign and

[3] See John Locke, *Second Treatise of Government* (Hackett Publishing, 1980), at 103 (Locke argues that the person who "exceeds the power given him by the law…may be opposed, as any other man, who by force invades the right of another).

[4] A.D. Woozley, "The Existence of Rules" (1967) 1:1 Journal Noûs.

[5] Conrad Johnson, "Moral and Legal Obligation " (1975) 72:12 Journal of Philosophy 315.

[6] League of Nations Economics and Finance Commission, *Report on Double Taxation* (Geneva League of Nations 1923).

[7] Ibid.

domestic source income of its resident *pari-passu*. Accordingly, the state assesses the foreign and domestic source incomes of its resident taxpayer as an aggregate amount and taxes it generally at the same rate. This is generally called “residence-based income taxation system”. Today, an overwhelming majority of countries follow this approach.[8]

For instance, if a resident taxpayer earns employment income by working for a local company and at the same time holds the shares of a foreign company, foreign real property, or deposits in a foreign bank, which yields dividend, rent, or interest income, the resident taxpayer is generally required to declare both domestic and foreign source income and pay taxes to the country of residence.[9]

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[8] See Sections 3 (Business taxation) and 6 (Tax on Individuals) of Deloitte Country Taxation and Investment Guides 2014. The Guides provide the brief and the most up-to-date summary of tax systems of over 150 countries worldwide. The Guides are available at https://dits.deloitte.com/#TaxGuides; See also Klaus Vogel, "Worldwide vs. Source Taxation of Income – A Review and Re-evaluation of Arguments (Part I)" (1988):8/9 Intertax 216-229, at 25.

[9] One important corollary of the worldwide income taxation is the potential double taxation of foreign-source income of the resident taxpayers. Foreign income is generally, but not always, subject to tax in the foreign country where the foreign-source income has been derived. When it is, the residence country’s tax constitutes a second layer of tax imposed on the foreign-source income. Typically, when levying tax on the foreign-source income of its residents, the residence country allows a foreign tax credit or an itemized deduction for those foreign taxes. Thus, the amount of the foreign tax paid is normally deductible from the amount of tax that is payable on such income to the residence country. As a result, the resident taxpayer is liable to pay the difference in tax rates applicable at the residence and source countries to the residence country to the extent that foreign tax paid is lower that residence country’s tax otherwise payable. Provided that tax rates in the source country of the income and the residence country of the taxpayer are comparable, the taxpayer may not owe any tax on the respective foreign-source income to her or his residence country, but she or he is still required to declare that income. This mechanism is commonly known as the ‘foreign tax credit system’. An overall result of the foreign tax credit system is that the residence country’s tax rate is in effect for the whole income of the taxpayer regardless of where it is earned - domestically or abroad. See at Articles 23 of the OECD Model Tax Convention on Income and on Capital, OECD, *Model Tax Convention on Income and on Capital (with commentaries)* (Paris: OECD, 2010); the UN Model Double Taxation Convention between Developed and Developing Countries; and UN, *United Nations Model Double Taxation Convention between Developed and Developing Countries (with commentaries)* (New York, US 2011); Kevin Holmes, *International Tax Policy and Double Tax Treaties: An Introduction to Principles and Application*

However, one of the biggest challenges of the residence-based income tax system, since its very inception, has been the enforceability of the tax law on the foreign-source income and the foreign-held (offshore) assets[10] of resident taxpayers.[11] The main questions are: **how can states possibly establish and monitor whether their residents hold foreign assets and derive foreign-source income? And, how do states actually administer and enforce their tax laws on the foreign source income of their residents?** As a fundamental principle of international law, a state cannot extend its administrative jurisdiction to the territory of another.[12] A centuries-old but rigorously applied common law doctrine, the "revenue rule", also supports this territoriality principle in tax matters. The doctrine holds that a foreign tax claim is generally unenforceable in countries outside that in which the claim has arisen.[13] Overall, the

(Amsterdam: IBFD Publications 2007), at 1-22; Angharad Miller & Lynne Oats, *Principles of International Taxation* (Haywards Heath: Tottel Publishing, 2009).

[10] Offshore assets are the assets held in a country where the owner has no legal residence or tax domicile.

[11] Roger Gordon, *Can Capital Income Taxes Survive in Open Economies?* (Cambridge, Massachusetts: National Bureau of Economic Research 1990), at 1159 (Gordon notes that income from savings invested outside the country is virtually impossible for a government to monitor. Individuals therefore can evade tax on such savings with very little risk of being caught by tax authorities of their residence country); Kurt Wagner, "US Taxation of Foreign Income: The Use of Tax Havens in a Changing Tax Environment" (1994) 18 Southern Illinois University Law Journal, at 634 (Wagner points out that noncompliance is an option to most taxpayers with foreign source income because of their tax authorities inability to collect information about foreign financial transactions); Philip Baker, "The Transnational Enforcement of Tax Liabilities" (1993) British Tax Review, at 313-318; Jeffrey Dubin, *The Causes and Consequences of Income Tax Noncompliance* (New York Springer Science+Business Media, 2012).

[12] See Lasse Oppenheim, *International Law: A Treatise, Vol. 2* London, Longmans, Green and Co, 1944), at 386-458 (The territorial authority is an important aspect of public international law. Oppenheim argues that a state may not exercise an act of administration or jurisdiction on foreign territory without permission and that as all persons within the territory of a state fall under its territorial authority, each state normally has jurisdiction – legislative, curial, and executive – over them); See also Asif Qureshi, *The Public International Law of Taxation: Text, Cases and Materials*, 1 ed. (London: Graham & Trotman, 1994), at 308 et seq.

[13] The revenue rule has been with us for centuries and as such has become firmly embedded in the case law. The earliest reported case referencing the revenue rule was decided in 1729 in England in *Attorney General v. Lutwydge,* [1729] 145 E.R. 674 (Ex.Ct.). In this case, Lord Chief Baron Pengelly held that "[b]efore the union this

enforceability of tax laws on foreign source income is arguably the most important questions in today's international income taxation. In fact, the matter has gained in importance in the face increasing economic globalization.

Globalisation of the world's financial system has made it increasingly easy for people to make, hold, and manage investments outside their country of residence. According to a recent study conducted by Global Financial Integrity, offshore deposits reached US$10 trillion in 2010.[14] The largest recipients of these non-resident deposits were the United States, the United Kingdom, and the Cayman Islands, each of which held over US$1.5 trillion in private, foreign deposits.[15] The study also found that such deposits have been growing at a compound rate of 9% annually over the last 13 years.[16] These assets are typically controlled through offshore companies, foundations, and trusts. They are often multi-layered, making it extremely difficult to track down their ultimate owner and the owner's country of residence. According to the Tax Justice Network, somewhere between US$190 and US$255 billion is lost in taxes every year by governments worldwide, solely as a result of the governments' lack of access to information on the offshore

court had no jurisdiction of the revenues in Scotland, and therefore the question is, whether the statute is not exclusive of us, since it is giving a farther jurisdiction to them who had it exclusive of us before." The Revenue Rule was further reinforced in 1775 in Holman v. Johnson. In this English case, Lord Mansfield wrote that "... no country ever takes notice of the revenue laws of another". Overall, the doctrine allows a state and its administrative bodies to decline enforcing foreign tax laws and judgments. See *Attorney Gen. v. Lutwydge*, (1729) 145 Eng. Rep. 674 (Ex. Div.) and *Holman v. Johnson*, (1775) 98 Eng. Rep. 1120, 1121 (1775). See also Brenda Mallinak, "The Revenue Rule: a Common Law Doctrine for the Twenty-First Century" (2006) 16:79 Duke Journal of Comparative and International Law. Supra note 29

[14] Ann Hollingshead, *Privately Held, Non-Resident Deposits in Secrecy Jurisdictions* (Washington DC: Global Financial Integrity 2010), at 1. Available at: http://www.gfintegrity.org/report/briefing-paper-secrecy-jurisdiction-deposits/

[15] ibid, at 15.

[16] Ibid, at 26.

assets of their resident taxpayers.[17] What is more troubling is that, in most cases, these foreign-held assets and foreign-source incomes do not yield tax even to host countries. This is largely due to the increasing tax competition between states to attract foreign capital and investment.[18] As a result, a substantial portion of global wealth, that belongs mainly to affluent and powerful, and that has been held offshore, almost never encounters tax.

Now, we return to our original argument, i.e. the enforceability of tax laws. After all, even though states claim that they treat and tax the domestic and foreign-source incomes of their residents *pari-passu;* and despite the fact that the volume of cross-border investments has grown substantially over the past few years, states do not yet have a feasible mechanism to enforce their tax laws on the foreign-source income of their individual resident taxpayers.

To work properly, a tax system must not only define domestic and foreign source incomes, rather than merely stating that they both are taxable, it must also have an effective enforce mechanism. The problem is not necessarily that the tax laws are prejudiced; the problem rests on the very fact that the states do not still have appropriate mechanisms to enforce them. After all **there is "a lack of parallelism in the enforcement of taxes on the parallel incomes".**

At the moment, there is no simple and perfect solution to the problem. However, the implications are alarming. Some governments have begun to direct their efforts to administer their tax laws on the foreign-source income of their resident taxpayers in a compelling and controversial manner:

[17] The Tax Justice Network states that if the unreported $21-32 trillion, conservatively estimated, earned a modest rate of return of just 3%, and that income was taxed at just 30%, this would have generated income tax revenues of between $190-280 billion. See Tax Justice Network, *Tax Us If You Can* Tax Justice Network 2012), at 10.

[18] Ronen Palan, Richard Murphy & Christian Chavagneux, *Tax Havens: How Globalization Really Works* (Ithaca, N.Y.: Cornell University Press, 2010).

a) **Proliferation of extra-territorial tax information kidnapping activities.** Some countries have begun to openly encourage and reward an act of tax information kidnapping from foreign jurisdictions by adopting statutory measures that reward foreign tax information kidnapping acts.[19] They offer large monetary rewards and guarantee protection from possible retaliation for private persons who have reasonably reliable information and data about abusive taxpayer behaviour of fellow residents and who come forward to provide such information to relevant tax authorities. These laws and programs are commonly known as whistle-blower laws and programs.[20] The 'Tax Relief and Health Care Act' of the United States,[21] 'Public Interest Disclosure Act' of the United Kingdom, and the 'Offshore Tax Informant Program' of Canada are examples of such laws and programs.[22]

At the same time, foreign bank data kidnapping activities have increased. For example, in the summer of 2007 a computer technician of a Lichtenstein bank offered the German tax

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[19] Frederick Lipman, *Whistleblowers: Incentives, Disincentives, and Protection Strategies*, vol. 575 Wiley, 2011).

[20] E.A. Morse, "Whistleblowers and Tax Enforcement: Using Inside Information to Close the "Tax Gap"" (2008), at 3; P. Latimer & A. Brown, "Whistleblower Laws: International Best Practice" (2008) 31 UNSWLJ, at 766-768.

[21] On 20 December 2006, the US adopted legislation – the Tax Relief and Health Care Act. See *Tax Relief and Health Care Act*, vol. 152 2006). For more information, see also http://www.irs.gov/uac/Whistleblower-Informant-Award.

[22] The Public Interest Disclosure Act of the United Kingdom came into force on 2 July 1999. The Act protects workers that disclose information about malpractice at their workplace, or former workplace, provided certain conditions are met. See Douglas Pyper, *Whistleblowing and Gagging Clauses: the Public Interest Disclosure Act 1998* (London The House Of Commons 2014). Available at http://www.legislation.gov.uk/ukpga/1998/23/contents ; See also the Offshore Tax Informant Program in Canada introduced in the 2013 Federal Budget on March 21, 2013. Launched as part of the Canada Revenue Agency's efforts to fight international tax evasion and aggressive tax avoidance, the program allows the CRA to make financial awards to individuals who provide information related to major international tax non-compliance that leads to the collection of taxes owing.

authorities the data that he had stolen from the bank.[23] The data in CDs contained confidential information on thousands of German and non-German residents suspected of holding millions of euros in allegedly undeclared offshore accounts with the Lichtenstein bank. Germany paid the informant roughly €5 million in remuneration and shared some of that information relevant to the residents of other countries to their fiscal authorities.[24] This has broken open one of the massive tax evasion investigations by the fiscal authorities of many countries on their resident taxpayers.[25]

In the meantime, a similar event occurred in the United States, where a former executive of a Swiss bank, UBS, offered the US Internal Revenue Service (IRS) a confidential data stolen from the bank. The data revealed the identities of thousands of high-net-worth US residents suspected of holding undeclared accounts with UBS. The informant received a landmark $104 million award from the Whistle-blower Office of the U.S. Internal Revenue Agency. This whistleblowing deal opened up one of the biggest tax evasion scandal in US history.[26]

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[23] Spiegel Staff, " Liechtenstein's Shadowy Informant: Tax Whistleblower Sold Data to the US" Spiegel Online International (25 February 2008). Available at http://www.spiegel.de/international/business/liechtenstein-s-shadowy-informant-tax-whistleblower-sold-data-to-the-us-a-537640.html

[24] Carter Dougherty & Mark Landler, "Tax Scandal in Germany Fans Complaints of Inequity " New York Times (18 February 2008). Available at http://www.nytimes.com/2008/02/18/business/worldbusiness/18tax.html?pagewanted=all

[25] Mike Esterl, Glenn Simpson & David Crawford, "Stolen Data Spur Tax Probes " The Wall Street Journal (February 19, 2008).

[26] David Hilzenrath, "For American Who Blew Whistle, Only Reward May Be a Jail Sentence" Washington Post (20 August, 2009). Available at http://articles.washingtonpost.com/2009-08-20/business/36769607_1_ubs-probe-whistleblower-reward-national-whistleblowers-center

In April 2013, an unidentified informant provided the tax authorities in German state of Rhineland-Palatinate with a computer disc containing 40,000 records of information on more than 10,000 German residents holding secret accounts in Swiss banks.[27] The sources reveal that the authorities had paid the informant €4 million in remuneration for the data.[28]

b) **The emergence of an extraterritorial law on tax information collection.** In March 2010, the US enacted a law called "the Foreign Account Tax Compliance Act" or colloquially "FATCA", prescribing an extraterritorial and unilateral obligation on all financial institutions around the world to routinely report tax information on their US customers to US tax authorities.[29] The law attempts to impose, for the first time, significant tax compliance obligations on almost all financial institutions around the world that maintain a business relationship, in one way or another, with U.S. resident taxpayers. FATCA requires these foreign financial institutions to register with the U.S. Internal Revenue Service and to carry out (a) regular due diligence, (b) reporting, and (c) tax withholding obligations vis-à-vis the U.S. government concerning their customers who happen to be U.S. persons. This fairly controversial US law was a result of some revealed abuse cases of the existing US income tax regime by its citizens and Swiss

[27] See Matthias Bartsch, " Swiss Bank Data: German Tax Officials Launch Nationwide Raids" Spiegel International (16 April 2013). Available at http://www.spiegel.de/international/business/germany-raids-200-suspected-tax-evaders-in-nationwide-hunt-a-894693.html; See also a TV news report on France 24 at http://www.youtube.com/watch?v=JVSniNw4PyE

[28] Ibid. See also a TV news report on France 24 at http://www.youtube.com/watch?v=JVSniNw4PyE

[29] The Foreign Account Tax Compliance Act, Public Law 111-147, Title V (March 18, 2010). The Law has been incorporated within new sections §1471-1474 of the US Internal Revenue Code of 1986.

financial institutions.[30]

These representative cases suggest that something is not quite working with the national tax systems or with the current international tax cooperation as a whole. Thus, there is a need to analyse these developments and explore possible solutions.

a) Hypothesis

The hypothesis of this research is that the modern income tax system has a significant enforcement problem: most states claim worldwide tax jurisdiction over their resident taxpayers by statutorily establishing that they levy tax on their income from domestic and foreign sources. However, this claim has no real force as far as the foreign-source income is concerned. The states have no viable and systematic mechanism to enforce their tax laws on the foreign-source income of their residents. The biggest problem in this paradigm is the states' lack of access to the extra-territorial information that is relevant and material to the application of tax laws on the foreign-source income of resident taxpayers. It is a type of information that is used by tax authorities to assess, collect, and recover taxes. It normally identifies the taxpayer, verifies her residence, income, and expenses, and establishes links between these elements. It covers a range of documents, records that are relevant. Such information is central for the proper application and enforcement of income taxes.

This problem can be addressed through a robust cooperation between states; and the system of automatic exchange of tax information between states offers a great potential to address the problem.

[30] US Department of Justice, *United States Asks Court to Enforce Summons for UBS Swiss Bank Account Records* (Washington DC: 2009).

This research project will attempt to analyse this hypothesis and will explore the challenges of establishing such a system.

b) Methodology

The topic of international exchange of tax information has always been studied as one of the important topics of international taxation. Lately it has become an important subject of its own, grounded in a unique set of concepts, rules, and legal principles.

This research analyses, interprets, and develops these concepts, rules, and principles. It also attempts to evaluate the adequacy of these rules and predict future developments in the field. Thus, the methodological approach taken in this research is predominantly doctrinal.

The primarily sources of the research will be the provisions of the OECD Model Taxation Convention (1977, as periodically updated) and the UN Model Taxation Convention (1980, as periodically updated) and their commentaries pertaining to the exchange of tax information. I also examine the Nordic Convention on Mutual Assistance in Tax Matters (1972), the Convention on Mutual Administrative Assistance in Tax Matters (1988), the EU Savings Directive (2003), the US Foreign Account Tax Compliance Act (2010), the Model FATCA Intergovernmental Agreements (2012), and finally the recently introduced OECD Standard on Automatic Exchange of Financial Account Information on Tax Matters (2014). I will also examine case laws, judgements, and scholarly works and their interpretation of the relevant concepts and principles where they are necessary.

Since the topic is inherently transnational, the analysis also involves extensive comparative study of these international legal frameworks, especially their provisions pertaining to exchange of tax information, more specifically to the automatic exchange of tax information.

c) Relationship to the existing literature

International exchange of information, particularly, the international *automatic* exchange of information, is a relatively new topic in legal scholarship. The topic has, by and large, been ignored in scholarship until very recently. The result is that it is still not as widely understood as it should be. One can observe a few references and short discussions on the topic in the works of Tanzi, Zee,[31] Keen,[32] Wisselink,[33] Schenk-Geers,[34] and Aujean.[35] They offer cursory and general accounts of the concept. Lately, the topic has also appeared in some tax policy papers of the international organizations and non-governmental agencies.[36] The latter provide policy guidance on the phenomenon.

[31] Vito Tanzi & Howell Zee, "Taxation in a Borderless World: The Role of Information Exchange" in G. Lindencrona & S. Lodin, eds., *International Studies in Taxation: Law and Economics* Wiman (1999) 321.

[32] Michael Keen & Jenny E. Ligthart, "Information Sharing and International Taxation: A Primer" (2006) 13:1 International Tax and Public Finance.

[33] Arnold Wisselink, *Fiscale Informatie-uitwisseling Tussen Europese en Andere Landen* (Netherlands Kluwer-Deventer, 1996); Arnold Wisselink, "International Exchange of Tax Information between European and Other Countries" (1997) 6:2 EC Tax Review.

[34] Tonny Schenk-Geers, *International Exchange of Information and the Protection of Taxpayers* (Alphen aan den Rijn, The Netherlands: Kluwer Law International 2009).

[35] Michel Aujean, "Savings Taxation: Is Automatic Exchange of Information Becoming a Panacea?" (2010) 19:1 EC Tax Review.

[36] Markus Mainzer, *Policy Paper on Automatic exchange of tax information Between Northern and Southern Countries* (Unpublished Tax Justice Network 2010); OECD Committee on Fiscal Affaires, *Automatic Exchange of Information: What It Is, How It Works, benefits, What Remains to Be Done* (Paris: OECD, 2012).

Looking at these relatively scarce discussions on this increasingly important topic, one quickly realizes that the phenomenon is in the early stage of its development and a comprehensive legal theoretical scholarly work on it yet to be pursued. This work represents one of such attempts to fill the gap in the literature.

Chapter 1: Concept and sources of tax information

Tax information is central for the proper application and enforcement of income taxes. This chapter explores the concepts and the sources of tax information in modern income taxation. It also discusses some fundamental issues with the current administration and enforcement of national tax laws caused by tax authorities' lack of access to information on foreign-source income of resident taxpayers. It aims to show that time is ripe to address these issues.

1.1 Income tax systems and concept of tax information

1.1.1 Income taxation systems in the world

Historically, tax policy required states to have certain benchmarks to establish their tax jurisdiction.[37] One possible, relatively common, and easily justifiable benchmark, as it was used in most other areas of international law, was "territorial jurisdiction".[38] However, the states have chosen completely different benchmarks of jurisdiction for income taxation. These are "source", "citizenship", or "residence", or combination of these three.[39] These jurisdictional benchmarks are narrower or broader than territorial jurisdiction in their scope but not necessarily same.

[37] Rutsel Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* (Boston: Kluwer Law and Taxation Publishers, 1989).

[38] Cara Nine, *Global Justice and Territory* (Oxford, U.K.: Oxford University Press, 2012); Michail Vagias & John Dugard, *The Territorial Jurisdiction of the International Criminal Court* 2014).

[39] Reuven Avi-Yonah, Nicola Sartori & Omri Marian, *Global Perspectives on Income Taxation Law* (New York, Oxford University Press 2011), at 151.

1.1.1.1 Citizenship-based income taxation system

For example, a few countries have adopted citizenship as a benchmark of their tax jurisdiction. Under this system, a state levies tax on its citizens' worldwide income regardless of where these citizens live or reside.[40] Thus, in determining its tax jurisdiction the state emphasizes more on the place of birth (as citizenship is often acquired by virtue of birth in a particular country) and its political rather than economic or social connections to its taxpayers. The citizenship-based tax system has been subject to strong criticism by scholar due to its out-dated nature, unfair outcomes, and administrative challenges.[41] Moreover, today only a few countries tax the worldwide income of their citizens.[42]

1.1.1.2 Source-based income taxation system

Under the source-based income tax system, a state asserts its tax jurisdiction based on the place of source of income. It levies taxes on transactions occurring or income having its source within its territory regardless of who earns it – residents or non-residents. Therefore, this system is also referred to as "territorial tax system".[43] Consequently, if a resident taxpayer is engaged in an

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[40] John Christie, "Citizenship as a Jurisdictional Basis for Taxation: Section 911 and the Foreign Source Income Experience" (1982) 8 Brook. J. Int'l L., at 110.

[41] Reuven S Avi-Yonah, "The Case against Taxing Citizens" (2010):10-009 U of Michigan Law & Econ, Empirical Legal Studies Center Paper, at 11; Bernard Schneider, "The End of Taxation Without End: A New Tax Regime for US Expatriates" (2012) 32:1 Virginia Tax Review;

[42] See a Wikipedia discussion on tax jurisdiction at <https://en.wikipedia.org/wiki/International_taxation#Citizenship>.

[43] For a general theoretical discussion on the territorial tax system see Vogel. *Supra* note 8; Klaus Vogel, "Worldwide vs. Source Taxation of Income–A Review and Re-evaluation of Arguments (Part II)" (1988):10 Intertax; Klaus Vogel, "Worldwide vs. Source Taxation of Income–A Review and Re-evaluation of Arguments (Part III)" (1988) 11 Intertax; Clifton Fleming, Robert Peroni & Stephen Shay, "Some Perspectives From the United States on the Worldwide Taxation vs. Territorial Taxation Debate" (2008) 3:2 Journal of the Australasian Tax Teachers

economic activity both domestically and cross-border, his or her foreign-source income is exempted from taxation. In so doing, the residence country assumes that the foreign-source income of its resident has been subject to tax in the host country. Today, countries such as Hong Kong, Malaysia, Singapore, Uruguay, and Panama operate under the source-based tax system.[44]

The territorial income tax system is supported by the Capital Import Neutrality (CIN) doctrine.[45] The doctrine holds that all investments within a country should face a similar tax burden, regardless of whether they belong to a domestic or a foreign investor. This proposition suggests that states should refrain from taxing their residents on their foreign-source income. The rationale is that taxing residents on their foreign-source income may put them at a competitive disadvantage with their counterparts in the host country because the former carry two levels of tax burden: residence and host country taxes, while the carries only the domestic tax burden. On the other hand, relieving the foreign-source income from taxation allows them to have similar tax burden with their competitors in the host country, leading to an optimal outcome, i.e. capital import neutrality.

However, determining the source of income is a daunting task in today's complex economic activities. This is because there are various types of income sourced from various economic activities and it is often challenging to attribute them to a particular place or source. Emerging e-

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Association; Toshihiro Ihori, "Capital Income Taxation in a World Economy: A Territorial System Versus A Residence System" (1991) 101:407 The Economic Journal.

[44] APCSIT, *Taxation of Foreign Source Income in Selected Countries* (Canada Advisory Panel on Canada's System of International Taxation 2008); See also Edward Kleinbard, "Throw Territorial Taxation From the Train" (2007) 46:1 Tax Notes International.

[45] Thomas Horst, "A Note on the Optimal Taxation of International Investment Income" (1980) 94:4 The Quarterly Journal of Economics, at 796-798.

commerce is an apparent example.[46] In practice, the manner of determining the source of income is generally based on the nature of income. Income from the performance of services is generally treated as arising where the services are performed. Financing income is generally treated as arising where the user of the financing resides. Income related to use of immovable properties (e.g., rents) is generally treated as arising where the property is situated. Income related to use of intangible property (e.g., royalties) is generally treated as arising where the property is used.

1.1.1.3 Residence-based income taxation system

An alternative to the source-based income tax system is the residence-based system. Under this tax system, residence is considered to be the principal factor used to establish tax jurisdiction. The system emphasizes whether a person has substantial social and economic connections to a particular jurisdiction, which, in return, allows this jurisdiction to impose tax liability on that person. Consequently, a country, which employs the residence-based income taxation, taxes its residents on their incomes regardless of their source.[47]

According to common practice, one of the main determinants of tax residence for individuals is the existence of substantial social and economic ties with particular jurisdiction (e.g. owning adobe, maintaining family ties, and employment). Sometimes, a person may be physically present in a particular jurisdiction for a particular period of time without developing the

[46] Dale Pinto & Documentation International Bureau of Fiscal, *E-commerce and Source-based Income Taxation* (Amsterdam: IBFD, 2003). (The author argues that source-based taxation is theoretically justifiable for income that arises from international transactions, which are conducted in an electronic commerce environment. However, the thesis also argues that the way in which the source of income is defined needs to be reconceptualised because the application of source-based taxation under traditional principles may be rendered problematic in light of certain characteristics of electronic commerce that are significant from a tax perspective).

[47] Leland Badler, "The Residence Concept and Taxation of Foreign Income" (1951) 51:3 Columbia Law Review.

aforementioned social and economic ties. In such circumstance, the person is still deemed to be resident in that jurisdiction for tax purposes if he or she has spent there for more than 183 days.[48] The rationale is that if a person has spent this much time in the country even without developing substantial social and economic ties (which is difficult in practice), the person has a stake in that country which is not markedly different from that of who lives there permanently, and is thus obliged to pay tax to that country.

As for corporations, a default rule to establish their tax residence traditionally has been the place of incorporation. However, lately countries have shifted their focus from the place of incorporation to another factor – central management and control, that is, they attribute tax residence of entities to a place where their central management and control actually reside.[49]

The residence-based tax system gets strong theoretical support from 'capital export neutrality', 'economic allegiance', 'benefits', and 'ability-to-pay' theories. For example, the capital export neutrality (CEN) doctrine holds that a resident's decision whether to carry out business or investment activity domestically or abroad should not be distorted by locational tax factors or rates.[50] It is argued that the residence-based tax regime supports this neutrality by maintaining

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[48] See "tax sojourner" rules in national tax laws. For example, the Canadian Income Tax Act (R.S.C. , 1985, c. 1 (5th Supp.)), Paragraph 250(1)(a). Available at http://laws-lois.justice.gc.ca/eng/acts/I-3.3/.

[49] This test was first enunciated in the De Beers Consolidated Mines v. Howe (1906). The corporation whose residence was in issue was incorporated in South Africa, had its head office in South Africa, and carried on its business of mining in South Africa. Because a majority of the board of directors lived in England, and the board always met in England and made all major policy decisions there, the House of Lords held that the corporation was resident in England.

[50] See Richard Musgrave, *The Theory of Public Finance: a Study in Public Economy* (New York: McGraw-Hill 1959), at 145-50; Peggy Musgrave, *United States Taxation of Foreign Investment Income: Issues and Arguments* Law School of Harvard University, 1969).

same tax burden on domestic as well as foreign-source income of resident taxpayers so that the resident investor is neither encouraged nor discouraged by tax factors when making locational decisions.

The residence-based income tax system receives theoretical support also from economic allegiance theory. It is one of the most influential theories in contemporary income taxation.[51] The theory starts with the proposition that purpose of the income taxation is to finance government services and a government has no recognizable jurisdiction to tax unless it has an appropriate and sufficient economic connecting factor to the taxpayer. In order to determine true economic connection, the founders of the economic allegiance theory posed three fundamental questions: a) where the wealth is really produced? b) where is it owned? and, finally, c) where is it disposed of?[52] Based on the answers for these questions, the source of income and the residence of income earner were chosen as two main elements of connection.[53] However, the problem was to ascertain where the true and primary economic interests of the individual are found. Here, the benefit theory came into play. The benefit theory extends the economic allegiance doctrine by arguing that if a person is a resident in a particular jurisdiction, which is determined largely by reference to the person's physical attachment, economic, and social ties to that jurisdiction over a substantial period of time, it is most likely that the person is benefiting

[51] Liam Murphy & Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (New York: Oxford University Press, 2004).

[52] League of Nations Economics and Finance Commission. *Supra* note 6, at pp.22-23 [4026-4027].

[53] The economic allegiance doctrine was developed by four renowned economists, Gijsbert W. J. Bruins (the Netherlands), Luigi Einaudi (Italy), Edwin R. Seligman (U.S.), Sir Josiah Stamps (U.K.). It was developed as a result of this group's theoretical study on the problem of international double taxation in response to the League of Nations request in 1923. See League of Nations, *Double Taxation and Tax Evasion. Report and Resolutions Submitted by the Technical Experts to the Financial Committee of the League of Nations* Geneva: League of Nations, 1925).

from public goods and services provided by that jurisdiction. The enjoyment of the benefits and services then requires the person to contribute to the financing of these benefits in that jurisdiction.[54] However, it is recognized that the residence state may depend on the `source' state assistance in administering its tax laws, either because the source state has relevant information or because it is in a better position of taxing the income. Therefore, the source state also has the right to tax the income but it should be limited to a mutually agreed percentage.[55]

The benefit theory had one small deficiency: it may imply that only those who are able to and do pay taxes must be entitled enjoy the benefits and protection provided by government. Here came the ability-to-pay doctrine for a further clarification. This doctrine addresses the question as to how distribute the overall tax burden among the members of society. It holds that a total tax burden of government services shall be distributed among its relevant taxpayers according to their capacity to bear it.[56] Thus, the doctrine places an increased tax burden on taxpayers with a higher income and a less or no tax burden on those segments of society with low-income. Given the amount of income tax payable is determined based on the percentage of the income, no income means no tax liability. Today, most countries have integrated this doctrine into their

[54] The benefit doctrine is essentially an extended form of the economic allegiance doctrine. Its main premise is that tax must be seen as a payment for services and goods rendered by government to persons. Joseph Dodge, "Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles" (2004) 58 Tax L. Rev.

[55] League of Nations. *Supra* note 55, at 26, 62-65.

[56] The earlier proponents of the ability-to-pay doctrine were Adam Smith and John Stuart Mills. Adam Smith argues, “Subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities”. Adam Smith, *The Wealth of Nations* (New York: Random House, 1937/1976). Later on John Stuart Mills developed this idea into ‘equal sacrifice’ doctrine. The equal sacrifice doctrine argue that tax contribution of each person towards the expenses of government must be determined in such a way that he shall feel neither more nor less in-convenience from his share of the payment than every other person experiences from his. John Stuart Mill, *Principles of Political Economy With Some of Their Applications to Social Philosophy*, vol. V (London: John W. Parker, 1848). See also Dodge. *Supra* note 45.

income tax system. However, the difficulty is that one's ability-to-pay cannot be accurately established without taking into consideration his or her income from all sources (i.e. from domestic and foreign).[57] The residence-based tax system attempts to addresses this problem by requiring resident taxpayers to declare their income from domestic and foreign sources.

Today, the residence-based tax system is also referred to as 'worldwide income tax system'. However, one distinguishing aspect of the worldwide income tax system from the classic residence-based income tax system is that a country, which operates under the worldwide income tax system, does not restrict its tax jurisdiction on residents. It imposes tax also on non-residents but only on their income earned within its territory. The residence country administers this tax system generally by imposing on its residents the obligation to withhold tax on income payments that they make to non-residents. In this context, the worldwide income tax system integrates the characteristics of both source and residence-based tax systems.

1.1.1.4 Income taxation systems and international double taxation

One of the biggest challenges of the coexistence of these systems is international double taxation. In the absence of compromise between the country of source and the country of residence to deal with their overlapping tax claims, it is quite possible that a person who engages in a cross-border economic activity may end-up with having liability to pay taxes on same income for more than

[57] See David R. Tillinghast, *Tax Aspects of International Transactions* (New York: M. Bender, 1984), at 3 (The modern proponents of the doctrine claim that the ability-to-pay or equal sacrifice cannot be accurately established without taking into consideration the income of taxpayer from all sources (i.e. from domestic and foreign). Tillinghas argues that in the international context, the "ability to pay" is meaningless until one has identified the persons or the enterprises whose wealth is to be taken into account…").

two countries: first, to the country where the income has been earned and then to the country where the person resides.

One of the main reasons for the development of tax conventions or treaties is to mitigate this double taxation problem.[58] In order to resolve this problem, tax treaties include foreign tax credit mechanism.[59] Under the foreign tax credit mechanism, the taxpayer is allowed to deduct the amount of foreign taxes incurred on the income from the tax otherwise payable on this income to the residence country. To the extent that the amount of foreign tax incurred is less than the amount of tax otherwise payable on the income to the residence country, the resident taxpayer is required to pay the difference to the residence country. On the other hand, when the amount of tax paid on the income to the host country is comparable to the amount of tax otherwise payable to the residence country, the taxpayer does not owe any tax on the income to the residence country. If the amount of tax paid on the income to the host country is higher than the amount of tax otherwise payable to the residence country, the latter does not tax the income but neither does it compensate its residents for the excessive foreign taxes.[60] An ultimate result of the foreign tax credit system is that the taxpayer's overall tax burden on foreign-source income would be the higher of the host and residence countries' taxes. Thus, when properly implemented, the foreign

[58] Peter Harris, *Taxation of Residents on Foreign Source Income* (New York United Nations 2013), at 12-28.

[59] OECD Model Tax Convention on Income and on Capital (OECD Committee on Fiscal Affaires ed., OECD 2010), See Article 23. See also Robert Deutsch, Roisin Arkwright & Daniela Chiew, *Principles and Practice of Double Taxation Agreements* (London, UK: BNA International Inc, 2008), at 30-61.

[60] The US income tax law allowed compensation on its foreign-source income earning taxpayers for the excessive foreign tax for a while after it had introduced the foreign tax credit system in 1918. However, a few years later it amended the law (i.e. an amendment to Section 904(a) of IRC) so that no foreign tax credit is allowed for the taxes paid at host country above the US tax liability. See Reuven Avi-Yonah, *International Tax as International Law: An Analysis of the International Tax Regime* (New York: Cambridge University Press, 2007), at 157-158.

tax credit mechanism would eliminate any tax advantage for residents through earning income in low-tax jurisdictions.

1.1.1.5 Predominance of the residence-based income taxation system

Today, an overwhelming majority of states operate under the residence-based income tax system.[61] They tax their residents on their worldwide income, while allowing foreign tax credit for the taxes paid on their foreign-source income to host countries.

As discussed in the preceding sections, this tax system has a strong theoretical base. It also promises a better conceptual tax mechanism for the globalized world where people invest or render services across the globe without departing their country of residence.

In contrast, the source-based tax system has several limitations. As the foreign-source income of resident taxpayers under the source-based tax regime is not taxable, the taxpayers have a strong incentive to move their investments to jurisdictions with lower taxes. This, in turn, encourages countries to engage in international tax competition, undermines national revenue basis and damages taxpayer morale. The residence-based income tax system, on the other hand, may decrease such tax competition and can be one of the potential drivers of harmonization of income tax rates across the globe.

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[61] See Sections 3 (Business taxation) and 6 (Tax on Individuals) of Deloitte Country Taxation and Investment Guides for 2014. The Guides provide the brief and the most up-to-date summary of tax systems of over 150 countries worldwide. The Guides can be downloaded at https://dits.deloitte.com/#TaxGuides . (The guides provide that all countries tax their residents on their worldwide income. See Klaus Vogel, "Worldwide vs. Source Taxation of Income – A Review and Re-evaluation of Arguments (Part I)" (1988):8/9 Intertax 216-229, at 25.

There is also a question of consistency of the classic source-based system with the ability-to-pay doctrine. Under such system, the taxpayer's ability-to-pay tax is measured only in reference to his or her income earned within the country, as the foreign-source income is not taxable. If the taxpayer earns income largely or exclusively from a foreign country, the taxpayer unfairly escapes from taxes in the country of domicile despite his or her overall economic ability to pay taxes and notwithstanding the benefits he or she has received in the country of domicile.

Finally, the residence-based taxation system is mutually inclusive. Its existence does not exclude source-based taxation. In fact, its foreign tax credit mechanism accommodates the source-based taxation. Through the foreign tax credit mechanism, the residence-based tax system admits the source country's tax jurisdiction over its own territory.

Overall, the residence-based income tax system appears a more equitable, fair, and all-inclusive tax system. However, one of the biggest challenges of the system is its enforceability, which we will discuss in subsequent chapters.

1.1.2 Concept and types of tax information

As Thomas Greenaway once eloquently testified there are two mutually inclusive elements for the effective enforcement of income taxes: tax jurisdiction and tax information.[62] Tax jurisdiction is a legitimate authority to prescribe and collect taxes.[63] Tax information is a type of information that enables tax authorities to carry out this mandate. Greenaway argues that the tax

[62] Thomas Greenaway, "Worldwide Taxation, Worldwide Enforcement " (2009):561 Tax Notes International, at 759.

[63] Rutsel Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* (Boston: Kluwer Law and Taxation Publishers, 1989), at 54-66.

jurisdiction without such information is useless; and the tax information without jurisdiction is powerless. Tax enforcement will be real only when both elements are combined.[64]

The income tax is generally assessed on a periodical basis on the net accretion to one's wealth before consumption.[65] Thus, the system requires taxpayers to make a reasonable disclosure of this incident to tax authorities. Without such disclosure, a state would have a great difficulty to enforce its income tax laws.

However, there is a fundamental challenge associated with attaining such disclosure. By nature, people disclose information to others only when they perceive it to be in their own interest to do so, or at least where the outcome of the disclosure would be neutral to their interest; otherwise, they generally tend to hold it back. It also is naïve to believe that people enjoy paying their hard-earned income to the government. In their attempts to understand the roots of tax avoidance and evasion, economics Professors Slemrod and Bakija noted that "it is not anyone individual's interest to contribute voluntarily to government's coffers. Each citizen has a very strong incentive to ride free on the contributions of other, since one's own individual contribution is just a drop in the bucket and does not materially affect what one gets from government".[66] Thus, in the absence of certain enforcement mechanisms, it is not in the taxpayer's immediate selfish interest

[64] Greenaway. *Supra note* 66, at 759.

[65] Generally, the modern concept of income was shaped in the 1920s and 1930s by the American economists Robert M. Haig and Henry C. Simons. They defined the income as "the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question." See Robert M. Haig, "The Concept of Income-economic and Legal Aspects" in Robert M. Haig, ed., *The Federal Income Tax* (New York: Columbia University Press 1921) 1-28; Henry Simons, *Personal income taxation: The definition of income as a problem of fiscal policy* (Chicago University Press, 1938), at 49.

[66] See Joel Slemrod & Jon Bakija, *Taxing Ourselves: a Citizen's Guide to the Debate Over Taxes* (Cambridge: Mit Press, 2004), at 145.

to voluntarily disclose information on their income. This requires some sort of mechanism which ensures reasonable visibility of taxpayers' periodical income positions to the state. The collection, recordkeeping, and reporting of tax-relevant information by private and public bodies provide this structural mechanism.

Tax information is a type of information that is used by tax authorities to determine, assess, collect, and recover taxes. It normally identifies the taxpayer, verifies her residence, income, and expenses, and establishes links between these elements. Tax information covers a range of documents, records that are relevant and material to the application of tax laws.

When a resident taxpayer is involved in cross-border business and investment activities, tax information is generally located beyond the territorial reach of the residence country. To address this problem, countries have to cooperate with each other.

It is dangerous to draw generalization about tax information, as the concept is generally broad and constantly evolving phenomenon as the economies and financial systems evolve. Nonetheless, several characteristics seem to stand out according to current tax enforcement practice. There are typically five broad categories of information that are crucial for the enforcement of income taxes:

a) Information on taxpayer's identity;
b) Information on taxpayer's residence status;
c) Information on taxpayer's income status;
d) Information on taxpayer's ownership status;
e) Information on foreign taxes incurred.

1.1.2.1 Information on taxpayer's identity

The enforcement of income taxes requires information on taxpayers' identity. The taxpayer identification is the first step to enforce income tax laws. It is important for the following reasons: income tax is levied on income but it is the income earner – the economic owner of the income who discharges the tax liability. Therefore, there is need to determine whom the income belongs and who need to carry the tax liability. Moreover, the tax laws apply various tax rates to various taxpayers (i.e. marginal tax rates) depending on the taxpayer' income earning capacities and the type of income they earn. Generally, individual taxpayers are taxed at progressive rates.[67] Thus, without determining whom this income belongs to and putting this income together with that person's income from other sources, it would be difficult to apply proper marginal tax rate.

The taxpayer identification is generally achieved thorough collecting and verifying taxpayer's basic personal information such as name, date of birth, and tax identification number of the taxpayer (TIN).

The TIN is a unique identification number assigned by government to each taxpayer. It is a crucial and relatively effective tool that enables tax authorities to identify taxpayers when dealing with massive number of taxpayers with similar names and dates of birth.

1.1.2.2 Information on taxpayer's residence status

Information on taxpayer's residence is also crucial for the application of income tax laws. It essentially allows a state to determine whether it has a jurisdiction to tax the person, and if so, to

[67] John Buenker, *The Income Tax and the Progressive Era* (US, New York Garland Publishing 1985); Joel Slemrod, *Tax Progressivity and Income Inequality* (Cambridge, UK: Cambridge University Press, 1994).

what extent. As a general rule, most countries tax their residents on their worldwide income, while taxing non-residents on their income sourced within their territories.[68] Therefore, the country needs to establish the residence of the taxpayer for proper application of its tax laws. Furthermore, the person's residence status also determines whether his or her income is taxable at progressive or flat rate. Under most jurisdictions' income tax laws, residents are liable to pay income taxes at progressive rates, while non-residents are subject to withholding taxes, which are essentially flat.[69]

The information on taxpayer's residence status includes any fact or indicia that establish or deny the person's tax residence in a particular jurisdiction. These include the existence of home, family, economic or social ties in a particular country.

1.1.2.3 Information on taxpayer's income and ownership statuses

Tax authority's ability to determine taxpayers' income statuses is a next crucial step for the proper enforcement of income tax laws. In order to assess income tax, the tax authorities need to establish the quantum and character of taxpayer's income (e.g. whether it is an employment income, profit, property income, or capital gain) as well as the quantum and character of expenses incurred for the purpose of earning that income. Most countries require their tax residents to declare these information items in their year-end tax returns.

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[68] Murphy & Nagel., Kevin Holmes, *International Tax Policy and Double Tax Treaties: An Introduction to Principles and Application* (Amsterdam: IBFD Publications 2007).

[69] The Canadian Income Tax Act (R.S.C. , 1985, c. 1 (5th Supp.)), Section 212. Available at http://laws-lois.justice.gc.ca/eng/acts/I-3.3/.

Often establishing the taxpayer's ownership status would facilitate to determine his or her income status. Today, most businesses are carried and investments are held through entities, which themselves are generally considered as separate taxpayers. These are corporations, partnerships, and trusts. Thus, an ultimate owner of the business or investment is typically hidden behind corporate curtain. A common practice in international tax evasion schemes is to incorporate multiple layers of entities (i.e. sandwich mechanism) in jurisdictions with strict commercial secrecy provisions in order to hide ones foreign property ownership. For example, the laws of some countries require no identification of shareholders or directors, neither do they require the maintenance of financial records. Even if tax administrators have access to the records of corporations, they may not be able to get any useful information.

Moreover, in some cases, resident taxpayers transfer their assets abroad using a series of transactions intended to camouflage the flow of money, and the money would then be transferred back to the same country, but under a foreign company name (i.e. round-tripping). The only difference is that, after making its excursion to a foreign country, the returned investment no longer formally belongs to the resident taxpayer (i.e. beneficial owner) liable to tax on worldwide-income basis. Instead, the investment is seen as the property of the foreign company established under foreign laws. Thus, the income earned through this investment is treated as income to non-residents, which often enjoys favourable tax treatment.

In such cases, being able to trace the beneficial owner of the entities and investment is important for enforcement of tax laws and the tax information allows the states to achieve this goal.

1.1.2.4 Information on taxpayer's foreign tax status

Unlike domestic-source income, foreign-source income is generally subject to tax also in the host country (See Section 1.1.1.4). The payer of income normally withholds the host country's taxes and remits the after-tax income payment to the non-resident taxpayer. Therefore, any imposition of tax by the residence country on the foreign-source income constitutes a second layer of taxation on the income, and thus may cause international double taxation. In order to mitigate the international double taxation, when taxing foreign-source income of its residents, the residence country normally allows (unilaterally or bilaterally) foreign tax credit for the taxes that the resident taxpayers incurred in the host country. However, in order to properly apply a foreign tax credit, residence country may need to have information as to the amount of foreign tax incurred by the taxpayer on the foreign source income. The obligation to provide such information to the residence country normally rests with the taxpayer. The taxpayer obtains such information from the tax authorities of host country. In most cases, this will be the copy of receipts, certificate, or the documents issued by host country's tax authorities that confirms the payment and amount of the host country's income taxes.

1.2 Sources of tax information

1.2.1 Sources of tax information on domestic income

In a purely domestic context, tax authorities administer income tax laws by relying on the information obtained primarily from two sources:

a) Self-assessment reports;

b) Third-party's tax information reports.

1.2.1.1 Self-assessment reports

Generally, paying taxes is a fundamental constitutional obligation. Persons on whom this obligation mainly falls are statutorily defined as tax residents. The tax obligation of resident taxpayers involves typically three basic requirements:

a) **Tax registration.** Generally, an individual or entity aiming to commence an economic activity has to register with a relevant tax authority. For this purpose, the person is required to undergo basic identification process by providing the tax authority his or her name, address, and if necessary, the statement of the nature of purported economic activity or business. Upon registration this data, the authorities issue the person a specific identification number that is commonly known as tax identification number (TIN) or in some countries, social insurance number (SIN). This number is then used to identify the taxpayer for fiscal or other social purposes.

b) **Record keeping.** The registration with fiscal authorities generally entails the taxpayer a duty to maintain his or her financial records.[70] The scope of such recordkeeping depends on the type of taxpayer, the nature of economic activity, and the government's access to such information through other sources. For example, if the taxpayer is an employee, the recordkeeping obligation normally rests with the employer, while the recordkeeping obligation with respect to tax-deductible personal expenses remains with the taxpayer to the extent the person intends to claim tax deduction for such expenses.

Corporate taxpayers, on the other hand, are generally subject to strict recordkeeping rules; income tax laws require these taxpayers to keep their tax relevant records in certain forms and for a specified period of time.[71]

These records must typically allow tax authorities (a) to identify the taxpayer; b) to verify the source, type of income earned as well as deductible expenses, benefits, and allowances. Noncompliance with the recordkeeping obligation may result in the denial of deductions and sometimes civil, administrative, or criminal penalties.

C) Tax reporting. Tax residents are also required to make full and timely self-declaration of their taxable income to fiscal authorities. Such reports are generally

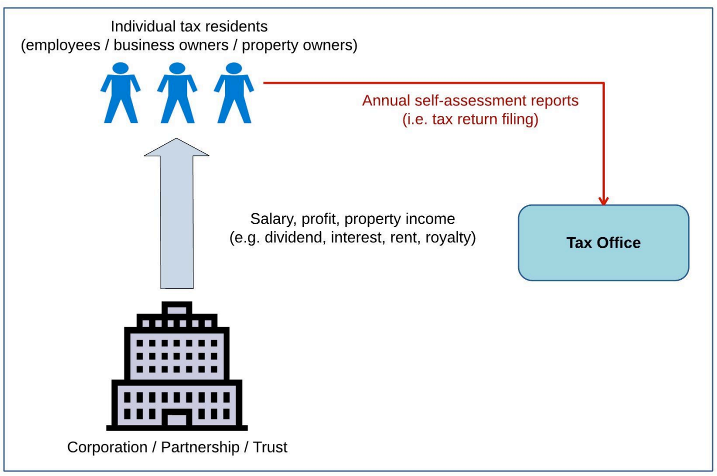
[70] S. 6001 of the Internal Revenue Code of the United States; ss.230(1) of the Income Tax Act of Canada; CH14100, the United Kingdom, S.140. Available at http://www.hmrc.gov.uk/sa/rk-bk1.pdf; http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Recordkeeping; http://www.cra-arc.gc.ca/tx/bsnss/tpcs/kprc/menu-eng.html.

[71] Chris Evans, Shirley Carlon & Darren Massey, "Record Keeping Practices and Tax Compliance of SMEs" (2005) 3:2 eJournal of Tax Research.

submitted annually and is often referred to as "self-assessment reports".[72] Self-assessment is a written declaration to fiscal authorities by taxpayer of his or her incomes and tax-deductible expenses applicable to a particular period of time. It crystallizes the liability to pay tax and determines the amount and time at which the tax is due.

Self-assessment is typically performed by filing annual tax return in a form prescribed by a competent tax authority (*see* Figure 1). Generally, a tax return has three major components: a) declaration of income; b) declaration of tax deductible expenses, allowances and eligible tax credits; and finally c) the computation of actual tax paid and/or payable for the year by subtracting tax deductions, allowances from income, and applying tax credits and determining applicable tax rates, and consequently overall tax liability.

Figure 1. Self-assessment / Self-reporting



The self-assessment report is the most common single source of tax information as well as the most common method of tax administration currently available and used by tax authorities in many countries. It asserts that taxpayers can and should be trusted to compute and determine their own income tax liabilities and pay them to the government.

[72] Self-assessment is timely filing and reporting of required tax information, the correct self-assessment of one's taxes owed, and timely payment of these taxes without much enforcement action. See Carlos Silvani & Katherine Baer, *Designing a Tax Administration Reform Strategy: Experiences and Guidelines* (US, Washington DC: International Monetary Fund, 1997), at 11; N. Barr, S. James & A. Prest, *Self Assesment of Income Tax* (London, UK: Heinemann Educational Books, 1977), at 3-8.

However, this raises an important question: what if the taxpayers fail to make self-assessment or files false self-assessment reports? There is already a long-running theory and a myriad of practical evidence, which establish that taxpayers have no special commitment to honesty when it comes to paying taxes.[73] The taxpayers' decision to declare or not to declare their income is generally determined by the expected outcome of the decision, namely the likelihood of detection of the misreporting or non-reporting.[74] Generally, if the likelihood of detection is higher, they more likely declare their income. If this is not the case, they less likely declare their income.[75] Consequently, in such cases, the way to ensure tax compliance would be to make the expected utility of compliance higher than the expected utility of noncompliance. As such, tax compliance behaviour is expected to improve as the detection or visibility of tax non-compliance

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[73] Tax noncompliance for rents and royalties, for instance, equalled 51%, for non-farm proprietor income, 57%, and for farm income tax noncompliance rate was 72%. Meanwhile, tax compliance rates for income subject to automatic withholding (wages and salaries) and information reporting (interest and dividend income) were estimated to be around 99 and 95%, respectively. See IRS, Tax Gap Figures in 2001, at 2, 3. Available at http://www.irs.gov/pub/irs-news/tax_gap_figures.pdf; See also Richard Doernberg, "Case Against Withholding" (1982) 61 Tex. L. Rev. at 595 (Doernberg argues that the US tax system is often said to be one of self-assessment, but for some time it has been known that tax compliance is the highest where self-assesment is the least relied upon. The effectiveness of the system is rooted primarily in the government's ability to verify returns filed by taxpayers).

[74] The theory is often referred to as an "economic deterrence model". See Michael Allingham & Agnar Sandmo, "Income Tax Evasion: a Theoretical Analysis" (1972) 1:3-4; Jeffrey Roth, John Scholz & Ann Witte, *Taxpayer Compliance* (Philadelphia University of Pennsylvania Press 1989), at 82; Henrik Kelvin *et al.*, "Unwilling or Unable to Cheat? Evidence from a Tax Audit Experiment in Denmark " (2011) 79:3 Econometrica, at 689. (The authors note that one possible explanation for higher rates of tax noncompliance or underreporting of taxalble income is the lower probablity of detection associated with some types income).

[75] Ibid., at 324-325 (The authors argue that if tax liability on a self-reporting form is accurate, then the taxpayer receives some level of utility from the after tax-income. If the taxpayer reports less than the actual taxable income, then the outcome is uncertain because tax authorities may or may not discover the unreported income. If it is not detected, the taxpayer is better off than if he or she reported accurately. But if the unreported income is detected, then he or she is worse off because tax due is collected together with penalties and interests. Therefore, the expected utility of underreporting a given amount of taxable income depends on the probability of detection of the respective income by tax authorities).

becomes more probable. Some scholars refer to this phenomenon as the 'visibility effect'.[76] Professor Kagan argues that the visibility of income-yielding transaction to tax authorities has an enormous impact on tax compliance.[77]

One way to ensure such visibility is to pair the self-assessment with some kind of complementary mechanism that allows tax administrations to verify the accuracy and truthfulness of self-assessment reports. This mechanism is called "third-party reporting".[78] Governments often employ this mechanism, where it is possible, as a parallel source of tax information.

1.2.1.2 Third-party tax reporting and tax withholding

Third party tax reporting. Entities play a central role in the administration of income taxes.[79] As taxpayers, they have to maintain books of their revenues and expenses for accounting and tax purposes. They also document payments made to their employees, suppliers, and creditors so that they can claim deductions for these business expenses. This creates a third-party paper trail of

[76] Robert Kagan, "On the Visibility of Income Tax Law Volations" in J. Roth, J. Scholz & A. Witte, eds., *Taxpayer Compliance* (Philadelphia: University of Pennsylvania Press 1989), at 77; Robert King Merton, *Social Theory and Social Structure* (US, New York: Simon and Schuster, 1968), at 320 (Merton notes that without direct and immediate observability deviant behaviour can cumulate).

[77] Kagan. *Supra* note 69, at 78.

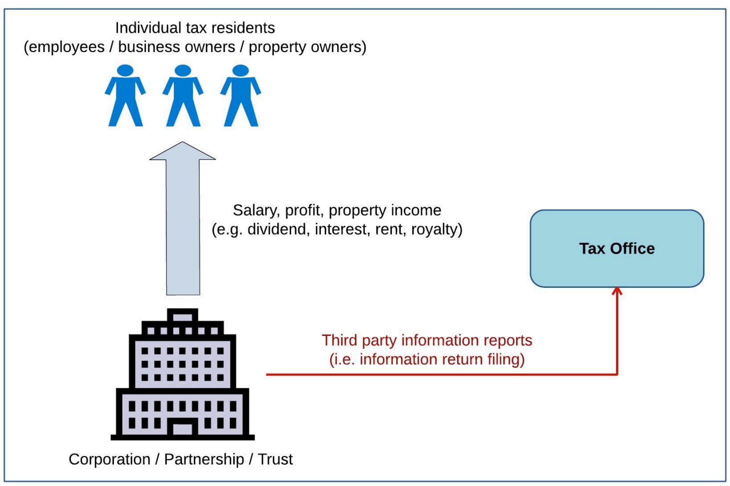
[78] James Alm, John Deskins & Michael McKee, "Third-Party Income Reporting and Income Tax Compliance" (2006) 06-35 Georgia State University Experimental Economics Center Working Paper; Center for Tax Policy and Administration, *Third Party Reporting Arrangements and Pre-filled Tax Returns: The Danish and Swedish Approaches* (Paris: OECD, 2008); OECD Center for Tax Policy and Administration, *Using Third Party Information Reports to Assist Taxpayers Meet their Return Filing Obligations— Country Experiences With the Use of Pre-populated Personal Tax Returns* (Paris OECD 2006).

[79] Wojciech Kopczuk & Joel Slemrod, "Putting Firms Into Optimal Tax Theory" (2006) 96:2 American Economic Review; Henrik Jacobsen Kleven, Claus Thustrup Kreiner & Emmanuel Saez, *Why Can Modern Governments Tax so Much? An Agency Model of Firms as Fiscal Intermediaries* (Cambridge, MA: National Bureau of Economic Research, 2009).

information, which is of a great interest to tax authorities to verify tax liability of other taxpayers. This coincidence of interests between the private parties, who seek tax deduction for their expenses, and government, who seek to levy tax from recipients, creates an informal alliance between these parties for effective enforcement of tax laws.

Thus, government requires the payers of income (e.g. employers) or the facilitators of income payments (e.g. financial institutions) to report to fiscal authorities information on payments made to other taxpayers. Generally, these private parties have two kinds of reporting obligation: automatic reporting (without a specific request from the tax authorities) and a specific reporting (in response to a specific request from tax authorities).

Figure 2. Third party reporting



Third party information reporting is typically performed in the form of filing monthly or annual information returns with local tax authorities reporting (*see* Figure 2).[80] They file information returns, often with a copy to the taxpayer, on salary, wage, dividend, or interest income payments made to their employees or customers.[81]

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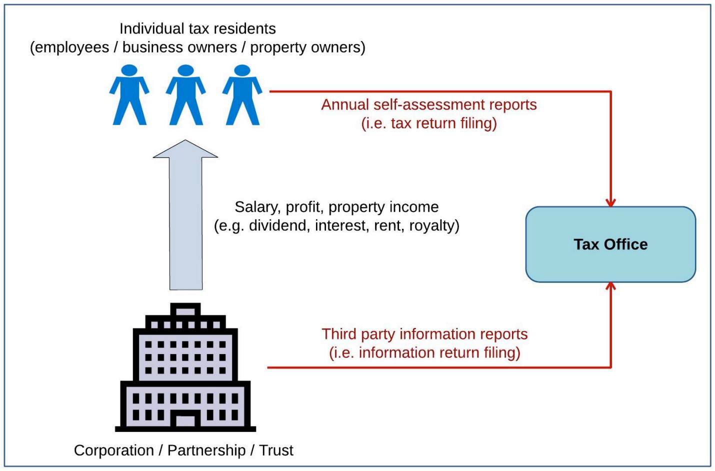
[80] In Canada, Ireland, Japan, Norway, and the US, third party information reports are made annually, while in New Zealand and the UK such reports are required to be filed monthly. See OECD Center for Tax Policy and Administration. See *Supra* note 71, at 37-56.

[81] OECD Center for Tax Policy and Administration. *Supra* note *71,* at 222-223.

Figure 3. Income matching



This third-party information reporting mechanism enables tax authorities to verify *the bona fides* of taxpayer's annual income reports to the tax administration by systematically matching them with the self-assessment reports presented by taxpayers (*see* Figure 3).

In practice, this verification procedure is known as "income matching".[82] It is designed to identify potential discrepancies in the reports.[83] If the discrepancies are substantial, tax authorities may ask the reported parties, normally the taxpayer, for an explanation.

However, the third-party tax information reporting mechanism is not always possible, especially when the taxpayer is a self-employed person. In this case, the lack of permanent relationship between the taxpayer and a particular third party makes it difficult to subject the latter to third-

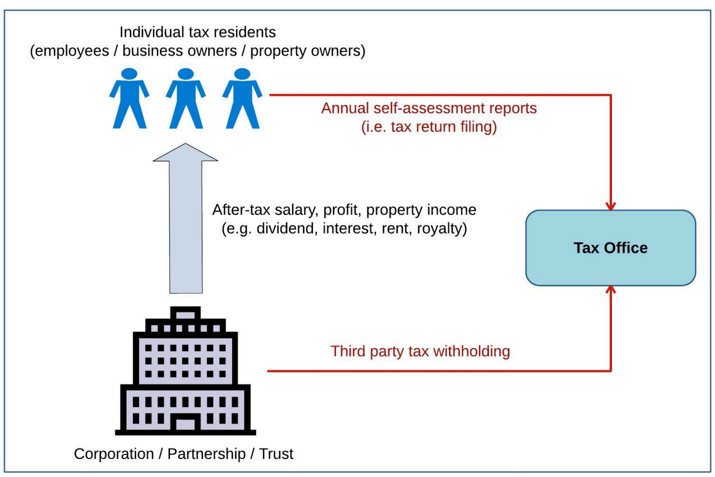
[82] James Alm, John Deskins & Michael McKee, "Third-Party Income Reporting and Income Tax Compliance" (2006) 06-35 Georgia State University Experimental Economics Center Working Paper.

[83] J. Block, *How to Avoid an IRS Audit?* Available at http://www.wwwebtax.com/audits/audit_avoiding.htm (The article notes that the US tax authorities use a special computerized system to match the tax information reports of taxpayers on their tax return with information gathered from banks and others. For example, if a taxpayer fails to report on its tax return the interest earned on bank savings account, the IRS typically discover it when it matches the bank's interest payment records, called 1099 forms, against the tax return.)

party tax information reporting requirement. Evidence suggests that the taxpayers often take full advantage of this information asymmetry.[84]

Third-party tax withholding. In all advanced economies, most income taxes are collected also through third parties. Traditionally, this is referred to as 'third-party tax withholding' or 'pay-as-you-go'. The third party withholding is a mandatory requirement for most payers of income to deduct and withhold tax at source from the payment they made to the income recipients, and to transmit the proceeds of withholding to the government. The payer of an income essentially holds back a portion of the income and remits it to the tax authorities, to be applied against the payee's tax liability. Thus, the government collects the tax not directly from the person who receives the income but indirectly, from the person who pays it (*see* Figure 4). The withheld tax is then treated as a prepayment on account of the recipient's final tax liability. The mechanism is often used in parallel or in lieu of third-party information reporting.[85]

Figure 4. Third party tax withholding and self-reporting



[84] Piroska Soos, "Self-Employed Evasion and Tax Withholding: A Comparative Study and Analysis of the Issues" (1990) 24 UC Davis L. Rev., at 120-122.

[85] Withholding tax system was first introduced in Germany to collect income taxes during World War I. By early 1940s, Australia, Canada, and the United Kingdom followed the suit and instituted withholding tax on wage income. The United States introduced it in the Current Tax Payment Act in 1943. It applied to wage and salary incomes. Ibid., at 125; See also Charlotte Twight, "Evolution of Federal Income Tax Withholding: The Machinery of Institutional Change" (1995) 14:3 Cato Journal.

A portion of the withheld tax may generally be refunded at the end of a fiscal period when the taxpayer files tax return and if it is determined that the recipient's annual assessed tax liability to the government is less than the tax actually withheld. Conversely, the taxpayer may be required to make an additional tax payment if it is subsequently determined that the assessed tax liability is more than the tax actually withheld.

Today, virtually every country uses the third-party tax withholding mechanism. In these countries, the withholding mechanism applies mainly to employment income such as salary and wage but not necessarily so for investment income (e.g. interest or dividends). The latter is generally subject only to the information reporting unless the recipient is a non-resident taxpayer from whom income tax might otherwise be difficult to collect.

1.2.1.3 Coexistence of the self-assessment, third-party reporting, and tax withholding regimes

One may wonder whether the third-party information reporting mechanism or third party tax withholding mechanism would make the self-assessment reports redundant. After all, the government has already received the information from third parties to apply income taxes on a particular taxpayer (e.g. in case of the third party reporting mechanism) or it has already collected the taxes on income of the taxpayer (e.g. in case of the third-party withholding mechanism).

In practice, each of these mechanisms complements the other. **First,** information reports that government receives from third parties are typically incomplete to determine a taxpayer's final tax liability; the report does not include information about the taxpayer's personal expenses (e.g. childcare, moving, educational expenses), which are often deductible for tax purposes. Such information normally rests with the taxpayer. Thus, the final tax liability cannot be determined without combining information from both ends at the end of the year. The same is true with the tax-withholding regime as it is normally levied on gross income at source. Thus, the amount of tax withheld is inaccurate until the end of fiscal period where the gross income is adjusted with the taxpayer's deductible expenses.

Second, most countries apply progressive income tax rates for individual taxpayers.[86] Under the progressive income tax system, an increase in the taxable income base leads to a marginal increase in applicable tax rate.[87] If the taxpayer earns income from more than one source, and from more than one place, each third party or tax-withholding agent has no information about the taxpayer's other income source. An applicable marginal tax rate and final tax liability can be determined only on the basis of the tax information declarations completed and submitted by all involved third parties and the taxpayer following the year-end. Any over or underpayment of tax is then rectified: the overpayment is refunded and the underpayment is collected.

1.2.2 Sources of tax information on foreign income

1.2.2.1 Self-assessment reports

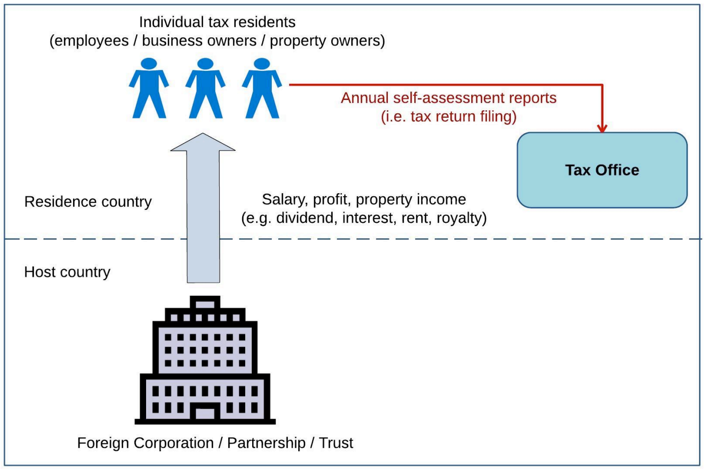
As briefly discussed above, a residence-based income tax system requires residents to report and to pay tax on all of their income, regardless of source, to their country of residence. Therefore, engaging in a cross-border economic activity generally entails the same registration, recordkeeping, and tax reporting requirements as engaging in an economic activity domestically

[86] Slemrod. *Supra* note 58.

[87] Edward McCaffery, ed., *Fair not Flat : How to Make the Tax System Better and Simpler* (US, Chicago University of Chicago Press 2002), at 10.

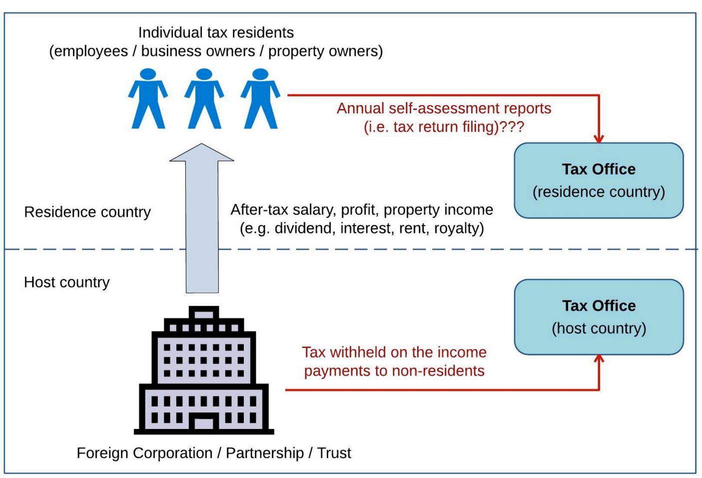
(see Section 1.2.1.1). In other words, resident taxpayers are generally required to register with the residence country's relevant tax authority, comply with recordkeeping obligations, and make periodical declaration of their foreign-source income to their country of residence (*see* Figure 5).

Figure 5. Self-assessment in cross-border context



However, the tax implications of foreign-source income are little complex. A cross-border activity raises a basic tax issues. One important corollary of earning foreign-source income is its vulnerability to international double taxation. Unlike domestic-source income, foreign-source income is normally subject to tax also in the host country (See Section 1.1.1.4). The payer of the foreign-source income (normally, a foreign entity) withholds host country taxes upon remittance of the income to the non-resident taxpayer (*see* Figure 6).

Figure 6. Self-assessment, double taxation, and information asymmetry



The tax enforcement on foreign-source income raises the same fundamental question: what if the resident taxpayer fails to report the foreign-source income to the residence country? For example, in their reports to US Congress in connection to the Patriot Act, US tax authorities estimated that 90% of US persons with foreign bank accounts fail to report their interest income from foreign banks to the IRS.[88] Another study estimates that yields on 80-90% of foreign-held assets by the wealthy residents of developing countries are never reported to their country of residence.[89]

The question is whether the state has *ex-ante* structural mechanisms to establish and verify the taxpayer's foreign-source income. To be more specific, whether state has access to information on the foreign-source income.

1.2.2.2 Third-party tax reporting and withholding (or absence thereof)

Information concerning the foreign-source income of resident taxpayers is normally located beyond the reach of the residence country. As a fundamental principle of international law, a state cannot extend its administrative jurisdiction to the territory of another.[90] This means that a state's domestic tax administrative mechanism such as third-party tax reporting or third-party tax withholding requirements have no force of law in another state's territory.

Given these facts, taxpayers face very little risk of visibility of their foreign-source income to the tax authorities of their residence countries. The absence of such systematic tax enforcement

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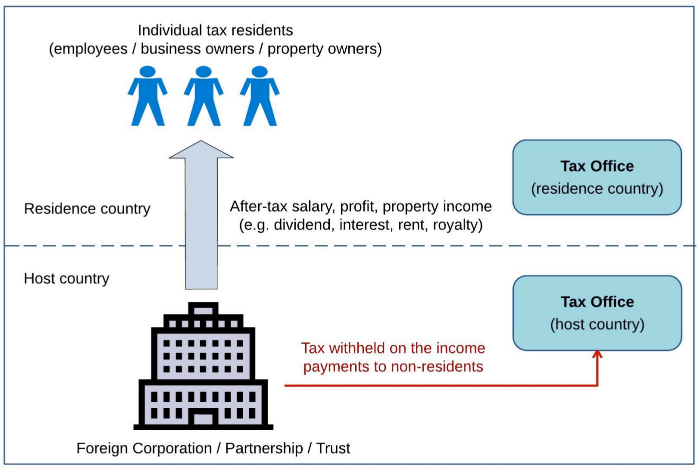
[88] David Tillinghast, "Issues of International Tax Enforcement " in H. Aaron & J. Slemrod, eds., *The Crisis in Tax Administration* (Washington D.C.: Brookings Inst Press, 2004), at 50.

[89] Markus Mainzer, *The Creeping Futility of the Global Forum's Peer Reviews* (London: Tax Justice Network 2012), at 25.

[90] For a discussion of the territorial authority, as an aspect of public international law. See Lasse Oppenheim, *International Law: A Treatise, Vol. 2* London, Longmans, Green and Co, 1944), at 386-458 (Concluding that a state may not exercise an act of administration or jurisdiction on foreign territory without permission and that as all persons within the territory of a state fall under its territorial authority, each state normally has jurisdiction – legislative, curial, and executive – over them); See also Asif Qureshi, *The Public International Law of Taxation: Text, Cases and Materials*, 1 ed. (London: Graham & Trotman, 1994), at 308 et seq.

mechanism encourages resident taxpayers not to report their foreign-source income to their residence countries and ultimately to evade the residence country taxes for the respective income (*see* Figure 7).

Figure 7. Taxpayer non-reporting and information asymmetry



The problem exacerbates when the resident taxpayer derives income from a controlling interest in a foreign entity that is located in a low-tax jurisdiction. In such a case, the taxpayer could defer the entity's income distribution decisions to permanently defer his tax-reporting obligation to the residence country. This is because the resident taxpayer holding a controlling interest (normally, 50% or more) in a foreign entity has sufficient power to influence the entity not to distribute the profits (i.e. dividends).

This was a serious problem given the corporation is a separate taxpayer. If it does not distributes the profits to its controlling shareholder, and then the shareholder has no income to report to his or her residence country. Without having rules in place to address this problem, this would result in permanent deferral of the residence country taxes on the foreign-source income earned through foreign controlled entities. The magnitude of such tax deferral is usually huge depending on the rate of return on the deferred taxes, and the period of deferral. Under standard present value calculations, extended deferral is nearly equivalent to tax exemption.[91]

As a response to this problem, a number of countries have adopted special anti-deferral rules, which have come to be known as "controlled foreign company rules" or "controlled foreign affiliate rules".[92] They require the resident taxpayers who have controlling interest in foreign entities that are located in relatively 'low-tax' or 'no-tax' jurisdictions to currently report the part of the profits of the controlled foreign entity corresponding to their ownership interest and attribute this profit to the resident taxpayer even though the profits have not yet been distributed or paid (i.e. taxation on accrual basis). In this case, the tax reporting requirements apply both for the resident taxpayer and the controlled foreign corporation (CFC).[93] Typical conditions for the application of CFC reporting regimes are that (a) a domestic taxpayer "controls" the foreign entity; (b) the entity is located in a "low tax" jurisdiction or a jurisdiction that imposes a tax rate lower than the rate (as specifically defined) in the shareholder's country creating a substantial tax advantage.

The United States was the first country, which pioneered the CFC rules in 1962 after which many other countries followed suit. Today, the number of countries applying CFC rules to their resident taxpayers holding controlled foreign companies reached over 25.[94] From the residence

[91] See Brian Arnold & Michael McIntyre, *International Tax Primer* (The Hague Kluwer Law International 2002), at 89.

[92] The United States was the first country which pioneered CFC rules in 1962 after which many other countries followed this practice. These countries are mostly industrialized and capital exporting countries. See Michael Lang, *CFC legislation, Tax Treaties and EC Law*, vol. 8 Kluwer law international, 2004), at 17.

[93] Ibid.

[94] Arnold & McIntyre. *Supra* note 88, at 87.

country's perspective, these rules seem to work in practice. However, they apply only to resident taxpayers' controlled foreign interests, and are not applicable to their foreign portfolio interests.

1.2.2.3 Tax whistle-blower reporting

Today, some countries have special laws and programs that facilitate the flow of a specific source of information to fiscal authorities. They offer a large monetary reward and guarantee protection from possible retaliation or harm for private persons who have knowledge about abusive taxpayer behaviour of fellow residents and who come forward to inform tax authorities about them. The 'Tax Relief and Health Care Act' of the United States,[95] 'Public Interest Disclosure Act' of the United Kingdom, and the 'Offshore Tax Informant Program' of Canada, are examples of such laws and programs.[96]

For example, in the summer of 2007, a computer technician of a Lichtenstein bank, LGT, sold the German tax authorities CDs.[97] The CDs contained confidential financial information on thousands of German and non-German residents suspected of holding millions of euros in undeclared accounts with the bank. Germany paid the informant roughly €5 million in

[95] On 20 December 2006, the US adopted legislation – the Tax Relief and Health Care Act. See also http://www.irs.gov/uac/Whistleblower-Informant-Award.

[96] The Public Interest Disclosure Act of the United Kingdom came into force on 2 July 1999. The Act protects workers that disclose information about malpractice at their workplace, or former workplace, provided certain conditions are met. See Pyper. *Supra* note 23; See also the Offshore Tax Informant Program in Canada introduced in the 2013 Federal Budget on March 21, 2013. Launched as part of the Canada Revenue Agency's efforts to fight international tax evasion and aggressive tax avoidance, the program allows the CRA to make financial awards to individuals who provide information related to major international tax non-compliance that leads to the collection of taxes owing.

[97] Spiegel Staff, *Supra* note 24; Brian Arnold, *Tax Discrimination Against Aliens, Non-residents, and Foreign Activities : Canada, Australia, New Zealand, the United Kingdom, and the United States* (Toronto, Ontario: Canadian Tax Foundation, 1991).

remuneration and shared the information with the tax authorities of other countries.[98] This has broken open one of the massive tax evasion investigations across the globe.[99]

Another similar case was known as the "UBS case". In April 2007, Brad Birkenfeld, a former U.S. employee of a Swiss bank, UBS, delivered the US Internal Revenue Service (IRS) a stolen bank data about thousands of U.S. accountholders holding undeclared accounts in the UBS in Switzerland.[100] The data resulted in as many as 30,000 U.S. taxpayers confessing for holding undeclared foreign bank accounts and recovering as much as $5 billion in taxes and penalties to the US Treasury.[101]

At the end of 2008, a former employee of the Geneva office of HSBC, Hervé Falciani, offered the French government a confidential bank data concerning about 130,000 foreign customers of HSBC. France's finance minister at the time, Christine Lagarde, shared the list with other countries including Germany, Greece, Italy, and the US. This list was often referred to as the "Lagarde list". On the strength of the information he provided, HBSC was forced to pay a $1.9 billion settlement with the US. One peculiarity of this case is that Falciani systematically refused rewards for the supplied data from governments.[102]

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[98] Dougherty & Landler. *Supra* note 25.

[99] Esterl, Simpson & Crawford. *Supra* note 26.

[100] Hilzenrath. *Supra* note 27.

[101] Laura Saunders & Robin Sidel, "Whistleblower Gets $104 Million" The Wall Street Journal (11 September 2012). Available at http://online.wsj.com/article/SB10000872396390444017504577645412614237708.html.

[102] Martin Hesse, " Swiss Bank Leaker: 'Money Is Easy to Hide'" Spiegel International (16 July 2013). Available at http://www.spiegel.de/international/business/interview-hsbc-swiss-bank-whistleblower-herve-falciani-on-tax-evasion-a-911279.html.

Recently, in April 2013, the tax authorities of German state of Rhineland-Palatinate announced that they had bought a computer disc that contained 40,000 records of information on more than 10,000 German residents holding secret accounts in Swiss banks. The authorities claimed that they had paid the unidentified informant €4 million in remuneration for the data; but they expect the data to yield tax revenues of about €500 million.[103]

Thus, the tax whistle-blower protection laws and programs are designed largely to obtain information on the foreign-source income of resident taxpayers. The amounts of reward for a 'whistle-blower informant' is generally determined as a percentage of tax revenue and penalties recovered as a result of the provided information. For example, the Canadian tax whistle-blower program reward the informant up to 15% of the tax money collected when the information provided leads to the assessment and collection of additional taxes in excess of C$100,000. The US whistle-blower law, on the other hand, pays the informant up to 30% of any tax revenue recouped by the IRS as a result of a whistle-blower's information.[104] For example, in 2012, the Whistle-blower Office of the U.S. Internal Revenue Agency paid Birkenfeld a landmark $104 million award for his UBS disclosure.[105]

Indeed, the whistle-blower laws have added the risk of detection of tax misreporting on foreign-source income and thereby helped to decrease the information asymmetries between the taxpayers and their tax authorities. The promise of lucrative rewards has also created an

[103] See Bartsch. *Supra* note 28; See also a TV news report on France 24 at http://www.youtube.com/watch?v=JVSniNw4PyE.

[104] Daniel Leblanc, "Whistleblowers in Line for Rewards as Ottawa Cracks Down on Tax Cheats" Globe and Mail (21 March 2013). Available at http://www.theglobeandmail.com/news/politics/budget/whistleblowers-in-line-for-rewards-as-ottawa-cracks-down-on-tax-cheats/article10083229/.

[105] Saunders & Sidel. *Supra* note 109.

incentive for people to report abusive taxpayer behaviour of fellow taxpayers. However, these laws have also caused some legal and political challenges.

First, an informant whistle-blower normally obtains such information by breaching foreign banking secrecy, confidentiality laws, or contractual trust obligations. If the whistleblowing act breached the confidentiality or banking secrecy laws, which is often the case, the act may make the evidence vulnerable in court proceedings under the *due process* requirements of law.[106]

Second, on a global level, the whistle-blower laws has a great potential to create tensions between countries. Because under these laws, one government encourages and rewards the act, which another government normally condemns by virtue of its confidentiality and privacy laws. No jurisdiction may be pleased to have its laws attacked by a foreign government and its financial institutions to become a target for a foreign whistle-blower. Neither it would be pleased to see the foreign government's support for such actions. Germany–Lichtenstein and US–Switzerland affairs after the whistle-blowing scandal may provide an apparent example for this argument.[107]

Moreover, in the light of proliferating tax whistle-blower protection laws and practices, the countries, that have already been or have a high potential to become target jurisdictions for

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[106] http://www.jovennarwal.com/insights/potential-pitfalls-of-the-cra-offshore-tax-informant-program/.

[107] See Eric Pfanner & Mark Landler, "Tax Inquiry? Principality Is Offended" New York Times (February 20, 2008). Available at http://www.nytimes.com/2008/02/20/business/worldbusiness/20evasion.html?pagewanted=all&_r=0; Matt Moore, "Germany Expands Probe of Liechtenstein Tax Evasion" USA Today (February 18, 2008). Available at http://usatoday30.usatoday.com/money/world/2008-02-18-germany-tax-evasion_N.htm. (The articles note that Liechtenstein government authorities argued that they would take legal steps to protect banking clients from German investigators. Prince Nikolaus of Liechtensten said in an interview that "the country is moving to a more cooperative stance but, of course, it does not like to be bullied").

whistle-blowers, are taking necessary measures against such laws. They argue that they may decline tax information assistance to their treaty partner if the latter's information request is based on the information obtained from a whistle-blower. For example, soon after the UBS scandal, Switzerland adopted the Ordinance Concerning Administrative Assistance for Tax Convention (Ordonnance relative a l'assistance administrative d'apres le convention contre les impositions "OACDI") on 1 September 2010.[108] Article 5(2)(c) of the OACDI stipulates that a tax information request of a treaty partner is refused if it is grounded on information which was obtained or transmitted by an act punishable under Swiss law. Swiss law makes it a crime to release account holders' names to unauthorized persons. By enacting this act, Switzerland is sending a message to its tax treaty partners not to use stolen data when making tax information requests to Swiss tax authorities.

All these events question the sustainability of this source of information as a stand-alone enforcement mechanism. As far as tax enforcement is concerned, such laws and programs worked only for serious, large, and selective tax cases with strong evidence of abuse. Even though the whistle-blower laws play an important role in the arsenal of information gathering tools, it is not a well-suited tool for regular tax enforcement.

1.2.2.4 Voluntary disclosure under tax amnesty programs

In recent years, governments have also begun to use tax amnesty programs as another common

[108] Xavier Oberson, *Swiss Report: New Exchange of Information Versus Tax Solutions of Equivalent Effect* (Turkey: 2014), at 15. Available at http://www.eatlp.org/uploads/public/2014/National%20report%20Switzerland.pdf

administrative tool in tax enforcement.[109] Tax amnesty is generally a limited time offer by government to taxpayers to come forward and voluntarily disclose their previously undeclared tax liabilities in exchange for forgiveness from general legal consequences of the tax offence. Essentially, it constitutes a special contract between government and its resident taxpayer whereby the latter agrees to disclose its past failure to declare its tax liabilities or underreporting, while the former agrees to waive the taxpayer from due criminal and civil charges that may result from the non-compliance. This allows the non-compliant taxpayers to regularize their past tax liabilities and to free themselves from potential criminal and civil penalties.

Tax amnesty is initiated generally when government perceives that the tax revenue it actually raises appears less than what it reasonably expects. Thus, the amnesty is intended to claw back the uncollected revenue due to taxpayers' past errors in tax liabilities, wilful omissions in tax declaration, and to allow them a smooth transition from tax delinquency to permanent tax compliance in the future.

In practice, tax amnesties can cover all taxpayers or a group of taxpayers. However, they normally target at a segment of economic activities where taxpayers have high rate of non-compliance. Carrying on foreign business and investment activities, and holding offshore financial accounts, are generally considered as such segments of economic activities. Therefore, today most tax amnesty programs focus on extracting information on income from such sources.

However, tax amnesty programs have their own problems. Their continuous introduction may

[109] See Julio Rodrigo Fernando Lupez-Laborda, "Tax Amnesties and Income Tax Compliance: The Case of Spain" (2003) 24:1 FISC Fiscal Studies; Key Bell, "Cash-strapped States Turn to Tax Amnesties" Bankrate. Available at http://www.bankrate.com/finance/taxes/cash-strapped-states-turn-to-tax-amnesties-1.aspx.

negatively affect on the credibility of tax administrations and the integrity of tax systems. First, it implies that government has a problem with its regular tax enforcement mechanism. Second, it has some equity implications as it essentially offers only a few taxpayers an exemption from general consequence of tax noncompliance. This inherent aspect of amnesty policy may be challenged as an unfair treatment of those taxpayers who always complied with the law but ultimately treated the same as non-compliant taxpayers. For all those reasons, this mechanism also cannot be fully relied upon as a systematic tax enforcement mechanism (for further discussions, see Section 5.2).

1.2.3 Theoretical support for third-party tax reporting on foreign income

1.2.3.1 Implications of the existing regime

As discussed in the preceding sections, apart from resident taxpayers' self-assessment declarations, rare reports from whistle-blowers, and occasional voluntary disclosure and tax amnesty programs, there is normally no systematic mechanism to enforce tax laws on the foreign-source income of resident taxpayers.

This issue may be very consequential for the revenue needs of both residence and host countries of a taxpayer also for the following reason. The international tax allocation rule in any given double taxation convention is schedular in nature.[110] They categorize the income from cross border activities mainly into two categories: active and passive (investment) income. International tax principles recommend that active income derived from cross-border activities be taxable primarily in the jurisdiction hosting the business, while income from cross-border

[110] Under the schedular system, items of income are classified into various categories and then the primary right to tax is assigned to either the residence or the host jurisdiction.

investment activities be taxable mainly in the country where the investor permanently resides.[111] Considering this international compromise, most countries apply relatively low withholding tax for non-residents earning investment income from sources within their territories or exempt such an income from taxation altogether.[112] Thus, resident taxpayers often do not pay any tax or pay relatively low tax on their foreign-source investment income to host countries. Under these circumstances, if the residence country does not have a necessary enforcement mechanism to tax the foreign-source investment income of its resident taxpayer, the income may escape from tax altogether: first, in the host country by virtue of the withholding tax exemption under a double tax convention and then in the residence country by simply not reporting the income.

1.2.3.2 Third-party tax reporting and tax withholding as cornerstones of tax enforcement

As we have discussed in the preceding sections (i.e. 1.2.1.2-1.2.1.3), the self-assessment combined by third party reporting or tax-withholding mechanisms are the cornerstones of tax enforcement in domestic context. They, by their very nature, reflect a structural enforcement system once comprehensively discussed by professors Freiberg and Cheng.[113] Cheng argues that structural law enforcement is a form of law enforcement, which attempts to regulate an undesired behaviour not through *ex post* harsh penalties; rather, it attempts to regulate such behaviour indirectly and *ex ante* through subtly designed other arrangements that discourage the undesired

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[111] See Articles 7, 10, 11, 12, 13, 23 of the OECD Model Tax Convention (1977) and UN Model Tax Conventions on Income and Capital (1980) and their subsequent updates.

[112] PricewaterhouseCoopers, *Taxation of Foreign Source Income in Selected Countries* (Canada Advisory Panel on Canada's System of International Taxation 2008). Available at http://publications.gc.ca/collections/collection_2010/fin/F34-3-8-2009-eng.pdf

[113] Arie Freiberg, "Enforcement Discretion and Taxation Offences", *Enforcement Discretion and Taxation Offences: Proceedings of the Australian Tax Forum, 1986* 55-91; Edward Cheng, "Structural Laws and Puzzle of Regulating Behavour " (2006) 100:2 Northwestern University Law Review.

behaviour to occur in the first place.[114] The structural law enforcement focuses on minimizing opportunities available for the undesired behaviour to develop in the first place rather than on dealing with its consequences.

In his analysis, Cheng describes two types of structural law enforcement but notes that one law can embody both enforcement mechanisms simultaneously.[115] The first type creates a process that makes an undesired behaviour more vulnerable for detection. The focus of the other enforcement mechanism is to prevent the undesirable behaviour from emerging in the first place by making it more difficult or troublesome.

This typology is true to the third party reporting and the tax withholding.[116] On the one hand, third party tax reporting makes taxpayer's non-reporting or underreporting vulnerable for detection. It gives tax administration a reliable source of information as to tax liabilities, without having to rely solely on taxpayers self reporting of their income and assets. In so doing, it increases the visibility of taxpayer's income to tax authorities. Thus, as the information on taxpayer's income is already available to tax authorities through third parties, it becomes riskier for the taxpayer not to report or misreport it.

Third-party tax withholding performs the latter function. It removes opportunities and incentives for non-reporting or underreporting altogether by applying immediate tax on income at source

[114] Ibid., at 622.

[115] Ibid., at 664.

[116] Ibid., at 675-676.

even before it reaches the taxpayer.[117] The tax withholding fully or partly discharges the person's tax liability upon receipt of the income. As a result, tax is already paid before the income is spent for any other purpose. This is how the modern income tax system is typically administered in a purely domestic context.

However, as soon as the resident taxpayers begin to carry out their economic activities across the border, the scope of tax enforcement drastically changes. States generally have no access to third-party tax withholding mechanism, nor to third party tax information reporting, which are readily available in a purely domestic context. Thus, the states have no more viable access to tax relevant information about its resident taxpayers. The only common enforcement mechanism that the governments have is to impose harsh and steep civil penalties and criminal sanctions for taxpayers who failure to report their taxable income. These sanctions seem to have not much persuaded the taxpayer into compliance. The taxpayers know that despite the existence of these sanctions, without systematic verification mechanisms in place, the risk of getting caught for their offshore tax evasion is remote. This is, in author's view, one of the core reasons for the prevalence of offshore tax evasion in today's world. After all, for resident taxpayers, making truthful self-reporting on their foreign-source income is still largely a matter of choice.

Indeed, no foreign third-party readily accepts the inherently costly regular tax information reporting or tax withholding obligations with respect to foreign tax authorities. There are also insurmountable jurisdictional and practical limitations for implementing such inherently domestic enforcement mechanisms. However, it is becoming more and more evident that in the context of increasing economic globalization, cross-border economic activities are creating a

[117] Ibid., at 676.

greater need for tax authorities to obtain extraterritorial information. It is creating a need for better international cooperation in the field of taxation. If the third party tax information reporting system has been a key enforcement mechanism to ensure tax compliance on domestic-source income of resident taxpayers, there is also a need for a certain international mechanism that can reflect the third-party tax information reporting system for foreign-source income of resident taxpayers. Otherwise, taxation of foreign-source income of resident taxpayers will remain under jeopardy.

1.2.4 Concluding remarks

Today most countries claim worldwide tax jurisdiction over their individual residents by statutorily establishing that they tax their residents on their domestic and foreign-source incomes. However, the analyses suggest that the claim has no real force when it comes to the foreign-source income. The biggest problem in this paradigm is government's lack of access to the extra-territorial information on the foreign-source income of its resident taxpayers. Thus, there is a lack of parallelism in the enforcement of taxes on the parallel incomes.

To work properly, a tax system must not only define domestic and foreign source incomes, not merely stipulate that they are both taxable, but it must also have an effective enforce mechanism. Yet, on their own the states would be unable to cope with this task, especially in today's highly globalized world; they need to launch a better and effective international cooperation in this field.

Chapter 2: International exchange of tax information on request and its limitations

As we have observed in the preceding chapter, there is a lack of parallelism in the enforcement of taxes on the domestic and foreign-source income of resident taxpayers. This is due to the fact that governments do not have similar level of access to information on the foreign-source income of their resident taxpayers as they do have with respect to their domestic-source income. To tackle this issue, some states have focused their efforts on establishing international cooperation on exchange of tax information.

International exchange of information on tax matters generally refers to an inter-governmental relation by which tax administration of one state request and obtain tax-relevant information from its counterparty in another state for the enforcement of domestic tax laws.[118] Over the years, the international community has developed certain international legal frameworks to establish and facilitate such exchanges. The two most prevalent frameworks are international double taxation treaties/conventions (TCs) and exchange of tax information agreements (TIEAs). They are fundamental frameworks for all those legal systems in which the tax administration wouldn't otherwise be able to obtain information on its tax residents' foreign-source income.[119]

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[118] Sara McCracken, "Going, Going, Gone... Global: A Canadian Perspective on International Tax Administration Issues in the" Exchange-of-Information Age"" (2002) 50:6 Canadian Tax Journal, at 1880.

[119] Currently there are more than 3500 bilateral tax treaties worldwide. The primary sources of these treaties are the OECD Model Double Taxation Convention and UN Model Double Taxation Convention. See also Global Forum on Transparency and Exchange of Information for Tax Purposes, *Report on Transparency and Exchange of Information for Tax Purposes* OECD, 2012), at 3.

Yet, it is not clear whether these frameworks adequately address the information asymmetry that we have discussed in the preceding sections. This chapter will explore this important question. Overall, it attempts to analyse the existing TCs and TIEAs and their exchange of information provisions.

2.1 Exchange of tax information under TCs

2.1.1 Introduction

TC is typically a bilateral agreement concluded by two states. It has resulted primarily from the need to resolve the issue of international double taxation in cross-border economic activities.[120] International double taxation occurs when the same stream of income of the same taxpayer is exposed to full taxation in more than one country, first, in the country where the income arises and then in the country where the income-earner or the taxpayer resides. TCs mitigate this problem by allocating and apportioning the taxing rights on the income resulting from cross-border activities between the host and residence countries.[121]

While the most frequently stated purpose is the mitigation of double taxation, TCs are also designed to assist the contracting parties to prevent international tax evasion. To accomplish this purpose, most double tax agreements contain, among some other relevant provisions, a provision that allows the tax authorities of contracting parties to exchange tax related information.

[120] Mogens Rasmussen, *International Double Taxation* (The Netherlands Wolters Kluwer, 2011).

[121] However, they also serve as vehicles for international exchange of tax information by incorporating themselves exchange of tax information clause. Deutsch, Arkwright & Chiew. *Supra note* 61, at 1-3.

Today, double tax agreements are generally based on either the OECD Model Convention on Income and on Capital (1977) or the United Nations Model Convention on Income and Capital (1980).[122] These model conventions are substantially similar, especially as far as their exchange of tax information provisions are concerned. Article 26 of these model conventions provides the most widely accepted legal basis for bilateral exchange of information for tax purposes. This is actually the only provision that deals with exchange of tax information under TCs.

The article generally stipulates the type of taxes that exchange of tax information provisions are applicable for; contains the rules that ensure the confidentiality of information exchanged; limits the persons to whom such information can be disclosed; specifies the purposes for which such persons may use the information; and finally , lists certain exceptions to the obligation to provide information.

2.1.2 Historical background

The first officially recorded exchange of tax information provisions in TCs were found in the treaty of administrative assistance in tax matters between France - Belgium (1843).[123] The provisions required the treaty partners to exchange information in relation to estate and registration taxes.[124] A few decades later, in 1920th, similar provisions were included in the

[122] Michael Lang, *The impact of the OECD and UN Model Conventions on Bilateral Tax Treaties* (Cambridge, New York Cambridge University Press 2012).

[123] The treaty between France and Belgium lost its force in 1 January 1870 but came back into force in in 1960. The treaty is considered to be the oldest treaty of its kind that is still in force. A French version of the treaty can be found in http://www.impots.gouv.fr/portal/dgi/public/documentation.impot?pageId=docu_international&espId=-1&sfid=440&choix=BEL#pays. See also Article 14(2) of the treaty of 1960. Parlementaire Bescheiden, 1958–1959, 305/1, bijlage I, in Wetboek Successierechten Story Scientia, and in the Pandectes belges,Tôme 26, V° Convention internationale (Dispositions fiscales) col. 818.

[124] The Treaty between France and Belgium on Administrative Assistance in Tax matters. Ibid. See Article 1-2.

League of Nations' the so-called 'Model Bilateral Convention on Administrative Assistance in Matters of Taxation' (the League of Nations Model Tax Convention).[125] The Convention had the following text:[126]

(Article 1)

> *With a view to obtaining a better apportionment of fiscal burdens in the interest both of Governments and taxpayers, the Contracting States undertake, subject to reciprocity, to give each other administrative assistance in regard to all matters required for the purpose of tax assessment. Such assistance may consist in:*
>
> > *(a) The exchange of fiscal information available in either of the contracting countries.*

[125] The International financial Conference held at Brussels in 1919 recommended that the League of Nations should take up the question of double taxation. In 1922, the Finance Committee of the League of Nations was entrusted with a study of the questions: the economic aspects of international double taxation. The Finance Committee delegated the study further to the Committee of technical Experts on Double Taxation and Tax Evasion, which consisted of professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp, four renowned economist scholars of that time. Meanwhile, the International Economic Conference, which had met at Genoa in April 1922, recommended that the League of Nations should also examine the problem of the flight of capital. The committee conducted the study and submitted their resulting report to the committee in 1923. That work was concluded by the League of Nations drafting of the first model tax conventions at the Geneva conference of 1928 in which 27 countries took part. It was considered expedient to divide up the subject matter into four separate conventions.

The question of double taxation has to be treated in two conventions: (a) Draft Convention for the Prevention of Double, Taxation; (b) Draft Convention for the Prevention of Double Taxation in the special matter of Succession Duties.

The question of tax evasion has also to be dealt with in two conventions: (a) Draft Convention on Administrative Assistance in Matters of Taxation; (b) Draft Convention on Judicial Assistance in the Collection of Taxes.

See Nations.; Committee of Technical Experts, *Double Taxation and Tax Evasion: Report of Technical Experts on Double Taxation and Tax Evasion* (Geneva: League of Nations 1927).

[126] Article 1-2 of the Model Convention on Administrative Assistance in Matters of Taxation of 1928. The conventions can be found in http://faculty.law.ubc.ca/brooks/treaties/models/league1927.pdf;

(b) The exchange will take place following a request concerning concrete cases, or, without any special request, for the class of particulars defined in Article 2.

(c) Co-operation between the administrative authorities in carrying out certain measures of procedure.

(Article 2)

The exchange of information as contemplated in paragraph (a) of Article 1 shall relate to natural or juristic persons taxable in one of the two contracting countries. The particulars given shall include the names, surnames and domicile or residence of the persons concerned, and their family responsibilities, if any, and shall have reference to:

(1) Immovable property (capital value or income, rights in rem, charges by way of mortgage or otherwise);

(2) Mortgages or other similar claims (description of the mortgaged property, amount and rate of interest);

(3) Industrial, commercial or agricultural undertakings (actual or conventional profits, business turnover, or other factors on which taxation is based);

(4) Earned income and directors' fees;

(5) Transferable securities, claims, deposits and current accounts (capital value and income); any information collected by an administration, more especially in

> *connection with exemption or relief granted by that authority by reason of the taxpayer's domicile or nationality;*
>
> *(6) Successions (names and addresses of deceased and heirs, date of death, estate, shares of heirs and other bases of the tax).*

These provisions of the League of Nations Model Tax Convention were the first international consensus on exchange of tax information between states. It was added to the Convention as a response to the national representatives' and the technical experts' concerns over international tax evasion.[127] These provisions laid a foundation for exchange of information "upon request".

However, the clauses of modern TCs on exchange of tax information owe their origin to the OECD Model Tax Convention published in 1963. Article 26 of the Model Convention embodied the duty to exchange tax information between treaty partners as following:

> *The competent authorities of contracting states shall exchange such information as is necessary for the carrying out this Convention and of the domestic laws of the contracting states concerning taxes covered by this convention in so far as the taxation thereunder is in accordance with this convention.*
>
> *Any information exchanged shall be treated as secret and shall not be disclosed to any persons or authorities other than those concerned with the assessment or collection of the taxes, which are the subject of the Convention.*

[127] Sunita Jogarajan, *The Drafting of the 1925 League of Nations Resolutions on Tax Evasion* (UK, Cambridge Melbourne University 2014), at 6-8, 11. Available at http://www.law.cam.ac.uk/faculty-resources/summary/sunita-jogarajan-the-drafting-of-the-1925-league-of-nations-resolutions-on-tax-evasion/13625.

In no case shall the provisions of paragraph 1 be construed so as to impose on one of the contracting states the obligation:

a) to carry out administrative measures at variance with the laws or the administrative practice of that or of the other contracting states:

b) to supply particulars which are not obtainable under the laws and in the normal course of the administration of that or the other contracting state;

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).[128]

These provisions allowed the contracting parties to exchange information that is necessary for the carrying out of the Convention and of the domestic laws of the contracting states in so far as the national tax in question is covered by the Convention. The Model Convention also limited the scope of exchange of information to taxes on income and capital.

In 1977, the OECD adopted a new version of the Model Tax Convention. The 1977 Model Convention replaced the earlier model. Article 26 of the 1977 Model Convention stipulates:

The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the

[128] OECD, *Exchange of tax information between OECD Member Countries : a Survey of Current Practices* (Paris, France; Washington, D.C.: Organization for Economic Co-operation and Development 1994), at 43.

taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Article 1.

Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the Convention. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.[129]

In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).

[129] Kees van Raad *et al.*, "Model Income Tax Treaties : a Comparative Presentation of the Texts of the Model Double Taxation Conventions on Income and Capital of the OECD (1963 and 1977), United Nations (1980), and United States (1981)" (1983), at 80.

As we see, the exchange of information provisions in the 1977 version of the Model Convention remained substantially similar to that of the 1963 Model Convention. However, there were a few differences. For example, the 1977 version of the Model Convention added a new clause: "the exchange of information is not restricted by Article 1". This sentence emphasizes that the exchange of information is not limited to residents of the contracting parties as referred to in the Article 1 of the Model Convention. The exchange of information now was possible also with respect to the residents of third states or individuals and bodies which are not fully or partly subject to taxation as referred to in Article 4 OECD Model Convention. However, the Convention limited the application of exchange of tax information only to the 'taxes covered by the Convention'. It did not concern with the taxes that are not covered in the Convention.

Moreover, under the 1963 OECD Model Convention tax information could be disclosed only to persons and authorities concerned with the assessment or collection of taxes. By contrast, the 1977 Model Convention included among the persons or authorities to whom tax information may be disclosed, those who were involved in the enforcement of prosecution in respect of or the determination of appeals in relation to the taxes covered by the Convention. As we see, the provisions further clarified that such persons or authorities may disclose the information in public court proceedings or judicial decisions.

In 1980, the United Nations also adopted its Model Tax Conventions (UN Model Convention) to be used as a model for tax treaties between developed and developing countries.[130] The UN

[130] The OECD Model Tax Convention was originally intended for use between the OECD member states. The model tended to allocate taxing rights on cross-border economic activities mostly to jurisdiction where taxpayer resides not where taxpayer carries out its business to investment activities by restricting source country's tax jurisdiction. This left source jurisdictions (i.e. essentially, capital importing countries) with restricted taxing rights. Thus,

Model Convention contained a similar exchange of tax information provisions in an identical article.

The OECD and UN Model Tax Conventions are broadly similar in substance concerning the information exchange, even in their subsequent revisions.[131] Thus, where there is double tax treaty, their exchange of tax information provisions are similar with that of other double tax treaties regardless of whether it is based on the OECD or UN Model Tax Conventions.

In 2000, the Article 26 of the OECD underwent a number of revisions. The revisions established that exchange of tax information applies to 'taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions of local authorities'.[132] The UN Model Tax Convention adopted the similar revision in its 2001 update. These revisions attempt to ensure that the exchange of tax information provisions extend beyond the taxes regulated within the Model Conventions to all taxes as long as the taxes under the domestic taxation laws concerned is not contrary to the Conventions.

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developing countries found the model non-representative of their interest. In 1980, as a response to the concerns of the developing countries over the OECD Model Tax Convention, the UN published its first model that can be used as a model for double tax treaty negotiations between the developed and developing countries. Even though the UN model adopts almost the same structure as the OECD model, it has taken a greater account of developing country concerns by somewhat enlarging the scope of source country taxation. It has provisions such as broader permanent establishment definitions and higher source country withholding-rate ceilings on dividend, interest, and royalty income. Thus, some TCs between developed countries tend reflect the OECD Model Tax Convention, while those between the developed and developing countries tend to reflect the UN Model Tax Convention. See Sol Picciotto, *International Business Taxation: a Study in the Internationalization of Business Regulation* (London Widenfeld & Nicolson 1992), at 14-25.

[131] Michael Lennard, "The UN Model Tax Convention as Compared with the OECD Model Tax Convention—Current Points of Difference and Recent Developments" (2009) 9:12 Asia-Pacific Tax Bulletin.

[132] See Article 26 of the OECD Model Convention (2000) and the UN Model Tax Convention (2001).

In 2003, the OECD Committee for Fiscal Affairs undertook another comprehensive review of the exchange of information provisions under the Model Convention. The review also took into account then the OECD report "Improving Access to Bank Information for Tax Purposes".[133]

In 2005, as a result of this review, Article 26 of the OECD Model Convention has undergone substantial modifications with a view to clarifying certain issues and expanding the scope of the article. The word 'necessary' in Article 26 was replaced by 'foreseeably relevant'. This revision indicates that the signatory states will exchange information in the broadest sense but they will not engage in 'fishing expeditions'.

The modifications also resulted in the following 2 new paragraphs (i.e. paragraphs 4 and 5) in the Article 26:[134]

> **(Paragraphs 4)** *If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.*

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[133] OECD, *2000 Report on Improving Access to Bank Information for Tax Purposes* (Paris: OECD, 2000); OECD, *Improving Access to Bank Information for Tax Purposes: The 2003 Progress Report* (Paris OECD, 2003).

[134] OECD, *Changes to Articles 25 and 26 of the Model Convention* (2004); OECD, *The 2005 Update to the Model Tax Convention* (2005). Available at http://www.oecd.org/tax/treaties/33614065.pdf, and http://www.oecd.org/tax/treaties/34576874.pdf

(Paragraph 5) *In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.*

The new paragraph 4 addresses domestic tax interest requirement in international exchange of tax information. The concept of domestic tax interest describes a situation where a contracting party can only provide information to another contracting party if it has an interest in the requested information for its own tax purposes. Thus, the requirement allows the competent authority of a contracting state to decline exchange of tax information request of its treaty partner if it does not have interest in the requested information for its own tax purposes. The new paragraph removes this requirement. Accordingly, the requested state now must use its information gathering measures even though invoked solely to obtain and provide information to the requesting jurisdiction.

Paragraph 5, on the other hand, deals with the situation in which the information requested is not readily available in the hands of a requested treaty partner but in the possession of banks, financial institutions, nominees, agents and fiduciaries located in its territory. It provides that a treaty partner cannot decline to provide information solely because such information is in the possession of by banks, financial institutions, nominees, agents and fiduciaries located in its territory. It also expressly states that domestic banking secrecy rules by themselves cannot be used as a basis for declining to provide information. This revision is intended to clarify the limitations set forth in the paragraph 3 of Article 26.

These revisions gave new life to the exchange of tax information provisions of the Model Tax Conventions.[135] Soon corresponding modifications were made to the UN Model Tax Convention in 2011.[136]

The Article 26 of the OECD Model TC was further modified in 2012. Paragraph 2 of the Article was amended to allow the competent authorities to use information received for other purposes provided (a) such use is allowed under the laws of both States and (b) the competent authority of the supplying State authorizes such use. As we remember, the earlier models allowed the competent authorities to use information received only for the assessment, collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes specified in the convention.

2.1.3 Scope of tax information exchange under TCs

The OECD and UN Model Tax Conventions authorize competent authorities of contracting states to exchange such information as is foreseeably relevant for carrying out the provisions of this convention or to the administration or enforcement of the domestic laws of the contracting states concerning taxes of every kind and description imposed on behalf of the contracting states,

[135] The term was first used by the G20 Ministers of Finance at their sixth meeting in Berlin (Germany) in 2004. See Paragraph 9 of G20, *Statement on Transparency and Exchange of Information for Tax Purposes* (Berlin G20 Meeting, 2004).

[136] The UN Model Tax Convention (2011). Available at http://www.un.org/esa/ffd/wp-content/uploads/2014/09/UN_Model_2011_Update.pdf

or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention.[137]

Laws covered. The language of the OECD Model tax Convention sets forth the fundamental principle that the information exchanged can relate to the administration of both tax treaty provisions and domestic laws. Information that may be exchanged under TCs generally includes, but is not limited to, information pertaining to processing of double taxation cases and related issues under competent authority consideration, information relating to a specific taxpayer or tax matter under review, information discovered during an investigation or examination when there is the potential for noncompliance with the tax law of a foreign country, and changes in tax law.

Persons covered. Article 26(1) makes clear that "the exchange of information is not restricted by Article 1 (i.e. the persons resident of the contracting states) and Article 2 (i.e. the taxes covered under the convention)". Consequently, a treaty partner may request for information on its residents as well as residents of a third country. For example, if a third-country resident has a permanent establishment in the other contracting state, the contracting party may request information regarding that permanent establishment, even though the third-country resident is not a resident of either contracting state.

Furthermore, the exchange of tax information provisions of the OECD Model Tax Convention obligate one treaty partner to obtain and extend to the other all information in its territory regardless of who possesses it. Thus, the obligation covers information in the possession of tax authorities, other government agencies, and private parties subject to procedural limitations

[137] See Article 26(1) of the OECD Model Tax Convention and the UN Model Tax Convention.

applicable in the requested state. Upon receipt of an information request, the competent authority of the requested state must first review whether it has all the information necessary to respond to a request. If the information requested is not found in the possession of the requested state's tax authorities, the tax authorities are expected to attempt to obtain it from other sources using the same procedures for obtaining information in relation to domestic tax matters.

Taxes covered. The taxes covered for the purposes of information exchange under TCs constitute a broader category of taxes. Article 26(1) of the OECD Model Tax Convention also makes clear that the exchange of information is not restricted by Article 2 (Taxes covered). This indicates that the exchange of information provisions under TCs apply for the enforcement of taxes of every kind imposed by a contracting state, not merely taxes covered in the convention.

2.1.4 Principles of tax information exchange under TCs

Treaty partners need to observe certain principles when carrying out information exchanges. The main principles are:

a) Foreseeable relevance;
b) Reciprocity;
c) Subsidiarity;
d) Confidentiality.

Foreseeable relevance. Under TCs information shall be exchanged if it is 'foreseeably relevant' for the application of double taxation treaty or for the administration or enforcement of the domestic laws of treaty partner.[138] Thus, a requesting state must demonstrate the foreseeable relevance of the requested information to its investigation and more generally to the administration and enforcement of its tax laws.

However, the criteria to determine 'foreseeable relevance' are complex. Information requests should have apparent nexus to an open inquiry or investigation. This means, the request will not be considered as foreseeable relevant if it is too general, is not well motivated, is not supported by a set of facts, or is aimed at a larger number of unidentified persons.[139] Overall, the principle of foreseeable relevance is intended to provide that contracting parties are not at liberty to engage in "fishing expeditions" or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer.[140]

The commentaries to the 2012 version of the OECD Model Tax Convention redefined the notion of foreseeable relevance to take into account recent developments in the practice. It made clear that a request for information does not constitute a fishing expedition solely because it does not provide the name or address (or both) of the taxpayer under examination or investigation.[141] It also provided that a request may not be declined in cases where a definite assessment of the

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[138] See Commentary to Paragraph 1 of Article 26 of the OECD Model Tax Convention.

[139] Roger Gordon, John Venuti & Arthur Galan, "An Analysis of Tax Information Exchange Agreements Concluded by the U.S." (1991):5 Tax Management International Journal, at 193.

[140] The term 'fishing expeditions' is metaphoric. It generally refers to unspecified information requests. See OECD, *Model Tax Convention on Income and on Capital (2010)*, Commentary to Paragraph 1.

[141] *The OECD Model Tax Convention and its Commentary* (France, Paris: OECD, 2012), Commentary to Paragraph 1 of Article 26. Available at http://www.oecd.org/ctp/exchange-of-tax-information/120718_Article%2026-ENG_no%20cover%20%282%29.pdf. Last accessed on November 27, 2015.

pertinence of the information to an on-going investigation can only be made following the receipt of the information.

In cases in which the requesting state does not provide the name or address (or both) of the taxpayer under examination or investigation, the requesting state must include other information sufficient to identify the taxpayer. However, where the request relates to a group of taxpayers not individually identified, it is often difficult to establish that the request is not a fishing expedition, as the requesting state cannot point to an on-going investigation into the affairs of a particular taxpayer which in most cases would by itself dispel the notion of the request being random or speculative. The commentaries state that in such cases it is therefore necessary that the requesting state provide a detailed description of the group and the specific facts and circumstances that have led to the request, an explanation of the applicable law and why there is reason to believe that the taxpayers in the group for whom information is requested have been non-compliant with that law supported by a clear factual basis.[142] It further requires a showing that the requested information would assist in determining compliance by the taxpayers in the group.

Reciprocity. As a general rule, information exchanges under the OECD Model Tax Convention must be reciprocal. That is, if a state requests its treaty partner to provide tax information, similar information must be obtainable under the laws or in the normal course of the administrative practice of the requesting state itself.[143] Thus, the requesting state is capable to render assistance

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[142] Ibid.

[143] Commentary to Paragraph 2 of Article 26 of the OECD Model Tax Convention (the 2010 update). See paragraph 15 of the commentary.

in information exchange, if similar request is made by the requested state. If this condition is not met, the requested state may decline the request of information exchange on the basis of lack of reciprocity.

However, different countries have different mechanisms for obtaining and providing information. Variations in practices and procedures should not be used as a basis for denying a request unless the effect of these variations would be to limit in a significant way the requesting state's overall ability to obtain and provide the information if the requesting state itself received a legitimate request from the requested state.[144]

The reciprocity question may be invoked in the developed and developing country context due. The developed countries may have a better administrative, financial, and legal capacity than the developing countries to process and administer information requests. The commentary to the UN Model Tax Convention states that a developed country is not allowed refusing to provide information to a developing country on the ground that the developing country does not have an administrative capacity comparable to the developed country. Reciprocity has to be measured by reference to the overall effects of a treaty, not with respect to the effects of a single article.[145] It is recognized that too rigorous application of the principle of reciprocity could frustrate effective exchange of information and that reciprocity should be interpreted in a broad and pragmatic manner.[146]

[144] Ibid.

[145] Commentary to the OECD Model Tax Convention (the 2010 update). See paragraph 1.3, Article 26.

[146] OECD Model Tax Convention (the 2010 update), *Supra note* 153.

Subsidiarity. According to this principle, a treaty partner can request for information from other contracting party only once it has exhausted its usual measures to obtain information under its domestic tax procedure.[147] This means that treaty partner can make information request to its partner only when it has already used all domestic administrative measures available to gather the necessary information domestically but it was unable to procure it.

Confidentiality. Long-term exchange of tax information relations are feasible only if each administration is assured that the other administration will treat with proper confidence the information that it will receive in the course of the exchange. Therefore, the OECD and UN Model Tax Conventions contain provisions regarding tax confidentiality and the obligation to keep information exchanged as confidential.[148] The confidentiality provisions require that the requesting state treat the information received as secret in the same manner as information obtained under the domestic laws of that state and allow disclosure of that information only to persons specified by the treaty as concerned with the taxes covered by the treaty and thereby protect taxpayer privacy rights.[149] The maintaining secrecy in the requested state is also a matter of domestic laws. It is required to treat the request for information as secret. This covers, for instance, competent authority letters, including the letter requesting information. Thus, the confidentiality rules apply to all types of information received, including (a) information provided in a request and (b) information transmitted in response to a request.

[147] Commentary to the OECD Model Tax Convention (the 2010 update), Paragraph 9(a), Article 26.

[148] The OECD and UN Model Tax Conventions, Article 26(2).

[149] Ibid.

In 2012, the OECD and Global Forum released a Joint Guide on Confidentiality, which sets out best practices related to confidentiality and provides practical guidance on how to meet an adequate level of protection.[150] The confidentiality provisions of the OECD Model Tax Conventions are discussed further in Section 5.4 of this paper.

2.1.5 Methods of tax information exchange under TCs

The commentaries to Article 26 of the OECD Model Tax Convention and UN Model Tax Convention mention three forms of information exchange: on request, automatic, and spontaneous.[151]

Exchange of information on request. Exchange of information on request is the most common method of exchange between tax authorities under TCs. Exchange of tax information on request refers to a situation where the competent authority of one country asks for specific information regarding specific case from the competent authority of another contracting party. The request must always relate to a specific case. Most of such requests arise from examination of a particular tax return, although requests may also arise from collection activities or criminal investigations. Normally, a response for such requests covers a range of documents and records about income and financial accounts of the resident taxpayer of requested jurisdiction. For the

[150] "Keeping it Safe: the OECD Guide on the Protection of Confidentiality of Information Exchanged for Tax Purposes" (2012). Available at http://www.oecd.org/tax/transparency/final%20Keeping%20it%20Safe%20with%20cover.pdf

[151] See paragraph 5.4 of the Commentary on Article 26 of the 2011 update of the UN Model Convention and the Inventory of Exchange Mechanisms at paragraph 30. See also the 2006 OECD Manual on Information Exchange, available at http://www.oecd.org/ctp/exchange-of-tax-information/cfaapprovesnewmanualoninformationexchange.htm

requested jurisdiction, the information is normally available through reports of its resident taxpayers (e.g. withholding agents) who make payment to non-residents or files of tax return.

Automatic exchange of tax information. Under automatic exchange of information, an exchange does not depend on the existence of a request: the information is exchanged routinely (e.g. annually) between the competent authorities of treaty partners. The information typically includes details of income arising in the source country, e.g. interest, dividends, royalties, pensions etc. and paid to the residents of the treaty partner. Normally, competent authorities interested in automatic exchange will agree in advance as to what type of information they wish to exchange and the timing of frequency and timing of such exchanges.

Spontaneous exchange of information. Under this mode of exchange, information is exchanged spontaneously when one of the contracting parties, having obtained information in the course of administering its own tax laws, considers that the information might be of interest to its treaty partner for tax purposes. Thus, it passes on this information without the latter's request. The information may relate to a particular taxpayer's situation and the relationship of that situation to the taxpayer's liability in the receiving country. The information providing country's tax authorities may have acquired such information in the course administering the tax laws (e.g. in the course of a tax audit, tax investigation). The effectiveness of this form of exchange of information largely depends on the ability of tax inspectors to identify, in the course of an investigation, information that may be relevant for a foreign tax administration.

It must be noted that the OECD and UN Model Tax Conventions theoretically do not limit the forms or manner in which information exchange can take place.[152] These three forms of exchange (i.e. upon request, automatic and spontaneous) may also be combined. However, only the first method is mandatory.[153]

2.1.6 Limitations of tax information exchange under TCs

The OECD and UN Model Tax Conventions set a number of situations under which a contracting party can refuse to fulfil the request for information from its treaty partner.[154]

According to Article 26(3) neither country is obliged to provide the information to its treaty partner if either of the following applies:

a) The treaty partner has to carry out administrative measures that are at variance with its law and administrative practice. It should be noted that a contracting state is obligated to obtain the requested information as if the tax in question were the tax of the requested state. The underlying rationale is that the requested party should be required to do no less than it would if its own taxation was at stake, but also to do no more. However, in certain cases, a request for information may compel the requested state to use the special examining or investigative powers provided by its laws for purposes of levying its

[152] OECD, *Tax Information Exchange between OECD Member Countries : a Survey of Current Practices* (Paris, France; Washington, D.C.: Organization for Economic Co-operation and Development 1994).

[153] See Paragraph 1 of the Manual on the Implementation of Exchange of Information Provisions for Tax Purposes in the OECD Model Double Taxation Convention. OECD Committee on Fiscal Affaires, *Manual on the Implementation of Exchange of Information Provisions for Tax Purposes* (Paris: OECD, 2006).

[154] Article 26(3) of the OECD Model Tax Convention and the UN Model Tax Convention.

domestic taxes even though the requested state does not need the information for these purposes. Thus, the requested state has no direct tax interest in the case to which the request relates. Paragraph 4 of Article 26 of the OECD Model Tax Convention restricts the right of the requested state to decline providing information in such cases. It provides that the requested state must use its information gathering measures, even though invoked solely to provide information to the requesting state and irrespective of whether the information could still be gathered or used for domestic tax purposes.[155] However, Paragraph 4 does not oblige the requested state to provide information in circumstances where it has attempted to obtain the requested information but finds that the information no longer exists following the expiration of a domestic record retention period.

After all, it is recommended that each contracting state shall take the necessary measures, including legislation, rule-making, or administrative arrangements, to ensure that its competent authority has sufficient powers under its domestic law to obtain information for the purpose of international exchanges regardless of whether that contracting state may need such information for its own tax purposes.

b) The information cannot be obtained under their domestic laws or in the normal course of their administration. Thus, the requested party is at liberty to decline to provide information if the information cannot be obtained under its domestic law and cannot be obtained in the normal course of administration. The commentary to the OECD Model Tax Convention makes clear that information is deemed to be obtainable in the normal

[155] Commentary to the OECD Model Tax Convention (the 2014 update), Paragraph 4, Article 26.

course of administration if it is in the possession of the tax authorities or can be obtained by them in the normal procedure of tax determination, which may include special investigations or special examination of the business accounts kept by the taxpayer or other persons, provided that the tax authorities would make similar investigations or examinations for their own purposes.[156] However, paragraph 5 of the OECD Model Tax Convention specifically addresses such situations in which the tax authorities' information gathering powers with respect to information held by banks and other financial institutions are subject to different requirements than those that are generally applicable with respect to information held by persons other than banks or other financial institutions. It stipulates that the requested state cannot resort this limitation to decline a request where the requested state's inability to obtain the information was specifically related to the fact that the requested information was believed to be held by banks, other financial institutions, nominees, agents, and fiduciaries in the territory of the requested state and the requested state's domestic bank secrecy laws may not allow disclosure of such information even for tax purposes. Thus, the paragraph 5 overrides the limitation that would otherwise permit a requested state to decline to supply information.

c) The information that would disclose any trade, business, industrial, commercial or professional secret or trade process or the information would be contrary to public policy or professional secret or information, which is the subject of attorney client privilege. Thus, if the request for information refers to a commercial, industrial or professional secret or to information that is the subject of attorney client privilege, provision of such

[156] Commentary to Article 26(3) of the OECD Model Tax Convention (2010), Paragraph 16.

information can be refused. A trade or business secret is generally understood to mean facts and circumstances that are of considerable economic importance and that can be exploited practically and the unauthorised use of which may lead to serious damage to the owner of the secret. Commercial, industrial or professional secret secrets protect companies, their inventions and investments and herewith strengthen economic competition. However, the Commentary to Article 26(3) of the OECD Model Tax Convention states that financial information, including books and records, does not by itself constitute a trade, business or other secret and the determination, assessment or collection of taxes as such could not be considered to result in serious damage.[157]

The requested party may also decline to provide information in cases where the information constitutes a confidential communication between a client and an attorney, solicitor or other admitted legal representatives. However, the rules on what constitutes a confidential communication should not be interpreted or applied in such a broad way so as to hamper effective exchange of information.

d) Finally, the requested state may also decline to supply information if it would be contrary to its public policy. The concept of public order is generally defined according to domestic legislation and administrative practices. The content of these concepts therefore varies considerably from country to country.

However, the commentary to the OECD and UN model tax conventions stipulate that this limitation should only become relevant in extreme cases. For instance, such a case could

[157] The Commentary to Article 26(3) of the OECD Model Tax Convention (2010), Paragraph 19.2.

arise if a tax investigation in the requesting state were motivated by political, racial, or religious persecution. The limitation may also be invoked where the information constitutes a state secret, the disclosure of which would be contrary to the vital interests of the requested state.[158]

2.1.7 Timing and cost of exchange of tax information under TCs

Timing of exchange of tax information. The Model Conventions do not provide specific timeline for the exchange of information. Thus, the competent authorities of contracting states may agree on such time limits among themselves. However, the Commentary to the OECD Model Tax Convention notes that in the absence of such an agreement, the information shall be supplied as quickly as possible and except where the delay is due to legal impediments, within the following time limits:

a) Where the tax authorities of the requested state are already in possession of the requested information, such information shall be supplied to the competent authority of the requesting state within two months of the receipt of the information request;
b) Where the tax authorities of the requested state are not already in the possession of the requested information, such information shall be supplied to the competent authority of the requesting state within six months of the receipt of the information request.

As noted, these rules set a default standard for time limits that would apply where the competent authorities have not made a specific arrangement on longer or shorter time limits.

[158] Commentary to Article 26(3) of the OECD Model Tax Convention (the 2010 update), Paragraph 19.5.

Notwithstanding the default standard time limits or time limits otherwise agreed, competent authorities may come to different agreements on a case-by-case basis, for example, when they both agree more time is appropriate. This may arise where the request is complex in nature.

Cost of exchange of information. Administering, processing, and responding to information requests involve cost. The cost matter becomes a major concern in cases where copies of large volumes of documents are requested or long documents need to be translated, and also where the flow of information is one-sided. There is no standard provision on the issue of costs in the Model Tax Conventions. Thus, the provisions on the recovery of costs incurred in providing assistance can be agreed on a case-by-case basis in each TC.

In general, costs that would be incurred in the ordinary course of administering the request would normally be expected to be borne by the requested state. Such costs would normally cover routine tasks such as obtaining and providing copies of documents. If the amount of work involved in obtaining and providing information is extensive and cause extraordinary costs, such costs in providing information can be shifted to the requesting state.

It must be noted that an information request from a developed country to a developing country could place excessive material burdens on the tax authorities in the developing country, due to the difference in resources and financial capacity of the treaty partners. This concern is often alleviated by making the requesting state responsible for material extraordinary costs associated with a request for information. The UN Model Tax Convention makes clear that the question of whether an extraordinary cost of obtaining requested information is material could be determined not by reference to some absolute amount but by reference to the cost relative to the total budget of the tax department being asked to provide information.[159] For example, a small absolute cost might be material for a tax department with very limited resources, whereas a larger absolute cost might not be material for a well-funded department.

2.2 Exchange of tax information under TIEAs

2.2.1 Introduction

Another common vehicles for international exchange of tax information are Tax Information Exchange Agreements (TIEAs).[160] As the name denotes, the TIEA is specifically designed to promote international co-operation in tax matters through exchange of information. Today, there are over 1000 TIEAs concluded between states worldwide.[161] Most of these TIEAs are concluded based on the OECD Model Agreement on Exchange of Information on Tax Matters published in April 2002.[162]

2.2.2 Development of exchange of tax information standards under TIEAs

Historically the countries with comprehensive income tax system have never attempted to conclude TC with jurisdictions, which do not impose any income tax or impose income tax at nominal rates.[163] Such jurisdictions are generally referred to as "tax havens".[164] The former

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[159] The Commentary to Article 26 of the UN Model Tax Convention (2011), Paragraph 29.3.

[160] *OECD Model Agreement on Exchange of Information on Tax Matters* (France, Paris OECD, 2002).

[161] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Report on Transparency and Exchange of Information for Tax Purposes* OECD, 27 June 2012), at 3.

[162] Available at http://www.oecd.org/ctp/exchange-of-tax-information/2082215.pdf

[163] Timothy Addison, "Shooting Blanks: The War on Tax Havens" (2009) 16:2 Indiana Journal of Global Legal Studies, at 717. (The author writes about the US policy and practice of concluding TIEAs with tax havens).

countries do not see much reason in having a treaty to avoid double taxation with such jurisdictions. Given that the exchange of tax information was typically operated under TCs, they have not been available in the absence of such a treaty. These facts may explain the existence of TIEAs. The TIEA as a separate international legal framework designed exclusively for the purpose of establishing tax information exchange relationship serves as a mechanism for information exchanges generally between countries where there is no TC in place.

TIEA is generally a bilateral agreement that is negotiated and signed between two countries to establish an inter-governmental system for the exchange of information on tax matters. They provide greater details than TCs on the procedure for tax information exchange.

TIEA is a very recent phenomenon. Even though they have been developed throughout 1970th, TIEAs have gained great attention only in late 1990th. In May 1996, the G7 Summit called upon the OECD to identify and report on harmful tax practices and to develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases.[165] The factor precipitating the initiative to combat harmful tax competition was the perception that choice of finance and jurisdiction would primarily be tax driven, forcing governments to engage in competitive tax bidding. In response to the request, the OECD's Committee on Fiscal Affairs launched a project on harmful tax competition and

[164] Tax havens, also sometimes referred to as 'non-cooperative jurisdictions' are commonly understood to be jurisdictions which are able to finance their public services with no or nominal income taxes and offer themselves as places to be used by non-residents to escape taxation in their countries of residence. The OECD has identified three typical 'confirming' features of a tax haven: (i) lack of effective exchange of information, (ii) lack of transparency, and (iii) no requirement for substantial activities. In addition they often offer preferential tax treatment to non-residents in order to attract investment from other countries. See M. Ambrosanio & M. Caroppo, "Eliminating Harmful Tax Practices in Tax Havens: Defensive Measures by Major EU Countries and Tax Haven Reforms" (2005) 53:3 Canadian Tax Journal.

[165] OECD, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998), at 3.

completed its first report entitled "Harmful Tax Competition – An Emerging Global Issue" in 1998.[166] It developed a list of four criteria that must be examined in order to determine whether a country is, in fact, involved in harmful tax competition. The criteria were: a) no or only nominal taxes; b) a lack of effective exchange of information; c) a lack of transparency; d) no substantial business activity.[167] Thus, the report identified the lack of effective exchange of information as one of the key criteria in determining harmful tax practices.

Soon after the report had been released, in 2000 the OECD established Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) whose members consist of both the OECD and non-OECD countries. One of the first mandates of the Global Forum was to develop an international instrument that could be used to establish effective exchange of tax information with countries, which have no comprehensive tax system.[168] Thus, the OECD, through the Global Forum, initiated consultations with a number of countries outside the OECD to draw up a model treaty on exchange of tax information. The working group consisted of representatives from OECD Member countries as well as delegates from Aruba, Bermuda, Bahrain, Cayman Islands, Cyprus, Isle of Man, Malta, Mauritius, the Netherlands Antilles, the Seychelles and San Marino. In 2002, the Global Forum finally developed the Model Agreement on Exchange of Information on Tax Matters (OECD Model TIEA).

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[166] Ibid.

[167] OECD, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998), at 16, 52, 62-68; See also L. Samuels & D. Kolb, "OECD Initiative: Harmful Tax Practices and Tax Havens" (2001) 79 Taxes. (The report targeted countries that pursue aggressive tax policy in order to attract foreign capital and condemned such policies as features of harmful tax competition between countries).

[168] See the Introduction section of the OECD Model Agreement on Exchange of Information on Tax Matters. Available at http://www.oecd.org/ctp/exchange-of-tax-information/taxinformationexchangeagreementstieas.htm

The Model TIEA is not a binding instrument and presents two versions: a multilateral version and a bilateral version, which largely share the same content.

Today, the majority of TIEAs have been concluded on the basis of this model. Actually, most of them were signed between 2002 and 2011 when the OECD started to use 'name and shame' strategy towards uncooperative jurisdictions.[169] On 2 April 2009, the OECD drafted a list reflecting a state of affaires of its member states relating to the implementation of the internationally agreed standards in tax matters.[170] It divided the countries into three categories: white, grey, and black listed countries.

The 'white list' represented jurisdictions that have substantially implemented the internationally agreed the OECD standard of that time on exchange of tax information. The 'grey list' was for jurisdictions that have committed to the standard but not yet substantially implemented it. The black list, on the other hand, was for jurisdictions that have not committed to the standard.

Apart from meeting many other criteria of the standard, a country is considered to have substantially implemented the standard of exchange of information for this purpose of the Global Forum assessment if it has in place signed agreements or unilateral mechanisms that provide for exchange of tax information with at least 12 OECD countries.[171] This benchmark was considered

[169] For the complete list of TIEA, please visit at http://www.oecd.org/ctp/exchange-of-tax-information/taxinformationexchangeagreementstieas.htm

[170] The list is available at www.oecd.org/ctp/42497950.pdf

[171] *Taking the Process Forward in a Practical Way* (France, Paris: Global Forum on Transparency and Exchange of Information for Tax Purposes, 2008).

to be an appropriate dividing line at that point in time, between those countries that are implementing the standards and those that are not. In addition, in conjunction with the G20 Leaders' meeting in London on 2 April 2009, the Secretary General of the OECD issued a progress report determining that a country that had signed agreements with 12 jurisdictions, whether OECD countries or other jurisdictions, would be considered to have substantially implemented the standard on exchange of information. However, the agreements could not be concluded only with counterparties without economic significance. If it appears that a jurisdiction is refusing to enter into agreements or negotiations with partners, in particular ones that have a reasonable expectation of requiring information from that jurisdiction in order to properly administer and enforce its tax laws, this should be drawn to the attention of the Global Forum, as it may indicate a lack of commitment to implement the standards. As of December 2012, ninety jurisdictions made it to the white list.

2.2.3 Scope of exchange of tax information under TIEAs

Article 1 of the OECD Model TIEA embodies a basic purpose of the agreement and sets forth the scope of information that can be exchanged. It stipulates:

> *The competent authorities of the Contracting Parties shall provide assistance through exchange of information that is foreseeably relevant to the administration and enforcement of the domestic laws of the Contracting Parties concerning taxes covered by this Agreement. Such information shall include information that is foreseeably relevant to the determination, assessment and collection of such taxes, the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters. Information shall be*

exchanged in accordance with the provisions of this Agreement and shall be treated as confidential in the manner provided in Article 8. The rights and safeguards secured to persons by the laws or administrative practice of the requested Party remain applicable to the extent that they do not unduly prevent or delay effective exchange of information.[172]

This wording is substantially similar to those of Article 26 of the OECD and the UN Model Tax Conventions. However, the OECD Model TIEA provides more detailed rules in its subsequent articles.

Taxes covered. Exchange of tax information under TIEA generally covers, at a minimum, four categories of direct taxes: taxes on income or profits, taxes on capital, taxes on net wealth, and estate, inheritance or gift taxes unless both parties agree to waive one or more of them.[173] It further permits the inclusion of taxes imposed by or on behalf of political sub-divisions or local authorities. Such taxes are covered by the agreement only if they are listed in the instrument of ratification, approval or acceptance.[174] Contracting parties may agree to extend the agreement to cover taxes other than these four categories of direct taxes, e.g. VAT.[175] This is also consistent with the OECD and UN Model Tax Conventions, which cover "taxes of every kind and description".

[172] Article 1 of the OECD Model Agreement on Exchange of Information on Tax Matters (2002). Available at http://www.oecd.org/ctp/exchange-of-tax-information/2082215.pdf

[173] Article 3 of the OECD Model TIEA.

[174] Paragraph 1 of the Commentary to Article 3 of the OECD Model TIEA.

[175] Paragraph 2 of the Commentary to Article 3 of the OECD Model TIEA.

Persons covered. Under the OECD Model TIEA, as provided by its Article 2, the obligation to provide information is not restricted by the residence or the nationality of the person to whom the information relates or by the residence or the nationality of the person in control or possession of the information requested.[176]

2.2.4 Principles of exchange of tax information under TIEAs

TIEA partners are required to observe certain principles when carrying out information exchanges. The principles that apply for information exchanges under TIEAs are same as that apply under TCs, i.e. foreseeable relevance, reciprocity, subsidiarity, and confidentiality (see Section 2.1.4). However, the following distinctions should be noted. The OECD Model TIEA has clear criteria to determine 'foreseeable relevance' of an information request. The competent authority of the requesting state shall provide the following information to the competent authority of the requested state to demonstrate the foreseeable relevance of the information it requests:[177]

(a) The identity of the person under examination or investigation;
(b) A statement of the information sought including its nature and the form in which the applicant Party wishes to receive the information from the requested Party;
(c) The tax purpose for which the information is sought;
(d) Grounds for believing that the information requested is held in the requested Party or is in the possession or control of a person within the jurisdiction of the requested Party;

[176] Article 2 of the OECD Model TIEA.

[177] Article 1 of the OECD Model TIEA.

(e) To the extent known, the name and address of any person believed to be in possession of the requested information;

(f) A statement that the request is in conformity with the law and administrative practices of the applicant Party, that if the requested information was within the jurisdiction of the applicant Party then the competent authority of the applicant Party would be able to obtain the information under the laws of the applicant Party or in the normal course of administrative practice and that it is in conformity with this Agreement;

(g) A statement that the applicant Party has pursued all means available in its own territory to obtain the information, except those that would give rise to disproportionate difficulties.

Another distinguishing feature of the TIEA is that the exchanges occur on requests relating to a specific criminal or civil tax matters under investigation. Thus, it requires a contracting party to respond to an information request from its treaty partner even though the request does not relate to tax fraud or other allegation of criminality.

2.2.5 Methods of exchange of tax information under TIEAs

The OECD Model TIEA clearly expresses that the exchange of tax information upon request is the only mode of information exchange under TIEAs.[178] Thus, in its current form, the OECD Model TIEA does not presuppose automatic or spontaneous exchange of information.

[178] Article 5 of the OECD Model TIEA.

2.2.6 Limitations on exchange of tax information under TIEAs

Article 7 of the OECD Model TIEA deals with certain provisions that limit information exchanges. These provisions are substantially same as that apply under the OECD Model Tax Convention (see Section 2.1.5). However, there are some differences that must be noted.

The OECD Model TIEA makes clear that the requested party may decline to provide information that would reveal confidential communications between a client and an attorney, solicitor or other admitted legal representative where such communications are:

a) produced for the purposes of seeking or providing legal advice or;
b) produced for the purposes of use in existing or contemplated legal proceedings.[179]

Moreover, the requested party may decline a request for information if the information is requested by the applicant party to administer or enforce a provision of the tax law of the applicant party discriminates against a national of the requested party as compared with a national of the applicant party in the same circumstances. This is intended to ensure that an exchange of tax information does not result in discrimination.

While these limitations for exchange of tax information generally apply, the requested state is not precluded from providing tax information at its discretion even criteria to apply some of these limitations are not met.

[179] Article 7(3) of the OECD Model TIEA.

2.2.7 Time and cost of exchange of tax information under TIEAs

Timing. The OECD Model TIEA sets out an implicit time limit for the requested state to respond to the information request of its treaty partner. It states that the competent authority of the treaty partner shall forward the requested information 'as promptly as possible'.[180] It further states that in order to ensure a prompt response, the competent authority of the requested party shall confirm receipt of a request in writing to the competent authority of the applicant party and shall notify the competent authority of the applicant party of deficiencies in the request, if any, within 60 days of the receipt of the request. If the competent authority of the requested Party has been unable to obtain and provide the information within 90 days of receipt of the request, including if it encounters obstacles in furnishing the information or it refuses to furnish the information, it shall immediately inform the applicant Party, explaining the reason for its inability, the nature of the obstacles or the reasons for its refusal.

Costs. The OECD Model TIEA does not have specific rules on cost allocation. It stipulates that the costs incurred in providing assistance shall be agreed by the contracting parties.[181] The commentaries to the OECD Model TIEA states that flexibility is required in determining the incidence of costs to take into account factors such as the likely flow of information requests between the contracting parties, whether both parties have income tax administrations, the capacity of each party to obtain and provide information, and the volume of information involved.[182] The commentaries also suggest that the competent authorities may wish to establish

[180] Article 5(6) of the OECD Model TIEA.

[181] Article 9 of the OECD Model TIEA.

[182] Paragraph 99 of the Commentary to Article 9 of the OECD Model TIEA.

a scale of fees for the processing of requests that would take into account the amount of work involved in responding to a request.

2.3 Limitations of tax information exchange upon request under TCs and TIEAs

The exchange of tax information standards under the OECD and UN Model Tax Conventions, and the OECD Model TIEA have substantially improved since their initial introduction. However, one of the major questions is whether these standards are still relevant in today's highly globalized world. In fact, closer analyses of these standards reveal some important procedural and practical issues. This section aims to discuss these issues in detail.

2.3.1 Limitations of tax information exchange under TCs

One of the most problematic aspects of the exchange of information standards under TCs pertains to the method through which exchanges occur. Today, tax information exchanges under TCs occur upon request. In other words, the country seeking information on the foreign-source income of its taxpayer, can obtain such information only by making a specific information request to its treaty partner. In fact, the OECD and UN Model Tax Conventions prescribe this method of exchange as the only mandatory method for information exchanges under TCs.[183] Some scholars describe this method of exchange as 'pull' approach.[184] That is, a state needs to pull the information from its treaty partner.

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[183] See Paragraph 1 of the Manual on the Implementation of Exchange of Information Provisions for Tax Purposes in the OECD Model Double Taxation Convention. See Paragraph 1 of the Manual on the Implementation of Exchange of Information Provisions for Tax Purposes. OECD Committee on Fiscal Affaires, *Manual on the Implementation of Exchange of Information Provisions for Tax Purposes* (Paris: OECD, 2006).

[184] Marco Greggi, "Understanding 'Rubik' Agreements and Their Impact on EU Law (Do Germans and Brits Do It Better?)" (2012), at 3. (Greggi describes the current exchange of tax information standards the OECD Model

The precondition for the supply of information is that the requested information must be 'foreseeably relevant' to the enforcement of a tax convention and the domestic laws of the partner countries. Generally, the foreseeable relevance of the information is determined based on two criteria:

First, the information request must be made with the greatest degree of specificity regarding the taxpayer(s) about whom the information is sought.[185] There is often an official checklist of items that a requesting state generally has to provide in order to meet this requirement: [186]

1) Name of taxpayer (for individuals and legal entities);
2) Registration number (in the case of a legal entity),
3) Tax identification number and address (to the extent known);
4) Statement of the information sought, including its nature;
5) Tax purpose for which the information is sought;
6) Reasons for believing that the information sought is held by the requested party or is in the possession or control of a persona within the jurisdiction of the requested party;
7) Name and address of any person believed to be in possession of the requested information (to the extent known);

Double Taxation Convention as 'Pull" approach. This is because of the characteristic of the exchange of information that information were (and are) delivered on request).

[185] See Paragraph 5 of the Manual on the Implementation of Exchange of Information Provisions for Tax Purposes in the OECD Model Double Taxation Convention.

[186] See Paragraph 5 of OECD Committee on Fiscal Affairs, *Manual on the Implementation of Exchange of Information Provisions for Tax Purposes* (Paris OECD, 2006). See also Article 5 (Paragraph 5 (a)) the OECD Model Exchange of Tax information Agreement (2002).

8) A statement that the requesting party has pursued all means available in its territory to obtain the information, except those giving rise to disproportionate difficulties.

Second, most bilateral treaties also require that a requesting state must present satisfactory evidence in its information request that a taxpayer, about whom information is sought, is suspected in tax evasion, tax fraud, or criminal activity of such kind.[187] Thus, information request must be backed-up by a *prima facie* evidence linking the taxpayer to such unlawful activities. The information requests that do not meet these requirements are found inadequate and are often rejected.[188]

These requirements are intended to provide that contracting parties are not at liberty to engage in unspecified information requests or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer, which are commonly known as 'fishing expeditions'.[189] Fishing

[187] See Article 7(1) the OECD Model Exchange of tax information Agreement (2002); paragraph 5 of the Manual on the Implementation of Exchange of Information Provisions for Tax Purposes in the OECD Model Double Taxation Convention; the Commentary to Article 26 of the UN Model Double Taxation Convention (2011), Paragraph 25.

[188] See the report of the Federal Department of Finance of Switzerland. The report indicates that any tax information request to Switzerland's from its treaty partners is declined if it does not include the name and address of person about whom information is sought. The report can be found at http://www.efd.admin.ch/aktuell/medieninformation/00462/index.html?lang=en&msg-id=37645. These are also the positions taken by case laws. See *Re Lambert and Pinto*, vol. 962 Supreme Court of Bahamas, 1986); *Re Ansbacher*, vol. CILR 214 Cayman Islands Grand Court, 2001). (A Cayman bank had received notice of an order made by the Irish High Court authorizing an investigation into allegations that its affairs had been conducted with intent to defraud its clients' creditors by tax evasion. The bank wished to cooperate with the investigators to clear its own name by disclosing confidential information, including the identities of some of its clients, so that the investigators could seek confirmation from them of the bona fides of the transactions in question. Some of the clients objected on the basis that it would be an invasion of their privacy. The Cayman Grand Court held that no disclosure of the clients' identities to a foreign tribunal investigating a bank's alleged conspiracy to defraud would be permitted, unless there were specific and provable allegations of wrongdoing against the clients.)

[189] The term 'fishing expeditions' is metaphoric. It generally refers to unspecified information requests. See Commentary to paragraph 1 of Article 26 of the OECD Model Tax Convention. OECD, *Model Tax Convention on Income and on Capital (2010)*; Gordon, Venuti & Galan. *Supra* note 62, at 193.

expeditions are speculative requests for information that have no apparent link to an open inquiry or investigation.

However, these requirements also suggest that requesting country must have already collected significant information about its resident taxpayer and his or her foreign assets before making tax information request to its treaty partner. The more initial information is required from the requesting treaty partner, the less likely that the exchange of tax information will occur. The problem rests on the very fact that governments do not always know whether their tax residents hold offshore assets and derive foreign-source income; neither they are able to assert whether a taxpayer in question are involved in tax evasion or fraud without having *priori* information on the existence of their foreign assets. As a result, countries have been often unable to make tax information requests to their tax treaty partners under TCs.

For example, on March 12, 2009, the Swiss tax authorities reported a total of only 30 incoming tax information requests within the last 10 years.[190] This was an anecdotal result for a country, whose financial institutions are believed to hold one-third of the world's offshore wealth. Therefore, some government officials call the existing exchange of tax information regime under TCs as 'the highly restrictive, maddeningly slow and unproductive process".[191]

Realizing these problems, the OECD revisited the matter in 2012. In July 2012, it updated the Commentary to Article 26 of the OECD Model Tax Convention (2010). The update clarifies and

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[190] Jean-Rodolphe Fiechter, "Exchange of Tax Information: The End of Banking Secrecy in Switzerland and Singapore?" (2010) 36:6 International Tax Journal, at 59.

[191] David Voreacos, "Credit Suisse U.S. Clients in Limbo as Probe Inches Ahead" Bloomberg Business (7 March 2014). Available at http://www.bloomberg.com/news/2014-03-07/credit-suisse-u-s-clients-in-limbo-as-probe-inches-ahead.html

somehow simplifies the principle of foreseeable relevance. It provides that a request for information does not constitute a fishing expedition solely because it does not provide the name or address (or both) of the taxpayer under examination or investigation.[192]

In cases in which the requesting state does not provide the name or address (or both) of the taxpayer under examination or investigation, the requesting state must include other information sufficient to identify the taxpayer. However, where the request relates to a group of taxpayers not individually identified, it is often difficult to establish that the request is not a fishing expedition, as the requesting state cannot point to an on-going investigation into the affairs of a particular taxpayer which in most cases would by itself dispel the notion of the request being random or speculative. The commentaries state that in such cases it is therefore necessary that the requesting state provide:

a) A detailed description of the group and the specific facts and circumstances that have led to the request;
b) An explanation of the applicable law and why there is reason to believe that the taxpayers in the group for whom information is requested have been non-compliant with that law supported by a clear factual basis;
c) The requested information would assist in determining compliance by the taxpayers in the group.

Thus, the 2012 update of the Commentary to Article 26 of the OECD Model Tax Convention has endorsed the 'group requests' and established that group requests can meet the standard of

[192] Paragraph 5.2 of the Commentary to Article 26 of the OECD Model Tax Convention (2010). Available at http://www.oecd.org/ctp/exchange-of-tax-information/120718_Article%2026-ENG_no%20cover%20%282%29.pdf

foreseeable relevance. The significance of the the updates of the commentaries on the OECD Model Tax Conventions is that even though they substantially change the way the information requests are treated, they do not require any amendment to the relevant convention, neither to the TCs derived from it. By their nature, the commentaries are meant to clarify the existing provisions of the Model Conventions. Hence, the new provisions have been applicable since July 2012.

This has been an unprecedented progress in international tax law. It enables states to obtain information on the income of their residents in the territory of their treaty partners without providing detailed identification information. This brought the exchange of information upon request standard one step closer to the automatic information exchange regime. However, this progress still appears inadequate for the following reasons:

Information exchanges under TCs still occurs ‘upon request’. A contracting party is still required to make written information request to obtain tax information from its contracting partner; and such requests still carries some burden of proof that the request is specific. Moreover, under the existing system the states still needs to make multiple information requests to multiple countries even if the information they request are necessary for regular enforcement of its tax laws and even if the information they request every time relates to the same category of taxpayers and to the same category of incomes. Thus, why not to make such exchanges automatic? We will discuss this question in the next chapters.

2.3.2 Limitations of tax information exchange under TIEAs

The TIEAs have had the same inherent problem: exchanges occur upon request. In fact, the provisions of Model TIEA clearly express that the exchange of tax information "upon request" is the only mode of information exchange under TIEAs.[193] Moreover, TIEAs employ more stringent requirements for the information requests to be accepted. Article 5 of the OECD Model TIEA establish that a request for information must include the following information:

a) Name of taxpayer (for individuals and legal entities), registration number (in the case of a legal entity), to the extent known, tax identification number (TIN) and address;
b) Statement of the information sought, including its nature;
c) Tax purpose for which the information is sought;
d) Reasons for believing that the information sought is held by the requested party or is in the possession or control of a persona within the jurisdiction of the requested party;
e) To the extent known, the name and address of any person believed to be in possession of the requested information;
f) A statement that the request is in conformity with the laws and administrative practices of the applicant party, and that if the requested information is within the jurisdiction of the applicant party, the Competent Authority of the applicant party would be able to obtain the information under the applicant party's law or in the normal course of administrative practice;

[193] See Article 5 of the OECD Model Exchange of tax information Agreement (2002). (It should be noted that the exchange of tax information upon request is the only method of information exchange under the Model Exchange of tax information Agreement).

g) A statement that the applicant party has pursued all means available in its territory to obtain the information, except those giving rise to disproportionate difficulties.

After reading this comprehensive list, one's perception of the effectiveness of the agreements becomes obvious. In most cases, it is virtually impossible for tax authorities of the jurisdiction, which seek information, to know this information in advance. Therefore, there is doubt about TIEAs practicality in most cases.

2.3.3 Concluding remarks

Today, international exchange of tax information frameworks under TCs and TIEAs are the most prevalent vehicles for international exchanges of tax information. However, the volume of actual information exchanges under these frameworks is surprisingly low. One of the main reasons of the low performance of the frameworks appears to be the existing default rule that that exchanges of information must occur in response to specific tax information requests. In order to make such a request, a state effectively has to possess detailed information about the taxpayer in question: his or her foreign income, assets, location of these income and assets, and the name and details of the foreign institutions and third parties that hold such information. In fact, the states often seek the exact same information from their treaty partners to administer their tax laws.

Therefore, the existing international exchange of tax information frameworks remains fairly symbolic lacking any practical value. All that is possible through these frameworks are probably test checks of the actual or assessed amount of taxable foreign-source income of resident taxpayers on a very limited number of cases, the existence of which have been already known to the requesting state.

In the following chapters we will discuss possible venues for improvement.

2.4 International exchange of tax information frameworks and banking secrecy laws

Today most cross-border trade and investments are handled through international banking system, whereby a series of major regional banks and financial institutions are linked together to move funds across the globe.[194] These banks and financial institutions have an enormous reserve of financial information that is also crucial for tax purposes. Typically, bank information that is relevant for taxation purposes includes account, financial asset, and transactional information as well as information on the identity and residence status of account holders.

However, in practice for fiscal authorities, obtaining such information from these institutions has never been easy.[195] Historically, the banks and financial institutions have refused to disclose the financial affaires of their customers to third parties due to banking secrecy and other confidentiality laws.[196] This has created an opportunity for some taxpayers to use banks, especially banks in jurisdictions with strict banking secrecy laws, to shield their assets and incomes from domestic tax authorities. After all, the effectiveness of international taxation and international tax information exchange relations has become dependent largely on the access to

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[194] Yoon Park, *The Inefficiencies of Cross-Border Payments: How Current Forces Are Shaping the Future* (USA George Washington University 2007), at 2.

[195] Cynthia Blum, "Sharing Bank Deposit Information with Other Countries: Should Tax Compliance or Privacy Claims Prevail?" (2004) 6:6 Florida Tax Review 579, at 605.

[196] One of the most strict bank secrecy laws exists in Switzerland. Financial privacy is accorded the status of a constitutional right as part of individual's right to liberty and freedom. Ibid.; Doron Herman, *Taxing Portfolio Income in Global Financial Markets : a Positive and Normative Exploration of Possible Solutions* (Amsterdam: IBFD, 2002), at 223-224; Jean Saugy & Pascale Chapius, "Bank Secrecy and tax Law in Switzerland " in D. Campbell, ed., *International Tax Planning* (London Kluwer 1995) 127; Anne-Marie Berthault, "A French Perspective on Tax Havens and Bank Secrecy: Is the Future a Transparent One?" (2001):22 Tax Notes International 3171; US Senate Permanent Subcommittee on Investigations, *Tax Haven Banks and U.S. ta Compliance* (Washington, D.C.: United State Senate 2008).

tax relevant information held by banks and financial institutions.

This chapter aims to shed some light on the relationship between international exchange of tax information frameworks and national banking secrecy and confidentiality laws.

2.4.1 Concept and evolution of banking secrecy laws

Today banking secrecy as a fundamental principle of banking services is known to a greater or less extent in all countries.[197] It is generally understood as being the financial institution's professional or statutory obligation to keep its customers' financial information acquired in the course of the banking business confidential.[198] This confidentiality relationship gives the financial institution the right to reject a third party's inquiries into this information in order to protect the customers' interests. Thus, it is about keeping bank customers' personal information, accounts, and financial inflows and outflows in these accounts from the gaze of ordinary third parties.

A rational bank customer seeks privacy protection for these facts for variety of reasons: **First**, the banking information is a matter of privacy. The disclosure of such information may reveal considerably about one's earning status, savings position, spending habits, purchase preferences, and ultimately about one's personality. **Second**, such disclosure may also make the

[197] See http://www.financialsecrecyindex.com/. The index contains the list of countries with solid banking secrecy tradition.

[198] Jennifer Mencken, "Supervising Secrecy: Preventing Abuses Within Bank Secrecy and Financial Privacy Systems" (1998) 21 BC Int'l & Comp. L. Rev., at 470; He Ping, "Bank Secrecy and Money Laundering " (2004):7 Journal of Money Laundering Control 376, at 376.

accountholder physically, psychologically, and politically vulnerable.[199] Therefore, customers would be unlikely to entrust their money and financial data to banks if the confidentiality of their financial affaires could not be ensured. Given these considerations, banks also have their own business interest in maintaining the confidentiality of banking information of their customers.

The concept of banking secrecy has relatively long history and can be traced back to the beginning of banking activities in the seventeenth century.[200] Initially, it was bankers' mere ethical duty to maintain their clients' banking affaires confidential. Over time, this ethical duty has developed into a solid contractual relationship between bank and its customers.

One of the key dates in the evolution of banking secrecy practice is considered to be the revocation of the Edict of Nantes and the declaration of Protestantism illegal in France in 1685 by Louis XIV in France.[201] This led as many as 400,000 Protestants to flee France, with many of them moving to a neighbouring country, Switzerland, and transferring most of their wealth to Swiss banks. At that time, French kings were the best borrowing clients of Swiss banks. The discretion was of the utmost importance about these protestant depositors, as it should not be known publicly that the French Roman Catholic king, who declared Protestantism illegal, was, in substance, borrowing from the deposits of 'heretic' Protestants. Thus, the banks need to keep the identity of their depositors and borrowers confidential from one another.

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[199] MJ Lee & Byron Tau, "Democrats aim at Mitt Romney's Swiss bank account" Politico. Available at http://www.politico.com/news/stories/0712/78203.html

[200] Kurt Mueller, "The Swiss Banking Secret" (1969) 18:02 International and Comparative Law Quarterly, at 361.

[201] Miroslav Jovanović, *The Economics of International Integration*, vol. 423 (Edward Elgar Publishing, 2006), at 395.

The first known text on banking secrecy dates back to 1713 when the Great Council of Geneva adopted banking regulation, which required bankers to keep a register of their clients and their transactions. They were, however, prohibited from disclosing the information to anyone other than the client concerned, except the expressed agreement of the City Council.[202] During this period, bank secrecy laws were at their formative stage also in other parts of Europe. For example, in 1756 a decree by Friedrich the Great in Prussia stated that all German banks have to maintain confidentiality on the wealth of their customers and have to take that information with them to the grave.[203]

The first modern banking secrecy law was again introduced in Europe, in Switzerland by enacting the Federal Banking and Savings Bank Law in 1934. It, for the first time, made the violation of banking secrecy law as a crime punishable under criminal law.[204] This development

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[202] Ibid., at 395.

[203] Thomas Schulz & Torsten Fett, "Germany: Bank Confidentiality" in G. Griffiths, ed., *Neate: Bank Confidentiality* Tottel Publishing, 2006) 335-356. (Quoted from Art *19 des Reglements der Koniglichen Giro- und Lehn-Banco quoted in Claussen Bank- und Borsenrecht* (3rd edn, 2002), at 335.

[204] The Federal Banking and Savings Bank Law (8 November 1934), Article 47 (original text): Whosoever

a) as auditor or assistant to an auditor intentionally and seriously violates his duties during the audit or at the occasion of the drafting or rendering of the auditing report, whosoever intentionally omits the prescribed request to the bank to take the necessary measures or does not submit the prescribed reports to the Banking Commission.

b) As executive, official, or employee of a bank, as auditor or assistant to an auditor, as member of the Banking Commission, as official or employee of the Banking Commission's Secretariat intentionally violates the professional secret, induces or tries to induce others to do so, shall be punished by a fine not exceeding CHf. 20,000 or six months in jail. The penalties can be combined. If the act has been committed by negligence, the penalty shall be a fine not exceeding CHf. 10,000.

See Robert Vogler, "The Genesis of Swiss Banking Secrecy: Political and Economic Environment" (2001) 8:1 Financial History Review; Cambridge University Press.

The current revised version of Article 47 reads as follows:

brought the concept of banking secrecy from being mere contractual relationship between bank and its customers into a domain of public law by extending accountholder's protection beyond civil remedies. This sudden move in banking secrecy practice was associated with two concrete events:

a) In 1932, French government arrested two employees of a major Swiss bank, Basler Handelsbank, in Paris in relation to their open propaganda of the Swiss bank's 'utmost discretion' to French citizens and advising them to transfer their assets to Swiss banks.[205] The Basler Handelsbank affair eventually revealed that over 1,000 members of the French elite already held undeclared bank accounts in Switzerland. This revelation of these accounts to French government dropped the confidence of French people in Swiss banks' discretion, and in the aftermath, many French clients began to withdraw their money from Swiss banks. Concerned with the consequences of these developments, Switzerland had to take immediate measures to protect its banking system by enhancing its bank secrecy laws.

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c) Whoever divulges a secret entrusted to him in his capacity as officer, employee, mandatory, liquidator or commissioner of a bank, as a representative of the Banking Commission, officer or employee of a recognized auditing company, or who has become aware of such a secret in this capacity, and whoever tries to induce others to violate professional secrecy, shall be punished by a prison term not to exceed 6 months or by a fine not exceeding 50,000 francs.
d) If the act has been committed by negligence, the penalty shall be a fine not exceeding 30,000 francs.
e) The violation of professional secrecy remains punishable even after termination of the official or employment relationship or the exercise of the profession.
f) Federal and cantonal regulations concerning the obligation to testify and to furnish information to a government authority shall remain reserved.

See the Swiss Federal Law Relating to Banks and Savings Banks, RECUEIL SYST'MATIQUE DU DROIT FtDt-RAL [R.S.] 952.0.

[205] Sando Sasako, *Farewell to the Swiss Bank Secrecy Tradition and Principle* (Indonesia, Jakarta: 2010), at 4. Available at https://mayachitchatting.files.wordpress.com/2012/05/farewell-to-the-swiss-bank-secrecy-tradition-and-principle.pdf

b) The new development in banking secrecy laws was also associated with another concrete event.[206] The hyperinflation caused by the World War I substantially weakened national currencies in many European countries.[207] The post-War period witnessed restrictive monetary and exchange control policy in Germany.[208] In June 1933, the National Socialist government of Germany passed a law that required all German residents to declare their assets held outside of Germany or risk themselves with imprisonment, a minimum duration being three years. In some cases, non-reporting might also result in death penalty.[209] This event was followed by adoption of a law in Germany on the seizure of unpatriotic and anti-state assets in July 1933. The law was used mainly for confiscating the assets of Jews and political opponents of Nazi Germany. Thus, German Gestapo[210] began to espionage on Swiss banks for German "unpatriotic and anti-state" deposits, and when three Germans with Swiss bank deposits were revealed and put to death, the Swiss government was convinced of the necessity to reinforce its bank secrecy laws by criminalizing its breach.[211]

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[206] Vogler. *Supra* note 216, at 82.

[207] Edouard Chambost, *Bank Accounts: a World Guide to Confidentiality* (Wiley, 1983), at 5.

[208] C. Todd Jones, "Compulsion over Comity: The United States' Assault on Foreign Bank Secrecy" (1991) 12 Nw. J. Int'l L. & Bus, at 455.

[209] The Statute stated "Any German national who, deliberately or otherwise, activated by a base selfishness or other vile motive, has amassed his wealth abroad or left capital outside the country, shall be punished by death. See Chambost. *Supra note* 194, at 5.

[210] The Gestapo is an abbreviation of **Ge**heime **Sta**ats**po**lizei "Secret State Police" which was the official secret police agency of Nazi Germany before and during the World War II. It was formed in 1933 and existed until May 1945. See at http://en.wikipedia.org/wiki/Gestapo.

[211] Mueller. *Supra* note 187, at 361. (the author argues that in 1930s the Swiss Parliament considered it necessary to insert a specific secrecy provision in the Banking Law in response to Nazi Germany's attempt to investigate assets held by Jews and other "enemies of the state"); See also Adam LeBor, *Hitler's Secret Bankers: The Myth of*

As time passed, many people around the world began to realize the potential benefits of the strict Swiss banking secrecy law. The Switzerland was also making a large amount of money as a result of the enhanced secrecy factor. Thus, the objectives of maintaining undeclared foreign bank accounts have gone from preserving wealth and preventing political persecution to evading and cheating national taxes for some of the world's wealthiest individuals and companies.

2.4.2 International exchange of tax information frameworks and banking secrecy laws

Today, banking secrecy has become a fundamental principle of banking services in most countries. Generally, banks and similar institutions have statutory obligations as to confidentiality and secrecy in relation to their clients based either on specific law, e.g. bank secrecy law or on the civil contract between financial institution and the client.[212] Bank information for these purposes covers all information confided by the client to the bank or generated by bank itself in relation to that client which can be used to personally identify the client.

Generally tax administration of many countries has statutory power to override the bank secrecy laws to perform its mandate, however, in some other countries banking secrecy laws are so strict that they prohibit even tax administration from accessing the tax-relevant information of bank accountholders.

Swiss Neutrality During the Holocaust (New Jersey: Carol Publishing Group, 1997), at 3.

[212] "Bank secrecy law" indicates a category of laws that is intended to protect the secrecy of financial information accumulated generally by financial institutions but it is not necessarily limited to financial institutions. All countries provide to a greater or lesser extent, the authority and obligation for banks to refuse to disclose customer information to ordinary third parties.

This problem was first extensively analysed by the OECD, in its report entitled 'Improving Access to Bank Information for Tax Purposes' in 2000.[213] The report notes the lack of access to bank information for tax purposes to be one of the major impediments for effective international exchange of tax information between countries. The report also sets out an ideal standard of access to bank information, namely, that "all member countries should permit access to bank information, directly or indirectly, for all tax purposes so that tax authorities can fully discharge their revenue raising responsibilities and engage in effective exchange of information with their treaty partners".[214] Three years later, the OECD issued its second report on the problem. The second report notes that positive developments have occurred on the access to bank information for tax purposes in the OECD and non-OECD countries since the first report was issued but it noted that the main problem is still there. In 2004, the OECD moved from analyses to real actions. It revised Article 26 of its Model Tax Convention and incorporated, among others, a new paragraph (i.e. Paragraph 5) to the Article that deals with the issue of domestic banking secrecy laws. The paragraph expressly stipulates that in no case the domestic law limitations prescribed under Paragraph 3 shall be construed to permit a treaty partner to decline the tax information request of its treaty partner solely because the requested information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or it relates to ownership interests in a person.[215] Where requested information is not available in the tax files, the requested party must use its information gathering measures to seek to obtain the information

[213] OECD. *Supra* note 141.

[214] Ibid., at 45.

[215] See Article 26(5) of the OECD Model Tax Convention.

from such third parties.[216] The message was clear "no restriction to international exchange of tax information could be caused by application of a domestic bank secrecy laws". This means that tax treaties concluded after 2005 will normally contain these new paragraphs in their Article 26.

As a political support for this new standard, on 20 November 2004 at their Berlin meeting and on 15-16 October 2005 at their Xianghe meeting, the G20 Finance Ministers and Central Bank Governors declared that they are committed to the new standard developed by the OECD Committee on Fiscal Affaires.[217] They also called on those financial centres in and outside the OECD which have not yet adopted these standards to follow them and take necessary steps to allow their tax authorities to access in bank and ownership entity information.

The UN Committee of Experts on International Cooperation in Tax Matters also followed suit, and adopted the new wording of Article 26 of the OECD Model Tax in its proposed revision of Article 26 of the UN Model Tax Convention in 2008. [218]

Understandably, Austria, Belgium, Luxembourg, and Switzerland – all countries with strict banking secrecy laws – opposed to this new move and entered reservations on the 2004 amendments to the OECD Model Convention.[219] Particularly, they indicated that they would not

[216] See Paragraph 16 of the Commentary on Article 26 of the OECD Model Tax Convention.

[217] *Report on the Meeting of Finance Ministers and Central Bank Governors* (Berlin, Germany: G20, 2004); G20, *Report on the Meeting of Finance Ministers and Central Bank Governors* (Xianghe, China: G20, 2005).

[218] The Committee of Experts on International Cooperation in & Tax Matters, *Report on the Fourth Session, United Nations* (United Nations 2008).

[219] See the OECD Model Tax Convention on Income and on Capital: Commentary on Article 26, par. 24 (15 July 2005).

apply the new paragraph 5 of Article 26 of the Model Tax Conventions in their tax treaty negotiations.[220]

Peculiarity with the banking secrecy laws of Switzerland, Luxembourg, Austria, and Belgium was that their banking secrecy laws were so strict that they generally prohibit even domestic fiscal authorities from requesting financial institutions to provide with information about their customers' accounts.[221]

Luxembourg and Austria stated that banking secrecy clause was not negotiable unless Switzerland did the same. Switzerland had also rejected international pressure, saying that the OECD needs to ensure that Luxembourg and Austria back the new standards on the exchange of information before pressing others to adopt it. This tactic worked for some time and the OECD's pressure failed to yield any tangible result.

2.4.3 Transition to a new world: no banking secrecy protection in fiscal context

In the first half of the 2009, the international pressure to cooperate more proactively on tax matters mounted significantly. The potential breakthrough came from the United States in 2009 in the face of its massive tax evasion allegation against a Swiss bank, UBS. That case accused

[220] Confirmed in the reservations of Austria, Belgium, Luxembourg, and Switzerland to Article 26(5) of the 2005 OECD Model Tax Convention.

[221] See Articles 1, 2 and 4 of Grand-Ducal Decree of 24 March 1989 (Luxembourg). According to the Decree, credit institutions, other professionals of the financial sector, financial holding companies within the meaning of the act dated 31 July 1929, undertakings for collective investment, family wealth management companies may not be asked to provide information that may be used to levy taxes on their customers.

the UBS of facilitating offshore tax evasion by US customers.[222] Under the settlement agreement, UBS paid the IRS $780 million in criminal penalties and agreed to hand over names of 4,450 US accountholders with the bank.[223] However, UBS had claimed in court filings that turning over the names would violate Swiss law. Before it could supply those names, UBS needed to be shielded from another criminal charge – Swiss penalties for violating the country's legendary bank-secrecy laws. Switzerland immediately interfered the case claiming that such an affair is to be discussed at the government-to-government level. Eventually, the United States succeeded to renegotiate the exchange of tax information clause of its double taxation treaty with Switzerland as part of the settlement of the case.[224] Switzerland had to make painful concessions to the US. Under the amended agreement, the US can obtain all the Swiss banking data concerning its citizens, de facto eliminating Swiss banking secrecy laws for the US citizens.[225]

Eventually, Switzerland and other countries with strict banking secrecy laws found it hard to resist to the pressure from international community as the precedent now has been established. In 13 March 2009, Austria, Belgium, Luxembourg, and Switzerland withdrew their reservations

[222] Anand Sithian, ""But the Americans Made Me Do It!'': How United States v. UBS Makes the Case for Executive Exhaustion" (2011) 25:1 Emory International Law Review.

[223] Laura Szarmach, "Piercing the Veil of Bank Secrecy? Assessing the United States' Settlement in the UBS Case" (2010) 43:2 Cornell International Law Journal.

[224] See the Protocol on Amending the Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (23 September 2009). See also Martin Crutsinger, "U.S., Switzerland Agree to Crack Down on Tax Evaders" ABC News. Available at http://abcnews.go.com/Business/story?id=7884864&page=1#.Ud2tVIX78jw.

[225] Bradley Bondi, "Don't Tread On Me: Has the United States Government's Quest for Customer Records from UBS Sounded the Death Knell for Swiss Bank Secrecy Laws?" (2009) 30:1 Northwesternn Journal of International Law and Business.

and approved the new OECD standard for the exchange of information.[226] They agreed to revise their tax treaties so that their domestic banking secrecy laws are not used as justification to refuse information request of treaty partners. One of the main indications of the pledge was to conclude (or to renegotiate) at least 12 treaties that contain the new OECD standard concerning the banking secrecy. They are also required to commit to this new standard in their future tax treaty negotiations.

In 2 April 2009, the Global Forum published a progress report on implementing the internationally agreed tax standards in the OECD jurisdictions.[227] It notes that all OECD member countries have either substantially implemented or have committed to implement the new exchange of tax information standards except four countries: Costa Rica, Malaysia, Philippines, Uruguay. However, Austria, Belgium, Luxembourg, and Switzerland found themselves in the grey list as thy have not yet met the minimum information exchange agreement threshold. On the same day, in their London Summit, G20 leaders announced that 'the era of banking secrecy is over'.[228] In the summer of 2009, these countries were moved from the grey list into the white list, i.e. into the category of jurisdictions that have substantially implemented the internationally agreed tax standard.

[226] See Global Forum on Transparency and Exchange of Information for Tax Purposes, *G20 Report on Moving Forward on the Global Standards of Transparency and Exchange of Information for Tax Purposes* (Mexico G20, 2009), at 3. The report can be fount at www.oecd.org/tax/harmfultaxpractices/43775637.pdf

[227] The report is available at www.oecd.org/ctp/42497950.pdf

[228] For more information visit at http://www.oecd.org/belgium/belgiummakesprogressimplementingoecdstandardsontaxinformationexchange.htm

On March 2010, in an interview with Europolitics, then the head of Secretariat of the Global Forum, Pascal Saint-Amans stated "all these progresses mean the beginning of the end of banking secrecy in a fiscal context".[229] He further noted "banking secrecy is essential, because it enables the protection of privacy. Neither you nor I would like our banking information to be displayed in the window of the agency of which we are customers. Access to certain information should only be authorized in limited cases and defined by law. Combating fraud and tax evasion is part of this, universally from now on."

2.4.4 Concluding remarks

Historically banking secrecy laws were adopted with good intentions such as preserving individual's privacy, preventing extortion of property, and political persecution. However, as time passed by, people began to realize other potential benefits that offshore banking secrecy protection may provide, such as a tax minimization, tax evasion and alike. The banks were also making a large amount of profit from their services; the countries were attracting massive capital from abroad as a result of the secrecy factor in their banking industry. Thus, the purpose of maintaining undeclared foreign bank accounts has changed to protect the illegitimate interests of the world's wealthiest individuals and companies. Thus, has emerged excessive bank secrecy practice around the world. The excessiveness has begun from the time when bank secrecy laws began to shield their customers' banking affaires even from tax authorities that may need such information to enforce tax laws.

[229] Pascal Saint-Amans, "Exchange of fiscal information: Test of truth" (2010) Europolitics.

However, the latest surges against excessive national banking secrecy practices indicate a significant positive progress. Especially, the revision of Article 26 of the OECD and UN Model Tax Conventions in a manner that does not anymore allow treaty partner to decline the tax information request of its treaty partner due to domestic bank secrecy laws has been a major step forward to improve international exchange of tax information relations.

Chapter 3: International automatic exchange of tax information

Our analyses in Part 1 establishes that the states need extra-territorial information in order to enforce their tax laws on the foreign-source income of their resident taxpayers. However, their ability to access to such tax information is highly limited due to the well-recognized territoriality and sovereignty principles in international laws. Therefore, the states had to resort to international cooperation, namely international legal frameworks such as TCs and TIEAs to obtain the information.

However, our analysis in Part 2 concludes that the current tax information exchange mechanisms under TCs and TIEAs cannot effectively address this 'information gap' due to some default rules and restrictions in the frameworks. Hence, a more effective information exchange system appears necessary.

This part analyses automatic exchange of tax information as a promising solution for the problem. The analyses begin with exploring the concept, purpose, and history of automatic exchange of tax information system. It also examines some unilateral, regional, and multilateral frameworks as well as the recent OECD standard on automatic exchange of tax information with a view to evaluate their contribution to the development of the phenomenon. I also consider the challenges and prospects of these frameworks.

3.1 Concept, purpose, and history: automatic exchange of tax information

3.1.1 Concept of automatic exchange of tax information

International automatic exchange of tax information generally involves a systematic and periodic transmission of a bulk of tax-relevant information of non-resident taxpayers by tax authorities of one country to the tax authorities of another country where these taxpayers reside.[230] The exchange of information is automatic in that it occurs on a regular basis (e.g. annually) and the scope of information to be reported has been agreed in advance, rather than being proceeded by a specific request.[231] Such tax information is collected in the source country. The source country obtains this information on a routine basis through reporting of third parties (e.g. financial institutions) in its territory who make or administer payments to non-residents. The source country may then simply verify the accuracy of the bundled information and forward it to the taxpayer's country of residence. The OECD Information Brief divides the basic process of automatic exchange of information into 7 separate steps:[232]

1. Payer or paying agent of host country collects information from the taxpayer and/or generates information itself. While most tax systems operate in this way, some require

[230] The OECD Council Recommendation C (81)39. See "Recommendation of the Council concerning a standardized form for automatic exchanges of information under international tax agreements" dated May 5, 1981. Available at http://acts.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=84&InstrumentPID=81&Lang=en&Book=

[231] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Automatic Exchange of Information: A Roadmap for Developing Country Participation* (France: Paris Global Forum on Transparency and Exchange of Information for Tax Purposes 2014), at 4.

[232] OECD, *Automatic Exchange of Information: What it is, How it Works, Benefits, What Remain to Be Done* (Paris OECD, 2012), at 9. Available at http://www.oecd.org/ctp/exchange-of-tax-information/automatic-exchange-of-information-report.pdf

the taxpayer to file a refund claim directly to the tax administration. It is from such refund claims that the tax administration may obtain the information to exchange;

2. Payer or paying agent reports the information to their domestic tax authorities regarding the identity of non-resident taxpayers as well as payments made to them;
3. The tax authorities consolidate all information received and prepare separate country-by-country bundles depending on non-resident taxpayers' country of residence;
4. Information is encrypted and bundles are sent to residence country tax authorities;
5. Information is received and decrypted;
6. Residence country feeds relevant information into an automatic or manual matching process;
7. Residence country analyses the results and takes compliance action as appropriate;

This process may be much easier to understand with a basic example. For example, a Canadian resident taxpayer holds deposit of $100,000 in a Swiss bank. If that deposit earns 5% interest annually, the Canadian resident has a foreign-source interest income of $5,000 a year. Under the automatic exchange of tax information system the Swiss bank is supposed to report the income to the Swiss tax authorities on a periodical basis (e.g. annually), which in turn transmits this information to the Canadian tax authorities. The method of transmission generally takes place electronically and directly from one country's exchange of information portal to the other country's exchange of information portal. The Canadian tax authorities can then match this information with the information that it has received directly from the taxpayer (i.e. submitted through his or her tax return filing for the period) to verify whether the taxpayer has properly reported the relevant income for the relevant period. Based on the results of the matching process, the tax authorities may also commence compliance action against the taxpayer that may not have complied with reporting obligations.

The information to be exchanged typically covers name of the taxpayer, tax identification number (TIN) assigned by the residence country, the taxpayer's temporary and permanent addresses, the type and the amount of income earned for the period, and the details of the payer in the source country. It can also cover other items such as information on financial assets, immovable property, value added tax refund, etc.[233]

3.1.2 Purpose of automatic exchange of tax information

Automatic exchange of information may help states to establish an accurate picture of their residents' income, when their tax liability depends on their worldwide income or assets. It also helps to verify the accuracy of the taxpayers' income declaration or the accuracy of the claims or proof asserted by the resident taxpayers in defence of their tax declaration.

The system also improves tax compliance. It encourages resident taxpayers to report all tax relevant information on foreign-source income to their countries of residence as the latter has access to such information through the automatic exchange system.

Finally, automatic exchange of tax information ensures equal treatment of resident taxpayers with domestic and foreign source incomes thereby eliminating the opportunity for tax-distorted reallocation of economic and financial resources.

[233] OECD Committee on Fiscal Affaires, *Automatic Exchange of Information: What It Is, How It Works, benefits, What Remains to Be Done* (Paris: OECD, 2012), at 7.

3.1.3 Historical development of automatic exchange of tax information standards (in brief)

The idea of automatic exchange of tax information was first mentioned in the commentary to Article 26 (1) of the OECD Model Tax Convention of 1963 as one of three forms of information exchange between treaty partners: a) exchange on request, b) spontaneous exchange, and c) automatic exchange.[234] However, this form of exchange required treaty partners to have an additional administrative agreement in place for such exchanges to occur. This additional agreement was supposed to determine logistics and operational aspects of automatic exchange of tax information. Yet, there was no guidance or model on such agreements. Hence, this form of exchange remained largely as an idea rather than a practice.

One of the earliest international instruments that laid down a practical foundation for automatic exchange of tax information between states has been the Nordic Convention on Mutual Administrative Assistance in Tax Matters (Nordic Convention).[235] The Nordic Convention was concluded between Denmark, Finland, Iceland, Norway, and Sweden in 1972 and was amended in 1976, 1981, and 1987. This regional convention was renewed again in 1989 and included the Faroe Islands and Greenland (parts of Denmark but independent in tax matters) as new parties.[236]

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[234] *1963 and 1977 OECD Model Income Tax Treaties and Commentaries: A Comparative Presentation* (France, Paris: Organisation for Economic Co-operation and Development, 1987).

[235] *Nordic Convention on Mutual Administrative Assistance in Tax Matters as amended in 1989* (Copenhagen 1972).

[236] The Global Forum on Transparency and Exchange of Information for Tax Purposes, Combined Peer Review Report: Norway, paragraph 210. Available at http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/global-forum-on-transparency-and-exchange-of-information-for-tax-purposes-peer-reviews-norway-2013_9789264205888-en#page1

The Nordic Convention puts a great emphasis on automatic exchange of tax information. Particularly, Article 11 of the Convention stipulates that the competent authority of each contracting state shall regularly supply to the competent authorities of each of the other contracting states, without any special request, information concerning individuals and legal entities who are resident in such other state in respect of dividends, interest, royalties, wages, salaries, fees, pensions and life annuities, compensation for damage, insurance payments, and similar compensation received in connection with business activities, or any other income or property. This Convention later formed the basis for the Convention on Mutual Administrative Assistance in Tax Matters, which is another international framework that has greatly contributed to the evolution of the concept of automatic exchange of information.

The Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention) was developed jointly by the OECD and the Council of Europe in 1988.[237] Article 6 of the Convention talks about the possibility of automatic exchange of tax information between the contracting parties. However, this instrument also required the existence of an additional agreement between the competent authorities of interested contracting parties to launch automatic exchange of information. In practice, such administrative agreements were hardly concluded.

In the meantime, there begun to appear a few bilateral deals on automatic exchange. For example, Canada and the United States concluded an agreement under which they could automatically

[237] Council of Europe/ OECD, *Convention on Mutual Administrative Assistance in Tax Matters (as amended by Protocol in 2010)* Council of Europe/ OECD 1988).

exchange information on certain types of income.[238] Since 1997, the agreement allows the contracting parties automatically exchanging information on interest payments made to the resident individual taxpayers of one party on their bank deposits in the other party's territory.

In 1998, the OECD initiated a project, "Harmful tax competition: an emerging global issue" in response to a request by the OECD member states to develop measures to counter the spread of harmful tax practices.[239] The project focused on the concerns of OECD countries, which were exposed to significant revenue losses as a result of harmful tax competition.[240] The resulting report provided a set of guidelines and a timetable for the OECD member countries to identify, report, and eliminate the harmful features of their preferential regimes. In particular, it recommended a) to identify and eliminate harmful features of preferential tax regimes in OECD member countries b) to identify "tax havens" and seeking their commitments to the principles of transparency and effective exchange of information and c) to encourage other non-OECD economies to associate themselves with this work. The OECD member states welcomed this Report and mandated the organization to pursue the work. It was intended to ensure that the burden of taxation is fairly shared and that tax should not be the dominant factor in making capital allocation decisions. Although the OECD's project did not specifically discuss about

[238] See Article 27 of the Convention between Canada and the United States with Respect to Taxes on Income and on Capital from September 26, 1980, as amended by the Protocols done on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007.

[239] OECD, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998). The project and its agenda have evolved over time and following the gradual commitments made by the OECD member states.

[240] Andrew P Morriss & Lotta Moberg, "Cartelizing Taxes: Understanding the OECD's Campaign against Harmful Tax Competition" (2012).

automatic exchange of information, its call for global transparency and exchange of information on request in tax matters was leading in this direction.

In March 2001, the OECD finally introduced a long-awaited model administrative agreement, i.e. the Model Memorandum of Understanding on Automatic Exchange, which could be used to operationalize the automatic exchange of information frameworks under double tax treaties and the Convention on Mutual Administrative Agreement in Tax Matters.[241]

In the meanwhile, there was another regional attempt that significantly contributed to the automatic exchanges of information practice. The liberalization of capital markets and the free movement of capital within the EU member states revealed how important it is to establish cooperation between member states with a view to preventing tax evasion in cross-border financial investments. There were ample problems of taxpayers moving their investments to other member states which did not impose taxation at source while the taxpayers simultaneously under-reported or non-reported their foreign-source income to their respective state of residence. In 2003, the European Commission adopted a new regime called "Savings Directive" (2003/48/EC) to address this issue. The Directive imposes the obligation on each EU member state to automatically report the interest payments its residents make to the residents of other EU member states. Thus, the Savings Directive attempts to ensure that each EU Member State has information to tax the savings income of its residents, including their savings income from other EU Member States. The Directive has been applicable in the EU since July 2005.

[241] OECD, *Model Memorandum of Understanding on Automatic Exchange for Tax Purposes* (Paris: OECD, 2001).

Analysing these developments and summarizing their best practices, in January 2006 the OECD issued the Manual on the Implementation of Exchange of Information Provisions for Tax Purposes.[242] The Manual analyses the practical aspects of implementing automatic exchange of information, explaining the legal basis of such exchange.

In 2010s, attitudes to the automatic exchange of information system drastically changed. Political and scholarly interests have begun to focus increasingly on the opportunities provided by this system. This change of attitude was in part the result of the global financial crisis in 2007-2009. Invigorated by the impact of the financial crisis on the revenue, the international community began to call for greater global transparency for tax purposes. In this context, the United States gave the world a big push when it passed the Foreign Account Tax Compliance Act (FATCA) in 2010.[243] The law requires financial institutions outside the United States to register with the US Internal Revenue Service (IRS) and commit to regularly report their U.S. clients' accounts to the IRS. This fairly controversial US law was a result of some revealed abuse cases of the existing US tax regime concerning foreign-source income reporting by US taxpayers with the help of some foreign financial institutions.[244] The extraterritorial implications of the law eventually led

[242] OECD Committee on Fiscal Affairs, *Manual on the Implementation of Exchange of Information Provisions for Tax Purposes* (Paris OECD, 2006). Available at http://www.oecd.org/ctp/exchange-of-tax-information/cfaapprovesnewmanualoninformationexchange.htm

[243] Itai Grinberg, *Beyond FATCA: An Evolutionary Moment for the International Tax System* (Georgetown: Georgetown Law: Scholarly Commons 2012).

[244] Josepf Erwin, "The UBS Affäre: A Qualified Intermediary and "John Doe" Summons, Steuerbetrug, and Bankgeheimnis" (2009) 38:8 Tax Management International Journal.

to the emergence of FATCA intergovernmental agreements (IGAs).[245] According to the IGAs, the foreign government to collect the necessary information from its banks and transmit it to the US. In return, under some IGAs the US has agreed to do the same for the foreign government. Thus, the IGA essentially transformed FATCA from being a mere domestic law into bilateral agreements. More importantly, the US approach served as a catalyst to put the matter of automatic exchange of information once again to the OECD agenda, but this time with much urgency and vigour.

In Summer 2012, the OECD issued a report on automatic exchange "What it is, how it works, benefits, what remains to be done".[246] This report describes the key aspects of automatic exchange of information, in particular, (a) What is automatic exchange of information? (b) How does it work? (c) What is the legal basis? (d) What is the current state of play? (e) Does automatic exchange work, and (f) What is the OECD doing in this area and what still needs to be done? The work received applause from the G20 leaders in their Summit in Mexico in June 2012.[247]

In April 2013, there was a major breakthrough in international tax policy. The G20 countries took a formal move towards implementation of the automatic exchange of information practice by endorsing automatic exchange as the expected new standard for international tax information

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[245] US Treasury Department, "Joint Statement from the United States, France, Germany, Italy, Spain, and the United Kingdom regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA" (February 8, 2012).

[246] For more details, visit at http://www.oecd.org/ctp/exchange-of-tax-information/improvinginternationaltaxco-operationoecdreleasesreportsonautomaticexchangeandtaxconfidentiality.htm

[247] G20 Leaders Declaration (June 18-19), paragraph 48. Available at http://www.g20.utoronto.ca/summits/2012loscabos.html

exchanges and asked the OECD to develop a new multilateral standard on automatic exchange of information.[248] The G20 countries also called on all other countries to join this initiative by the earliest possible date.[249]

On 13 February 2014, the OECD released its initial draft of the Standard of automatic exchange of financial account information in tax matters.[250] The Standard essentially requires financial institutions around the world to take on the role of tax agents. It requires the financial institutions to necessary system in place to identify their clients and to report information on accounts held by non-resident individuals and entities (including trusts and foundations) to their local tax authority. The local tax authority then securely transmits the information to its counterparts in the account holders' countries of residence on an annual basis. In order to ensure that the

[248] *G20 Meeting of Finance Ministers and Central Bank Governors - Communiqué* (Washington DC: G20, 2013). Paragraph 14. The document can be found at http://www.g20.utoronto.ca/2013/2013-0419-finance.html

[249] "We commend the progress recently achieved in the area of tax transparency and we fully endorse the OECD proposal for a truly global model for multilateral and bilateral automatic exchange of information. Calling on all other jurisdictions to join us by the earliest possible date, we are committed to automatic exchange of information as the new global standard which must ensure confidentiality and the proper use of information exchanged, and we fully support the OECD work with G20 countries aimed at presenting such a new single global standard for automatic exchange of information by February 2014 and to finalizing technical modalities of effective automatic exchange by mid-2014. In parallel, we expect to begin to exchange information automatically on tax matters among G20 members by the end of 2015. We call on all countries to join the Multilateral Convention on Mutual Administrative Assistance in Tax Matters without further delay. We look forward to the practical and full implementation of the new standard on a global scale. We encourage the Global Forum to complete the allocation of comprehensive country ratings regarding the effective implementation of information exchange upon request and ensure that the implementation of the standards are monitored on a continuous basis. We urge all jurisdictions to address the Global Forum recommendations in particular those 14 that have not yet moved to Phase 2. We invite the Global Forum to draw on the work of the FATF with respect to beneficial ownership. We also ask the Global Forum to establish a mechanism to monitor and review the implementation of the new global standard on automatic exchange of information." See G20, *G20 Leaders' Declaration* (Russia, Saint Petersburg G20, 2013). http://www.g20.utoronto.ca/2013/2013-0906-declaration.html

[250] *OECD Standard for Automatic Exchange of Financial Account Information in Tax Matters (with commentaries)* (France: Paris OECD, 2014).

information is accurate and complete, the standard also specifies the information gathering procedures to be followed by financial institutions. Shortly thereafter, on 9 July 2014, the OECD released the full version of the Standard for Automatic Exchange of Financial Account Information in Tax Matters.[251] The full version of the Standard includes commentaries and guidance, detailed model agreements, as well as a standard format and requirements for secure transmission of data.

All these events indicate that the concept of international automatic exchange of tax information has evolved from being a mere idea into a practice within a relatively short period of time. In the next section, we analyse each of these frameworks in detail.

3.2 Evolution of automatic exchange of tax information regimes

Although each exchange of tax information framework has an individual accent because of its divergent origin, it has been strongly influenced by others and highly comparable in a number of aspects. Thus, in order to prevent unnecessary repetition, I will discuss them according to the theme where differences will be highlighted.

3.2.1 Nordic Mutual Assistance Convention (1972)

3.2.1.1 Introduction

The cooperation between the Nordic countries in the field of taxation and exchange of information is among the most oldest and extensive in the world. One of the earliest and most pioneering international instruments that laid down foundation for such cooperation was is the

[251] Available at http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm

Nordic Convention on Mutual Administrative Assistance in Tax Matters (Nordic Convention). The Nordic Convention was concluded between Denmark, Finland, Iceland, Norway, and Sweden in 1972 and was subsequently amended in 1976, 1981, and 1987. The convention was renewed in 1989 including the Faroe Islands and Greenland (parts of Denmark but independent in tax matters) as parties. This renewed convention now forms the basis for the current Nordic Convention, which entered into force in 1 May 1991.[252] The Nordic Convention was fully renegotiated in 2007, but the new Convention has not been signed yet.[253]

3.2.1.2 Historical background

Generally, the Nordic countries - Denmark, Finland, Iceland, Norway, and Sweden - maintain a higher burden of taxes compared to other countries.[254] When calculated the total tax revenue as a percentage of gross domestic product in these countries, its share ranges between 43.4 – 48%.[255] Therefore, these countries have a strong history of promoting mutual assistance for the prevention of tax evasion and for mutual assistance in assessment and collection of taxes. Strong historical, cultural, and economic ties between Denmark, Finland, Iceland, Norway, and Sweden

[252] Global Forum on Transparency and Exchange of Information for Tax Purposes, Combined Peer Review Report: Norway, Paragraph 210.

[253] Ibid, paragraph 211.

[254] In 2014, in Denmark corporate tax rate was 24%, while the highest individual marginal tax rate was 64%; in Finland these rates were 20% and 61.96% respectively; in Norway these rates were 28% and 47.8%; in Sweden these rates were 22% and 57%. See for more information http://en.wikipedia.org/wiki/List_of_countries_by_tax_rates.

[255] In 2014, the total tax revenue as a percentage of gross domestic product in Denmark was 48%, in Finland 43.4%, in Norway 43.6%, and in Sweden 44%. See the Index of Economic Freedom 2014 at http://www.heritage.org/index/ranking.

facilitate such cooperation. Historically, Denmark and Norway as well as Finland and Sweden both were, in fact, one states.[256]

As usual, these countries started collaboration in tax matters on a bilateral basis. The first mutual assistance agreement was signed between Finland and Sweden in 1943, followed by others in 1949, so that by 1956 Denmark, Finland, Norway and Sweden all had bilateral tax agreements with each other.[257] Apart from mitigating international double taxation, these agreements were also intended to facilitate the enforcement of taxes in which taxpayers had left one of the states or the other.

In 1970, the Nordic countries decided that a multilateral convention on administrative assistance in tax matters between Norway, Denmark, Finland, Iceland, and Sweden should be prepared. Thus, the Nordic Convention was signed in 1972. The 1972 treaty was amended in 1976, 1981 and 1987. A new convention was signed in 1989 including the Faroe Islands and Greenland as parties. The current version of the Convention became effective in May 1991 and it is in force to date. The Convention includes provisions concerning exchange of information, collection of taxes as well as supply of tax return forms and service of documents.

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[256] Nils Mattssan, "Is the Multilateral Convention a Solution for the Future?-Comments with Reflection to the Nordic Experience" (1985) 13:9 Intertax, at 212.

[257] Global Forum on Transparency and Exchange of Information for Tax Purposes, Combined Peer Review Report: Norway, Paragraph 210.

It must be noted that due to the existence of this separate convention on mutual tax cooperation, the multilateral double tax treaty concluded between the Nordic countries does not contain provisions concerning exchange of information or assistance in the recovery of claims.[258]

3.2.1.3 Scope of the Nordic Convention

The Nordic Convention has a very wide scope. According to the convention, a contracting state is obliged to provide administrative assistance regarding all tax matters and all tax claims arising in another contracting state in accordance with its laws relating to the taxes and levies covered by the convention.[259] Particularly, the Article 1 identifies the categories of assistance that may be requested and lent under the convention in the following forms:

a) Service of documents;
b) Supply of information in tax matters, such as the procurement of tax returns or other statements and the exchange of information, either spontaneously or upon request, in particular cases;
c) Supply of tax return forms and other tax forms;
d) Measures to avoid the imposition of preliminary tax in more than one Contracting State;
e) Collection of taxes;
f) Transfer of tax; and
g) Recovery of tax and the provision of guarantees for the payment of tax claims.

[258] Maria Valkama, "The Nordic Mutual Assistance Convention on Mutual Administrative Assistance in Tax Matters" in O. Gunther & N. Tuchler, eds., *Exchange of Information for Tax Purposes* (Vienna Linde Verlag 2013), at 200-201.

[259] Article 4(1), the Nordic Convention.

The Nordic Convention covers almost all kinds of direct and indirect taxes collected in the participating countries. Particularly, it covers income taxes, taxes on dividends, interest, royalties, wages, salaries, fees and ownership of real property. In addition to these taxes, the convention also covers taxes on inheritances, and excise duties, social security contributions, and other security contributions, and other public levies.[260]

The Convention states that tax information assistance may concern measures not only against the taxpayer but any other person who is obliged to give assistance to tax authorities of the contracting state to which the request is directed.[261] Thus, mutual assistance is not restricted by residence and nationality of persons as long as the information is necessary to assess the taxes covered by the Convention. It is often asserted that national borders between the Nordic countries are virtually non-existent for the purpose of this Convention.

3.2.1.4 Principles of mutual assistance under the Nordic Convention

Reciprocity. The assistance under the Nordic Convention may not be requested unless the applicant state is itself not in a position, under its own laws, to furnish comparable assistance at the petition of the requested state.[262] Thus, the mutual assistance under the Convention is based on reciprocity.

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[260] Article 2, the Nordic Convention.

[261] Article 4(2), the Nordic Convention.

[262] Article 4(3), the Nordic Convention.

Proportionality. A request for assistance under the Convention may only be made if the action requested cannot be undertaken in the state itself without considerable difficulties.[263] Thus, the applicant state must have exhausted all possible administrative actions under its law before requesting other contracting state for assistance.

Secrecy. With respect to any inquiries, information, statements and other communications supplied to one of the contracting states, the provisions of the laws of that state concerning secrecy shall apply.[264]

3.2.1.5 Methods of exchange of information under the Nordic Convention

The methods of information exchange under the Nordic Convention are extensive, consisting of following:

(a) Tax information upon request;

(b) Spontaneous exchange;

(c) Automatic exchange.

Tax information upon request. The Nordic Convention requires that a request for information assistance must contain the name of the authority, which requires such assistance and the name, occupation or title, address, date of birth, municipality of residence, and, if possible, the place of work, and place of sojourn of the person concerned. The request must also contain information

[263] Article 4(3), the Nordic Convention.

[264] Article 21, the Nordic Convention.

on any other particulars, which might be helpful in identifying that person.[265] The request for information must be drafted in or accompanied with a translation into Danish, Norwegian or Swedish.[266]

Spontaneous exchange of tax information. The Convention also establishes that the competent authority of contracting state commits itself to forward any information resulting from an examination carried on in that state in a tax matter, that can be assumed to be of interest for another contracting state, to the competent authority of that other state without delay.[267]

Automatic exchange of tax information. The convention puts a great emphasis on automatic exchange of tax information. Particularly, Article 11 of the Convention stipulates that as soon as after the end of each calendar year, the competent authority of each contracting state shall, to the extent possible on the basis of control information and similar information available, supply to the competent authorities of each of the other contracting states, without any special request, information concerning individuals and legal entities who are resident in such other state in respect of:

a) Dividends paid by companies and similar legal entities;
b) Interest on bonds and similar securities;
c) Credit balances with banks, savings banks and similar institutions and interest on such balances;

[265] Article 1, the Nordic Mutual Assistance Convention.

[266] Article 5, the Nordic Mutual Assistance Convention.

[267] Article 11(2), the Nordic Mutual Assistance Convention.

d) Ownership of immovable property;

e) Royalties and other periodic payments for the use of copyrights, patents, designs, trade marks and similar rights or property;

f) Wages, salaries, fees, pensions and life annuities;

g) Compensation for damage, insurance payments and similar compensation received in connection with business activities; and

h) Any other income or property.

Moreover, if a resident of one of the contracting states has died and leaves immovable property situated in another contracting state or property invested in a business therein, the competent authority of the first-mentioned state shall advise the competent authority of the other state about such event as soon as the event has come to the notice of that authority.

3.2.1.6 Limitations to the mutual assistance under the Nordic Convention

A request for assistance under the Nordic Convention may be rejected if the requested state deems it contrary to its general interests.[268] Moreover, a request for information may be refused if complying with the request would disclose business, manufacturing or professional secrets.[269] However, in all these cases the requesting state must be immediately notified of such a decision and the grounds therefore.

[268] Article 6, the Nordic Convention.

[269] Article 10(2), the Nordic Convention.

3.2.1.7 Cost and timing of the mutual assistance under the Nordic Convention

The applicant state is obliged to reimburse the expenses of assistance incurred by the requested state but only to the extent that these expenses result from court proceedings other than in administrative courts or bankruptcy proceedings.[270]

The Nordic Convention does not specify any time limits for the assistance. However, it states that if the request for assistance is accepted, the contracting state from which the assistance is requested shall notify the other Contracting State of the outcome of the assistance as soon as possible.[271]

3.2.1.8 Concluding remarks

The Nordic Convention has provided a comprehensive framework for exchange of tax information among Nordic countries. The significance of the Nordic Convention for our study on automatic exchange of tax information is that it is one of the earliest international instruments that include an explicit provision on the automatic exchange of information. Its automatic exchange of information provisions have existed in the Convention since it was first introduced in 1972. This makes the Nordic Convention one of the earliest international instruments that laid practical foundation on automatic exchange of tax information between countries.

The Nordic Convention is also the first international instrument that has brought the automatic exchange of tax information into multilateral setting. Finally, the success of the Nordic Convention led the Council of Europe and the OECD to use it as a basis to draft the 1988

[270] Article 19, the Nordic Convention.

[271] Article 7(2), the Nordic Convention.

Convention on Mutual Administrative Assistance in Tax Matters that introduced international automatic exchange of tax information to a wider geographical area.[272] The next section will discuss the Convention on Mutual Administrative Assistance in Tax Matters.

3.2.2 Convention on Mutual Administrative Assistance in Tax Matters (1988)

3.2.2.1 Historical backgrond

The Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention) is the result of work carried out jointly by the Council of Europe and the OECD. The Convention was originally introduced in 1988. It was initiated in a Council of Europe Parliamentary Assembly resolution in 1978;[273] and the draft Convention was approved by the OECD Fiscal Committee in 1986. The Multilateral Convention was opened for signature by the member states of each of these two international organizations on 25 January 1988. The Convention entered into force on 1 April 1995.[274]

The objective of the Multilateral Convention is to enable its signatory parties to combat international tax evasion and to better enforce its national tax laws through international

[272] See the Council of Europe Parliamentary Assembly recommendation 833 (24 April, 1978) on cooperation between the Council of Europe member states against international tax avoidance and evasion. Available at http://assembly.coe.int/Main.asp?link=/Documents/AdoptedText/ta78/EREC833.htm

[273] Ibid.

[274] Paragraph 39, Introduction to the OECD Model Tax Convention on Income and Capital (2010). Available at https://books.google.ca/books?id=jrP-NxB24MYC&pg=PA16&lpg=PA16&dq=Multilateral+convention+on+mutual+administrative+assistance+in+tax+matters+came+into+force+in+1995&source=bl&ots=3XDL4GKcJv&sig=B98jqIUZYRClFQuxzF0WnlBVARk&hl=en&sa=X&ei=-erWVLenEo-qyATwroFQ&ved=0CDAQ6AEwAw#v=onepage&q=Multilateral%20convention%20on%20mutual%20administrative%20assistance%20in%20tax%20matters%20came%20into%20force%20in%201995&f=false

administrative cooperation, while respecting the fundamental rights of taxpayers. The Multilateral Convention provides all possible forms of administrative co-operation between member states in the assessment and collection of taxes. It intends to facilitate international cooperation in three basic forms:

a) International exchange of tax information, including simultaneous tax examinations and participation in tax examinations abroad;
b) International assistance in recovery of taxes, including measures of conservancy;
c) International service of documents.[275]

Thus, the commitment to provide administrative assistance in tax matters may lead one tax administration to take the aforementioned actions on behalf of another State at any of these stages of taxation, not only to combat tax evasion but also to ensure the better implementation of tax legislation. In practice, a tax administration will, in most cases, take action only when a request is made by the tax administration of another party. In so doing, the assisting state makes use of the powers it possesses under its tax laws to obtain information, to examine taxpayers' accounts, and even to recover money on behalf of the other state and, more generally, to enforce the other state's tax laws.

Cooperation between the Multilateral Convention's signatory parties was greatly facilitated by the fact that the Council of Europe and by the OECD countries have legal systems based on similar general principles of justice and law as well as interrelated economies.

[275] Article 1 of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. Available at http://www.oecd.org/ctp/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm

One of the great supporters of the Multilateral Convention is the G20 group. In April 2009, at its London Summit, the G20 stressed the importance of improving international cooperation in tax matters especially through exchange of information and called for a multilateral approach for exchange of information.[276] It considered the Convention as a potential comprehensive multilateral framework in this direction. By April 2010, less than one year after the 2009 London Summit, the Multilateral Convention was amended by a protocol to respond to the call of the G20. The Protocol aligned the Multilateral Convention to the internationally agreed standards on transparency and exchange of information and opened it up to states outside of the OECD or of the Council of Europe. Since then the G20 has consistently encouraged all countries to sign the Multilateral Convention including most recently at the meeting of the G20 Leaders Summit in September 2013.[277]

Any state wishing to accede to the Convention may tailor the extent of its obligations, by virtue of a detailed system of reservations expressly provided for. Until now more than 60 jurisdictions, including all G20 countries, have signed the Multilateral Convention and 10 more countries have committed to do so.[278]

Today, the Multilateral Convention is considered as one of the most solid international legal frameworks to facilitate international tax cooperation through inter-country exchanges of tax

[276] For further details on the official website of the G20's London Summit, visit at http://www.londonsummit.gov.uk/en

[277] http://www.oecd.org/tax/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm

[278] See the chart of signatory parties of the Multilateral Convention. Available at http://www.oecd.org/ctp/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm

information. The OECD described the Multilateral Convention as a freestanding multilateral agreement designed to promote international co-operation for a better operation of national tax laws, while respecting the fundamental rights of taxpayers.[279]

3.2.2.2 Scope of exchange of tax information under Multilateral Convention

Exchanges of information are the most immediate form of administrative assistance between tax authorities under the Multilateral Convention. The Convention establish that the parties to the Convention shall exchange any information that is foreseeably relevant to the assessment and collection of tax, and the recovery and enforcement of tax claims, and the prosecution before an administrative authority or the initiation of prosecution before a judicial body.[280]

Taxes covered. As noted earlier, the Multilateral Convention, in principle, covers all taxes levied by governments at the national and local level. They are grouped together in categories, which are generally consistent with the OECD classification, which provides a systematic and internationally agreed classification.[281] It covers taxes on income, taxes on capital gains, taxes on net wealth, estate, inheritance or gift taxes, taxes on immovable property, general consumption taxes, such as value-added or sales taxes, specific taxes on goods and services such as excise taxes, taxes on the use or ownership of motor vehicles, taxes on the use or ownership of movable property other than motor vehicles. These include taxes imposed by central government, on behalf of it political sub-divisions or local authorities.

[279] For further information, visit at http://www.g20dwg.org/documents/pdf/view/317/

[280] Article 4 of the Multilateral Convention.

[281] Article 2 of the Multilateral Convention.

Unlike any other existing international tax frameworks (e.g. TCs and TIEAs), the Multilateral Convention also covers compulsory social contributions paid to social security agencies governed by public law. In other words, the Convention covers all forms of compulsory payments to general government except for customs duties.

It must be noted that not all countries are able or willing to provide assistance for all categories of taxes. Therefore, the Convention allows the parties, which are not able or willing to provide assistance for all categories of taxes, to place reservations on the application of the Convention on certain taxes and certain forms of assistance (e.g. assistance in the collection of taxes).[282] These reservations can be withdrawn at a later point in time. However, no reservation is possible concerning taxes levied at central government level on income or profit, on capital gains, or on net wealth.[283] Thus, all parties are committed to administrative assistance with respect to these categories of taxes.

Persons covered. The Multilateral Convention makes it clear that administrative assistance between parties is not restricted by the residence or the nationality of the taxpayer or of the other persons involved. In this respect, the Commentary to the Convention notes that if the tax administration of State A requires some assistance in tax matters from State B, this is obviously because it has to assess or reassess, or to collect or recover, a tax due in State A from a person who may, or may not be, a resident or a national of State A. If that person is not subject to tax in State A, there is no ground for any assistance in tax matters.[284] These provisions are designed to

[282] Article 30(a) of the Multilateral Convention.

[283] Ibid.

[284] Article 1(3), Commentaries on the Provisions of the Multilateral Convention.

make it clear that a person who is liable to tax in a state cannot prevent that state from requesting assistance from another contracting state on the grounds that he is not a national, or a resident, of one or other of the two states.

Moreover, in applying the Multilateral Convention, tax authorities will be bound to operate within the framework of national laws. The Convention specifically ensures that taxpayers' rights under national laws are fully safeguarded. However, national laws should not be applied in a manner that undermines the object of the Convention. In other words, the parties are expected not unduly prevent or delay effective administrative assistance.

Cases covered. The Multilateral Convention is limited only to civil cases in tax and parties may use information obtained under the Convention as evidence before a criminal court only if prior authorization has been given by the party which has supplied the information. However, parties may mutually agree to waive the condition of prior authorization.

3.2.2.3 Methods of exchange of tax information under Multilateral Convention

Even though the Multilateral Convention does not restrict the possibilities of exchanging information, it envisions five main methods of exchange of information: a) exchange of information on request under its Article 5; b) automatic exchange of information under Article 6; c) spontaneous exchange of information under Article 7; d) simultaneous tax examination under Article 8; e) tax examinations abroad under Article 9.

Exchange of information upon request. Under exchange of information on request, a party to the Convention extends tax information to another signatory party in response to the latter's specific tax information request.[285] Requests are normally made in writing. The Multilateral Convention requires the applicant state to provide the requested state with all available information, which can assist in identifying the person. As a general rule, the applicant states are supposed to provide in its request the following information:

a) the authority or agency which initiated the request made by the competent authority;
b) the name, address, or any other particulars assisting in the identification of the person in respect of whom the request is made;
c) in the case of a request for information, the form in which the applicant State wishes the information to be supplied in order to meet its needs;
d) in the case of a request for assistance in recovery or measures of conservancy, the nature of the tax claim, the components of the tax claim and the assets from which the tax claim may be recovered;
e) in the case of a request for service of documents, the nature and the subject of the document to be served;
f) whether it is in conformity with the law and administrative practice of the applicant State and whether it is justified in the light of the requirements of Article 21.2.g (i.e. whether the applicant State has pursued all reasonable measures available under its laws or administrative practice before making the request, except where recourse to such measures would give rise to disproportionate difficulty).

[285] Article 5 of the Multilateral Convention.

The Multilateral Convention was amended in 2010 to clarify these requirements.[286] The amendment has incorporated the internationally accepted standard for the exchange of information, which approves the possibility of requests with respect to ascertainable groups or classes of persons.

Automatic exchange of information. Automatic exchange of information under the Multilateral Convention is possible only if there is an additional agreement between the competent authorities in place.[287] Thus, the Multilateral Convention merely provides the basis for a series of agreements to activate automatic exchange between the participating countries. Such agreement would specify the information to be exchanged and would also deal with practical issues such as the time and format of the exchange.

Without an additional agreement, the signatory parties have no obligation to engage in automatic exchange of information. This agreement can be entered into by two or more parties thus allowing for a single agreement with several parties. The Convention recommends looking at the OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes for these types of agreements.[288]

The Multilateral Convention also recognizes that there may be situations where such exchanges may not be feasible, for example, because little bulk information is available in one of them or

[286] Paragraph 167, Explanatory Report to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters as amended by the Protocol (May 27, 2010). Available at http://conventions.coe.int/Treaty/EN/Reports/Html/127-Revised.htm

[287] Ibid. Paragraph 64.
[288] Ibid. Paragraph 65.

economic relations between the countries are limited, or because it would involve too great a load on the tax administrations concerned.[289]

Spontaneous exchange of information. Under spontaneous exchange of information, signatory party to the Convention shall, without prior request, forward to another party information that is relevant for tax administration of another party.[290] It sets out the various instances where a contracting party shall spontaneously forward to another, information of which it has knowledge:

i. The first mentioned party has grounds for supposing that there may be a loss of tax in the other party;
ii. A person liable to tax obtains a reduction in or an exemption from tax in the first mentioned party which would give rise to an increase in tax or to liability to tax in the other Party;
iii. Business dealings between a person liable to tax in a party and a person liable to tax in another party are conducted through one or more countries in such a way that a saving in tax may result in one or the other Party or in both;
iv. Party has grounds for supposing that a saving of tax may result from artificial transfers of profits within groups of enterprises;
v. Information forwarded to the first-mentioned party by the other party has enabled information to be obtained which may be relevant in assessing liability to tax in the latter party.

[289] Ibid. Paragraph 64.

[290] Article 7 of the Multilateral Convention.

The spontaneous exchange of information might be useful to supply information spontaneously as a supplement to information exchanged on request relating to a recovery case. It should be accompanied by any further documentary evidence which is available and which might assist the other state.

Besides these three methods of information exchange, the Convention stipulate two more methods of information exchange: simultaneous tax examinations and tax examinations abroad.

Simultaneous tax examination. Contracting parties may examine simultaneously, each in its own territory, the tax affairs of a person or persons in which they have a common or related interest, with a view to exchanging any relevant information, which they so obtain.[291] This form of cooperation between tax administrations is useful, in particular, when dealing with transactions between associated enterprises.

As a general rule, the applicant competent authority will inform the others of its choice of potential cases for a simultaneous tax examination. The other competent authorities will decide whether to enter into simultaneous tax examination of those cases and may also nominate other cases for consideration. Once agreement has been reached on implementation of a simultaneous tax examination, the tax administration personnel in charge of the case selected will consider with their counterparts from the other party or parties involved their examination plans, the periods (for example, tax years) to be covered, possible issues to be developed and target dates. Once agreement has been reached on the general lines to be followed, officials of each state will separately carry out their examination within their own jurisdiction.

[291] Article 8 of the Multilateral Convention.

Competent authorities may wish to consider negotiating bilateral or multilateral memorandum of understanding, working arrangements or any other similar instruments, in order to facilitate the efficient conduct of simultaneous tax examinations. The OECD Model Agreement for the Undertaking of Simultaneous Tax Examinations can serve as a basis for developing such instruments.[292]

Tax examinations abroad. In order to be able to ascertain a clear and complete picture of business and other relations between a resident of a party who is the subject of a tax examination and his foreign associates, it is often of great interest to be able to follow at close proximity an examination initiated in the foreign country. The tax examinations abroad provides for such a possibility. The Convention allows representatives of one signatory party to be present at the appropriate part of a tax examination in another signatory party's territory.[293] A signatory party that wants such an examination abroad submits a request to the competent authority of a relevant party. It is in the interests of the applicant state to specify, as thoroughly as possible, the motives for the request. The decision as to whether the foreign representative may be allowed to be present lies exclusively in the hands of the competent authority of the state where the examination is to take place.[294] If the request is accepted, the competent authority of the requested state notifies the competent authority of the applicant state about the time and place of the examination. The requested state also has the decisive power on how the examination is to be carried out.

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[292] Paragraph 72 of the Explanatory Report to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters as amended by the Protocol (May 27, 2010). Available at http://conventions.coe.int/Treaty/EN/Reports/Html/127-Revised.htm

[293] Article 9(1) of the Multilateral Convention.

[294] Article 9(2) of the Multilateral Convention.

3.2.2.4 Principles of exchange of tax information under Multilateral Convention

Reciprocity. The cooperation under the Multilateral Convention is based on reciprocity, i.e. a state cannot ask for assistance that it is not ready to grant to other states.[295] The requested state is not obliged, even if it can do so under its own law, to exercise powers, which the applicant state does not possess in its own territory. In other words, it is only those powers and practices which the contracting states have in common which the requested state is obliged to carry out. For example, not all member states may be in a position to provide all forms of assistance to other parties. Constitutional and other reasons may, for instance, prevent a state from being able to provide some forms of assistance, for example, collection of taxes on behalf of other state. In such cases, the states enter a reservation on that particular provision under Article 30 of the Convention.

Proportionality. When presenting a request for assistance, the applicant state shall indicate whether the request is in conformity with its own law and administrative practice and whether all means available in its own territory have been pursued and exhausted except where recourse to such means would give rise to disproportionate difficulty.[296] Should these conditions not be satisfied, the requested state would not be obliged to accept the request.

Confidentiality. Article 22 of the Multilateral Convention stipulates that any information obtained by a party under the Convention shall be treated as secret in the same manner as information obtained under the domestic laws of that party, or under the conditions of secrecy applying in the supplying party if such conditions are more restrictive.

[295] Article 21(2)(c) of the Multilateral Convention.

[296] Article 21(2)(g) of the Multilateral Convention.

Such information is disclosed only to persons or authorities (including courts and administrative or supervisory bodies) involved in the assessment, collection or recovery of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, taxes of that party. Only the persons or authorities mentioned above may use the information and then only for such purposes. They may disclose it in public court proceedings or in judicial decisions relating to such taxes, subject to prior authorisation by the competent authority of the supplying party. However, any two or more parties may mutually agree to waive the condition of prior authorisation.

Information received by a party may be used for other purposes when such information may be used for such other purposes under the laws of the supplying party and the competent authority of that party authorises such use. Information provided by a party to another party may be transmitted by the latter to a third party, subject to prior authorisation by the competent authority of the first-mentioned party.

3.2.2.5 Limitations of exchange of tax information under Multilateral Convention

Article 21 of the OECD model provides limits to the obligation to provide assistance. It sets some grounds under which the requested state may decline to supply information. According to these limitations:

a) The requested state does not need to provide information that is not obtained under its own laws or its administrative practice (Article 21(2)(a));
b) To carry out measures which it considers contrary to public policy (ordre public) or to its essential interests (Article 21(2)(b));

c) To supply information which is not obtainable under its own laws or its administrative practice or under the laws of the applicant state or its administrative practice (Article 21(2)(c)). Information is regarded as obtainable in the normal course of administration if it is in the possession of the tax authorities or can be obtained by them by following the normal procedure, which may include special investigations, provided that the tax authorities would make similar investigations for their own purposes. It follows that the requested state has to collect the information needed by the other state in the same way as if its own taxes were involved.

d) To supply information that would disclose any trade, business, industrial, commercial, or professional secret, or trade process or the information disclosure of which would be contrary to public policy (Article 21(2)(d)). A trade or business secret is generally understood to mean facts and circumstances that are of considerable economic importance and that can be exploited practically and the unauthorized use of which may lead to serious damage. The determination, assessment or collection of taxes as such could not be considered to result in serious damage.

e) To provide administrative assistance if and insofar as it considers taxation in the applicant state to be contrary to generally accepted principles or to the provisions of a convention for the avoidance of a double taxation, or of any other convention which the requested state has concluded with the applicant state (Article 21(2)(e)). This might be the case, for instance, where the requested state considers that taxation in the applicant state is confiscatory, or where it considers that the taxpayer's punishment for the tax offence would be excessive;

f) To provide administrative assistance for the purpose of administering or enforcing a provision of the tax laws of the applicant state, or any requirement connected therewith, which discriminates against a national of the requested state as compared with a national of the applicant state in the same circumstances (Article 21(2)(f)). In the exceptional circumstances in which this issue may arise, sub paragraph (f) allows the requested state to decline a request where the information requested by the applicant state would be used to administer or enforce tax laws of the applicant state, or any requirements connected therewith, which discriminate against nationals of the requested state. This rule does not apply to cases where tax rules differ only on the basis of residence;

g) To provide administrative assistance if the applicant state has not pursued all reasonable measures available under its laws or administrative practice, except where recourse would give rise to disproportionate difficulty (Article 21(2)(g);

The Multilateral Convention also allows signatory countries, through reservations, to limit the Convention's applicability to specific types of taxes and to limit the duty to assist either in collecting taxes or serving tax documents. However, Article 21(4) makes clear that in no case shall these limitations, be construed to permit a requested state to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

In 2010, the 'domestic interest' provision was added to the Convention. It deals with the obligation to exchange information in situations where the requested information is not needed by the requested state for its own tax purposes. According to this provision, when collecting information requested by another party, the requested party must use, if necessary, the special examining or investigative powers provided by its laws for purposes of levying its domestic taxes even though it does not itself need the information for these purposes.

3.2.2.6 Cost and timing of the mutual assistance under Multilateral Convention

Cost. The OECD considers flexibility to be necessary for a smooth and efficient implementation of the Convention. The competent authorities of signatory parties can consult with each other and agree, on a bilateral basis, on the rules they wish to apply generally, and the procedure to be followed for finding a solution in the most important and costly cases.[297]

In the absence of any bilateral agreement between the contracting parties, whether general or in specific cases, ordinary costs incurred in providing assistance shall be borne by the requested state.[298] These are costs normally incurred by tax authorities for obtaining information or collecting tax for domestic purposes.[299] In such cases a request for administrative assistance will not give rise to reimbursement by the requesting state. This follows the common practice, where a certain degree of reciprocity is assumed.

The Convention further establishes that when providing assistance involves extraordinary costs, these costs shall be borne by the applicant state.[300] Extraordinary costs are meant to cover, for instance, costs incurred when a particular form of procedure has been used at the request of the

[297] Paragraph 252 of the Commentary to Article 26 of the Multilateral Convention (2010 update).

[298] Article 26 of the Multilateral Convention.

[299] Paragraph 253 of the Commentary to Article 26 of the Multilateral Convention (2010 update).

[300] Article 26 of the Multilateral Convention.

applicant state, costs incurred by third parties from which the requested state has obtained the information (for example bank information), or supplementary costs of experts, interpreters, or translators if needed, for example for elucidating the case or translating accompanying documents or damages which the requested state has been obliged to pay to the taxpayer as a result of measures taken on the request of the applicant state.[301]

Timing. The Convention stipulates that the requested state must inform the applicant state of the action taken and the outcome of the assistance as soon as possible.[302]

3.2.2.7 Issues with the Multilateral Convention

Just like any other international instruments, the Multilateral Convention has its own shortcomings. One of the main concerns with the Multilateral Convention is the right of reservation. The Convention offers fairly broad flexibilities for participating countries to exclude or to modify some critical provisions of the Convention in their application to these states.[303] For example, when signing the Multilateral Convention, Canada reserved that it will not provide any form of assistance in relation to a) the taxes on income, profits, capital gains or net wealth which are imposed on behalf of political subdivisions or local authorities of a party, b) compulsory social security contributions payable to general government or to social security institutions established under public law; c) real estate, inheritance or gift taxes, taxes on immovable property, general consumption taxes, such as value added or sales taxes, specific taxes on goods and services such as excise taxes, taxes on the use or ownership of motor vehicles, taxes on the

[301] Paragraph 254 of the Commentary to Article 26 of the Multilateral Convention (2010 update).

[302] Article 20(1) of the Multilateral Convention.

[303] Article 30 of the Multilateral Convention.

use or ownership of movable property other than motor vehicles, any other taxes. It also stated that it would not provide assistance in the recovery of any tax claim, or in the recovery of an administrative fine, or the service of documents for any tax.[304] In effect, these reservations allow Canada to be a party to the Convention not to commit to some of its important provisions.

3.2.2.8 Concluding remarks

Today, the Multilateral Convention is the most comprehensive multilateral instrument available for all forms of administrative assistance and tax cooperation between states to tackle tax evasion and avoidance. It has enormous potential to revolutionize the international exchange of tax information system generally because it has large membership base and broader scope than the TCs, TIEAs, the Savings Directive, and FATCA Intergovernmental agreements in terms of taxes it covers.

3.2.3 EU Savings Directive (2003)

The liberalization of capital markets and the free movement of capital within the EU member states revealed how important it is to establish cooperation with a view to preventing tax evasion within the European Union. There have been ample problems of taxpayers moving their investments from one member state to another, which did not impose taxes at source, while the taxpayers simultaneously under-reported or not reported such income to their respective state of residence. In the absence of withholding taxes at source or effective information exchange

[304] Declaration And Reservations Deposited By The Government Of Canada With Its Instrument Of Ratification Of The Convention On Mutual Administrative Assistance In Tax Matters (25 January 19880, As Amended By The Protocol Amending The Convention On Mutual Administrative Assistance In Tax Matters (27 May 20100. Available at Http://Www.Fin.Gc.Ca/Treaties-Conventions/Maatm-Aammf-Eng.Asp

mechanism with the residence state, such income could easily escape being taxed all. The EU Council Directive 2003/48/EC on the Taxation of Savings Income in the Form of Interest Payments ('Savings Directive") intends to address this problem. The Directive was adopted on 3 June 2003 and became applicable on 1 July 2005.

The mechanism of the Directive works by imposing an obligation on any paying agent in an EU member state which makes a payment to an individual resident in the other member state which is the beneficial owner of the income, to report that payment of interest to the competent tax authorities of the member state in which the paying agent is established. The competent tax authorities of that (source) state in turn transfer the information collected to the competent tax authority of the residence of the beneficial owner. Based on the information received it is possible for the state of residence of the beneficial owner to verify if the amount is declared for tax purposes and to tax the corresponding income.

For example, an individual from an EU member state (state "A") depositing her savings in a bank in another member state (state "B") and earn a year after year interest income from that deposit. The Savings Directive attempts to ensure that the interest income paid from the bank in the member state A to the individual resident in the member state B will be reported to and be subject to effective taxation in the latter member state. In the absence of exchange of tax information between these two states, it is difficult for the state to discover this interest income unless the taxpayer did self-declaration.

Currently, the Savings Directive is in effect, in one way or other, in all EU member states, plus ten territories associated with EU member states, and five other European states, including Liechtenstein and Switzerland.

3.2.3.1 Historical background

Discussions on effective taxation of savings income have been at the centre of almost every major EU meetings for the past two decades.[305] However, real actions on the Savings Directive follows on from the Presidency Conclusions of the Santa Maria Da Feira on 19-20 June 2000, in which the EU member states agreed that in order that all EU residents pay tax due on all their savings income, exchange of information, on as wide a basis as possible, shall be the ultimate objective of the EU.[306] They called for a step-by-step development towards realization of this objective.[307] On the same day, the European Council requested its Economic and Financial Affaires Council (ECOFIN) to work on all aspects of this project so as to achieve full agreement on the implementation of the project as soon as possible and no later than 2002. The document also stipulates that as soon as the agreement has been reached by the Council on the substantial content of the instrument, the EU Commission must enter into discussions with the US and key

[305] The EU Council started discussing the proposed Directive in July 1998 under the Austrian Presidency. Over the past few years the proposal had been the subject of intensive discussions at both political and technical level. In the course of these discussions the Council has developed a significantly different approach to the issue of taxation of savings income. On 10 February 1999, the European Parliament finally issued its opinion on the proposal for a Directive to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community. See *Explanatory Memorandum to COM(2001)400 - Proposal for a Council directive to ensure effective taxation of savings income in the form of interest payments within the EC* European Comission 2001).

[306] Annex IV, Paragraph 2(a), the EC Presidency Conclusions at Santa Maria Da Feira on 19-20 June 2000. Available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/00200-r1.en0.htm

[307] Paragraph 42, the EC Presidency Conclusions at Santa Maria Da Feira on 19-20 June 2000. Available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/00200-r1.en0.htm

third countries such as Switzerland, Liechtenstein, Monaco, Andorra, San Marino to promote the adoption of equivalent measures in those countries.[308]

At its meeting in November 2000, the ECOFIN Council unanimously agreed the substantial content of the Savings Directive and the conditions for the implementation of the Directive, including the conditions governing transition from each stage to the next. The project was based on a "coexistence model", whereby each member state would have a) either to provide information automatically to other member states on interest income paid from that member state to individuals who are resident for tax purposes in those other member states (i.e. the automatic exchange regime); or b) to apply a withholding tax on the interest income paid from that member state to resident individuals of other member states and aggregate and transmit the collected taxes to the latter states without revealing the name of the taxpayer (i.e. the anonymous tax withholding regime).[309]

From its very outset, three European countries, namely Austria, Belgium, Luxembourg indicated their preference for the anonymous tax-withholding regime over the automatic information exchange regime.[310] Recognizing that the Directive might also cause a sizeable outflow of funds away from EU countries to competitor jurisdictions outside the Community, the member states instructed the European Commission to start exploratory discussions with some non-EU

[308] Ibid. Annex IV, Paragraph 2(c).

[309] Ibid. Paragraph 1.

[310] Jason Campbell Sharman, "Regional Deals and the Global Imperative: the External Dimension of the European Union Savings Tax Directive" (2008) 46:5 Journal of Common Market Studies, at 1057.

European countries, especially Switzerland, to induce them to adopt similar measures.[311] One of the earlier exploratory discussions took place between the EU and Swiss authorities on March 2, 1999.[312]

After many rounds of exploratory deliberations between 1999 and 2002, the EU convinced five non-EU European countries such as Switzerland, Andorra, Lichtenstein, San Marino, Monaco and ten dependent and associated territories (Aruba, Anguilla, Guernsey, Jersey, the Isle of Man, Cayman Islands, British Virgin Islands, Nether land Antilles, Montserrat, Turks and Caicos Islands), to adopt measures equivalent to those to be applied within the Community to ensure effective taxation of savings income. However, like Austria, Belgium, and Luxembourg, these countries also indicated their preference for the anonymous tax-withholding regime over the automatic exchange of information. The similar attempts were made to enlist the United States in the initiative, but without any success. [313] Thus, realizing the impracticality of any pressure on the sole super-power, the EU decided to move on without its involvement.

After fierce deliberations and negotiations among its member states and also with these third countries, it was agreed that all member states except Austria, Belgium, and Luxembourg would automatically exchange information with each of the other states. The exempt member states

[311] "In order to preserve the competitiveness of European financial markets, as soon as agreement has been reached by the Council on the substantive content of the Directive, the Presidency and the commission shall enter into discussions immediately with the US and key third countries (Switzerland, Liechtenstein, Monaco, Andorra, San Marino) to promote the adoption of equivalent measures; at the same time the Member States concerned commit themselves to promote the adoption of the same measures in all relevant dependent or associated territories. See the Bulletin EU 6-2000, 5/8 Annexes to the Presidency Conclusion.

[312] Francois-Xavier Delaloye, Michael Habib & Alexandre Ziegler, "Swiss Banking Secrecy: the Stock Market Evidence" (2012) 26:1 Financial Markets and Portfolio Management, at 147-48.

[313] Jason Campbell Sharman, "Regional Deals and the Global Imperative: the External Dimension of the European Union Savings Tax Directive" (2008) 46:5 JCMS: Journal of Common Market Studies, at 1062.

along with the listed non-EU states would exercise their option to operate under the anonymous tax-withholding regime, ostensibly before fully switching to the automatic exchange regime in 2010.[314] Thus, the EU finally approved the legal framework for automatic exchange of tax information under the EU Savings Directive (2003/48/EC) on 1 June 2003 and the Directive came into force on 1 July 2005.

In the meantime, between June and December 2004, the EC concluded specific agreements with Switzerland, Andorra, Lichtenstein, San Marino, and Monaco on measures equivalent to those to be applied in the Savings Directive.[315] According to the equivalent agreements, instead of extending information to other EU member states, these countries are allowed to withhold tax on interest payments made by paying agents located within their territories to beneficial owners who are individuals resident in other EU member states. The revenue received from the withholding tax will be shared between the withholding country and the country of the EU resident in the ratio of 25:75. Thus, the country, which withholds the tax, can retain 25% of the withholding proceeds and transfer 75% to residence country of the interest income recipient. The rate of withholding tax was set 15% during the first three years of the agreement starting on 1 July 2005, 20% for the next three years. If they still retain the withholding tax instead of switching to information exchange after July 2011, they would be required to withhold tax at 35% rate. The collected revenue is transferred to residence countries as an aggregate amount without disclosing

[314] The Conclusions of the ECOFIN Council 26/27 (November 2000), Press release (Press: 453) from 26.11.2000, published on the website of the Council of the European Union. Available at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/13861.en0.html

[315] The Agreements between the EC and these countries providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments are available at http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/legal_bases/index_en.htm

the assets and identity of the taxpayer. However, those EU residents impacted by the withholding tax arrangements could avoid it by giving permission to their bank or other financial institution to pass the details of their interest income to their home country's tax authorities. Moreover, the member states applying the anonymous tax-withholding system are entitled to receive information from member states applying the information exchange system.[316]

Today, on average more than 4 million records are sent each year from source member states to residence member states representing on average 20 billion euro of savings income.[317]

3.2.3.2 Scope of exchange of tax information under the Savings Directive

Income items covered. As mentioned above, the Savings Directive only covers interest income received in a member state by individuals resident in another member state. The EC deemed it necessary to adopt an exhaustive concept of interest income. Consequently, Article 6 of the Savings Directive provides an extensive definition of interest. It considers the following income items as interest:

a) An income from debt-claims of any kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular income from public debt securities, income from bonds or debentures, including

[316] Article 10(1) of the Savings Directive.

[317] See COM(2012) 351 final, at 6. Available at http://ec.europa.eu/taxation_customs/resources/documents/common/publications/com_reports/taxation/com%282012%29351_en.pdf

premiums and prizes attaching to the latter. This definition largely corresponds to the OECD definition of interest;[318]

b) The concept of interest also includes interest that is accrued or capitalized at the sale, refund or redemption of the debt claims. The specific reference to such income aims at eliminating possible doubts concerning for example, inclusion of income from zero coupon bonds;

c) The third category of interest income includes income derived from interest payments directly or through undertakings for collective investment in transferable securities within the meaning of Council Directive 85/611/EEC, entities within the extended paying agent definition which have opted to be treated as UCITS, and non-EU undertakings for collective investments. This is intended to cover interest, which is received in the form of distributions received from these entities. In principle, only the interest element of distribution would constitute an interest payment for purpose of the Directive;

d) Finally, the fourth category of interest income broadens the scope of the previous paragraph in order to avoid distortions resulting from capitalization of investment funds income. Thus, it is interest income realized upon the sale, refund or redemption of shares or units in the prescribed undertakings and entities, if they invest directly or indirectly, via other undertakings for collective investment or entities, more than 40% of their assets in debt claims. Thus, if the fund invested more than 40% of its assets in debt claims, the

[318] Article 11 in the condensed version of the "Model Tax Convention on Income and Capital". The Convention can be found online at http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2014_mtc_cond-2014-en#page1 (15 July 2014)

entire income will be considered as interest income.[319] This threshold, however, fell to 25% on 1 January 2011.

Persons covered. The Savings Directive applies only to individual taxpayers who are the residents of the other member states and who are the beneficial owners of the interest income. The Directive contains detailed provisions on the minimum standards for identifying the beneficial owners and restricts the concept of beneficial owner to individuals. It stipulates "beneficial owner is any individual who receives an interest payment or any individual for whom an interest payment is secured, unless he provides evidence that it was not received or secured for his own benefit".[320] Thus, the payments of interest in favour of companies as well as in favour of intermediate individuals acting as agents or authorized persons, are excluded from its scope. These persons, actually, act as reporting persons.

Reporting persons. A paying agent needs to take reasonable steps to establish the identity of the beneficial owner of the payments and make necessary reporting.[321] A paying agent is defined as 'any economic operator who pays interest to, or secures the payment of interest for the immediate benefit of, the beneficial owner".[322] An economic operator can be an individual or legal entity provided it pays interest in the course of its profession or business. While this could be the debtor itself, it could also be an intermediary (e.g. financial institution) acting for the debtor or for the beneficial owner. When there are several economic operators are involved, the

[319] Article 6(2) of the Savings Directive.

[320] Article 2(1) of the Savings Directive.

[321] Article 3 of the Savings Directive.

[322] Article 4(1) of the Savings Directive.

paying agent, for the purpose of the Directive, is the last one involved, i.e. the one, which makes the payment to the beneficial owner. So, the idea was that for any given interest payment, there would be only one paying agent for the purpose of the Directive.

Three types of entity (i.e. paying agents) are excluded from reporting obligation, because they are considered to be subject to adequate supervision by tax authorities. These entities are the entities that are subject to general business taxation and UCITS. [323]

Information reporting requirement is triggered once a paying agent has been identified with regard to a particular interest payment, but only as regards those beneficial owners who are residents in other member states from the paying agent. In this case, the paying agent has to determine beneficial owner's identity and residence. This means the paying agent needs to establish the beneficial owner's name and address; for customers after the implementation date, the agent needs to establish also the beneficial owner's TIN allocated by the country of her residence or, failing such number, the date and place of birth. This information may be available to paying agents under the know-your-customer (KYC) rules pursuant to anti-money laundering requirements.

The minimum information that the paying agent is required to report to its local tax authorities is as follows:

a) The identity and residence of the beneficial owner;
b) The name and address of the paying agent;

[323] Article 4(2) of the Savings Directive.

c) The account number of the beneficial owner or, where there is none, identification of the debt claim giving rise to the interest; and

d) Details of the interest payment.[324]

3.2.3.3 Mechanics of information exchange under the Savings Directive

According to the Directive, the information is transferred automatically to the competent authority of the member state of residence of a beneficial owner no later than six month after the end of the fiscal year in which interests are credited to the account of the beneficial owner.[325] It is transferred in a format to make them directly accessible to the tax inspectors of the residence state for further investigations or audit on the taxpayer.

3.2.3.4 Anonymous tax withholding under the Savings Directive and the related agreements

As agreed in the Savings Directive[326] and also in the associated agreements that provide measures equivalent to the Directive, the countries which opted for the anonymous tax-withholding regime began to withhold tax on payments made by their paying agents (e.g. banks and financial institutions) to the residents of the other member states.

During the second half of 2005 and until the end of 2007, Switzerland collected EUR 631.4 million, Luxembourg EUR 313.5 million, Austria collected only EUR 113.3 million, Jersey EUR 83.75 million, Belgium EUR 53.4 million, Guernsey EUR 21.76 million (for 2005-2006), and

[324] Article 8(1) of the Savings Directive.

[325] Article 9 of the Savings Directive.

[326] Article 18 of the Savings Directive.

Liechtenstein EUR 18.8 million and remitted the funds to the other EU member states.[327] The largest recipients of these withholding tax proceeds during these period were Germany, which received EUR 192.7 million, Italy EUR 112.9 million, Spain EUR 98.7 million, followed by France EUR 62.8 million and the United Kingdom EUR 94.9 million.[328] Belgium received more than EUR 71 million, mainly from Luxemburg (74% of the total).[329]

On January 1, 2010, Belgium decided to discontinue the anonymous tax-withholding regime and began to apply the automatic exchange of information regime. On April 10, 2013, Luxembourg also took the decision to apply the automatic exchange of information regime from January 1, 2015. In 9 December 2014, Austria announced that it would join the other EU member states and begin exchange information automatically by September 2017.[330] Currently, the applicable withholding tax rate in place of automatically exchanging information for applicable accounts is 35%.

3.2.3.5 Issues with exchange of tax information under the Savings Directive

Article 18 of the Savings Directive requires the European Commission to report to the Council every three years on the operation of the Directive in practice. On the basis of these reports, the

[327] Thomas Hemmelgarn & Gaëtan Nicodème, *Tax Co-ordination in Europe: Assessing the First Years of the EU Savings Taxation Directive* (Luxembourg: CESifo working paper, 2009), at 25.

[328] Ibid, at 26.

[329] European Commission, *Report on Taxation of Savings Income in the Form of Interest Payments* (Belgium: Brussels European Commission, 2008), at 3. The report can be found online at http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/implementation/com%282008%29552_en.pdf

[330] See the Council of the European Union press release on December 9, 2014. The revised Directive on Administrative Cooperation (DAC) was officially adopted by the European Council at an ECOFIN meeting of 9 December 2014. http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/146126.pdf

Commission is supposed to propose the Council any amendments and improvements to the Directive that are necessary to ensure effective taxation of savings income and to remove undesirable distortions of competition.

Thus, the first report on the operation of the Directive was issued on 15 September 2008.[331] The report analysed the Savings Directive's first two years in operation and concludes that the Directive and the related agreements proved to be effective but the short period of practice has unveiled a number of weaknesses.

The report holds that it is still relatively easy for wealthy individuals to adopt their investment pattern to circumvent the Directive. Specifically, it identified some concrete problems with the definitions of beneficial owner, paying agent, treatment of financial instruments equivalent to those already explicitly covered by the Directive, and procedural matters.[332]

Beneficial ownership. The European Commission makes clear that in its current form, the Savings Directive covers only interest payments made for the immediate benefit of individuals but not the similar payments to legal entities and arrangements. This narrow scope may provide individuals resident in the EU member states with opportunities to circumvent the Directive. One easy way to circumvent the Directive would be to hold interest bearing instruments through interposed entities, offshore foundations, discretionary trusts, or other 'ownerless' structures established both inside and outside the EU.[333]

[331] European Commission. *Supra* note 341.

[332] Ibid., at 4.

[333] Ibid., at 4.

Paying agent. The territorial scope of the Savings Directive is limited to the European Union, and agreements on the anonymous tax-withholding are limited a few countries and ten dependent and associated territories. It is therefore clear that investors will still be able to evade taxes by channeling their funds through banks and other intermediaries located in tax havens and financial centers that do not fall under the scope of the Savings Directive or its related agreements.[334]

Reportable income items. One more weakness with the Directive was its applicability only to selected categories of interest income. It does not apply to negotiable debt securities, payments from life insurance policies and pension schemes and private citizens. The European Commission concluded that sticking to a formal definition of interest payment would not be effective and could lead to undesirable distortions of competition between direct and indirect investment in debt claims. Banks have been quite innovative in creating savings instruments that are very similar to deposits in their nature, but the return they provide does not qualify as interest income as defined by the Directive.[335] The movement of EUR 7 billion into especially exempt bonds in July 2005 was directly attributed to the selective coverage of the Directive. Products like offshore portfolio bonds have enjoyed increased popularity since 2005 for the same reason.[336]

The other proposals include regular updating of the information on the permanent address of the beneficial owner for establishing his residence for the purposes of the Directive; dealing with uncertainties concerning the treatment of joint accounts and shared beneficial ownership; an

[334] Ibid., at 6.

[335] Ibid., at 7.

[336] Sharman. *Supra* note 325, at 1066.

obligation for the member states to share between themselves and with the Commission in a timely manner some key statistics in order to allow a comprehensive measurement of the effectiveness of the Directive.[337]

Proposed solutions. On 13 November 2008 the European Commission adopted an amending proposal, with a view to address the problems described in the earlier report on the Savings Directive's operation.[338]

Beneficial ownership. The proposal seeks to put an obligation on paying agents to use the information already available to them under the anti-money laundering (AML) rules in determining the actual beneficial owner of a payment made to some legal persons or arrangements ('look-through' approach). When the beneficial owner identified under the AML rule is an individual resident in another member state of the EU, the payment should be treated by the EU paying agent as made directly to this beneficial owner. Thus, rather than waiting until the final payment is made to a beneficiary, the Directive would apply when the intermediary legal person or arrangement receives the interest on behalf of the beneficiary and at that stage there is automatic reporting or withholding in the case of the countries which opted for the withholding regime. The EU paying agents are also supposed to carry strict due diligence procedure on interest payments to legal persons and arrangements established in some jurisdictions outside the EU, where appropriate taxation of interest income is not ensured. For this purpose, the proposal suggested including in the annex of the Directive a list of categories of

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[337] European Commission. *Supra* note 341, at 9.

[338] European Commission, *Proposal for Amending Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments* (Brussels: European Commission 2008).

entities and legal arrangements resident in non-EU jurisdictions, which do not ensure appropriate and effective taxation of income obtained by such entities and arrangements.[339]

Paying agent. The report also proposed to clarify the responsibilities of the paying agents so that these responsibilities cover reporting of interest payments channelled through intermediate tax-exempted structures like trusts or foundations established in the EU. Because these conduits or arrangements, even though they derive income from debt securities, may not pay out income to their beneficiaries in the form of interest and are not treated as paying agents upon receipt. Proposal clarified that in such cases the paying agent must be the last intermediary in the chain.[340] This would mean that the Directive must be complied with by these structures — including legal arrangements such as certain kinds of trusts and partnerships — upon receipt of interest payments from any upstream economic operator, regardless of where this operator is established (inside or outside the EU), as long as the beneficial owner is an individual resident in another EU member state.[341]

Reportable income items. Finally, the report also proposed to include in the definition of interest the income from some innovative financial products and from certain life insurance products that are comparable to debt claim products.[342] The proposal adds them to the scope in order to avoid distortions in the choices made by the investors.

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[339] Ibid., at 3.

[340] Ibid., at 4-6.

[341] Ibid., at 4.

[342] Ibid., 6-9.

All these problems and their possible solutions have been formally reported by the European Commission since 2008. However, no real progress has been achieved to incorporate these proposals into the Directive due to strong objections by some member states (including Austria and Luxembourg). They took the position that they would only consider an extension of the scope of the EU Savings Directive in case a level playing field was maintained in Europe. In other words, their position has been that the anonymous tax-withholding agreements concluded in 2004 and 2005 between the EU and Switzerland and between the EU and four other third countries (Liechtenstein, Monaco, Andorra, and San Marino) must be updated to reflect the extended scope of the EU Savings Taxation Directive.[343]

Only on 20 March 2014, Luxembourg agreed to a proposed revision of the Savings Directive, thereby clearing the way for the EU Council of Ministers to adopt the amendments. Four days later the European Council formally adopted the revised EU Savings Directive.[344]

As a next step, the revised Savings Directive has to be enacted at European Union level and then transposed into the national legislation of the EU member states. However, these processes were postponed due to another important legislative development in the EU concerning automatic information exchange.

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[343] KPMG, *EU Savings Directive: major changes ahead* (Luxembourg: KPMG, 2014). Available at https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/taxnewsflash/Documents/eu-mar-21-2014.pdf

[344] Further information on the adoption process of the revised version of the Savings Directive can be found online at http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/index_en.htm

3.2.3.6 Latest developments

Recently, the EU has begun to explore the possibility of a broader automatic exchange of information system through a parallel instrument to the Savings Directive. In 12 October 2014, the European Council of Finance Ministers (ECOFIN) revised the Directive on Administrative Cooperation in Direct Taxation (2011/16/EU) and has been considering implementing the automatic exchange of information through this instrument. When revised, the Directive on Administrative Cooperation on Tax Matters (DAC) is supposed to cover a wide scope of income and capital: interest, dividends, gross proceeds from the sale of financial assets and other income, as well as account balances, within the scope of the automatic exchange of information.

The revised DAC was officially adopted by the European Council at an ECOFIN meeting in December 2014.[345] The deadline for member states to adopt local legislation consistent with the revised DAC is 31 December 2015. The revised DAC will be effective on 1 January 2016 and the EU member states will have to begin the automatic exchange of information under the revised DAC no later than September 2017.[346]

In addition to this development, the EU Commission has also been negotiating corresponding measures with Switzerland, San Marino, Andorra, Monaco and Liechtenstein. Initially the aim of such negotiations was to ensure that these countries applied a level of measures equivalent to that

[345] The text of the DAC can be found at http://data.consilium.europa.eu/doc/document/ST-14425-2014-INIT/en/pdf

[346] Council of European Union, *Preventing Tax Evasion and Fraud: the Scope for Automatic Exchange of Information is Extended* (Brussels Council of European Union 2014).

applied by member states under the revised Savings Directive. However, this time the EU is expecting a much more ambitious outcome from these negotiations.

Given the new, full-scope automatic exchange system under the DAC now agreed by member states under the revised DAC and on-going negotiations with the non-EU countries, there is a question whether the Savings Directive will still be relevant. Due to these concerns, the European Commission has postponed its plans to implement its recent amendments to the Savings Directive. In fact, the EU Commission has released a memo concerning the automatic exchange of information. It contains a suggestion that in order to avoid legislative overlaps between these two directives, the Savings Directive might be repealed.[347] This process will have to be coordinated with the introduction of DAC to ensure that no new loopholes are created.

3.2.3.7 Concluding remarks

In recent years, European Union laws have become increasingly important in dealing with cross-border challenges of taxation within the region. Most of its initiatives on issues of cross-border taxation among its member states can be a good example also for global system. One of such examples is the EU Savings Directive. It is the most advanced attempt to make an automatic exchange of tax information system function in the EU. Currently, the Directive and the related agreements are in force in twenty-eight EU member states, five non-EU European countries, and ten dependent and associated territories.

[347] *Automatic Exchange of Information: Frequently Asked Questions* (Belgium, Brussels European Commission 2014). Available at http://europa.eu/rapid/press-release_MEMO-14-591_en.htm

However, the Savings Directive has certain limitations that lead us to the following conclusions. As the title of the Directive suggests, the Directive has a narrow coverage – it applies only to interest income. This means that dividends, capital gains, and other types of income are not subject to similar automatic exchange of information regime. By opening a bank account and holding an investment that bears no interest, no information reporting will be necessary by paying agents. In fact, interest constitutes only a small portion of foreign-source income that residents generally earn abroad. Thus, this selective approach taken by the Directive could easily lead to distortions in the taxpayer choice of financial instruments.

Another critical aspect that is posing a real challenge to the effectiveness of the Savings Directive is its limited geographical scope. It is limited to intra-community situations in which a paying agent from one member state pays to an individual resident in another Member State. It does not apply to payments from outside the EU and a few other non-EU jurisdictions, i.e. when the paying agent is located in a jurisdiction that does not fall under the scope of the Directive and its related agreements, for example, Hong Kong, Dubai, or Singapore. In this situation, capital flight or displacement is a major problem.

However, the Savings Directive has greatly contributed to the evolution of the automatic exchange of information practice by allowing to discover some real-life implications of the system.

3.2.4 FATCA Intergovernmental Agreements (2012)

3.2.4.1 Historical background: from FATCA to Intergovernmental Agreements

In 2010, the U.S. government enacted the Foreign Account Tax Compliance Act, commonly known as 'FATCA' as a part of the Hiring Incentives to Restore Employment Act.[348] The law has been incorporated within new sections, §1471-1474, of the U.S. Internal Revenue Code of 1986 ("IRC"). The law grew out of Congressional concern that U.S. taxpayers were evading taxes by failing to report income on assets held abroad.

The significance of this U.S. law rests on the fact that even though it is a domestic law in nature, its enforcement is global in reach. The law attempts to impose significant tax compliance obligations on almost all financial institutions around the world that maintain a business relationship, in one way or another, with U.S. persons. FATCA requires foreign financial institutions ("FFIs")[349] around the world to register with the U.S. Internal Revenue Service ("IRS") and to carry out regular (a) due diligence, (b) reporting, and (c) tax withholding obligations vis-à-vis the U.S. government concerning their customers who happen to be U.S. persons.[350] More specifically, it requires FFIs to conduct due diligence reviews relating to all their existing and new clientele in order to verify their financial account-holders who are U.S.

[348] The US Congress, Public Law 111-147, Title V (March 18, 2010).

[349] The definition of foreign financial institution is intended to be very broad in scope. It covers virtually any foreign entity that is engaged primarily in the business of accepting deposits, holding financial assets for the account of others, investing, re-investing, or trading in assets, partnership interests, commodities and any interest in such assets. Generally, this includes foreign banks, credit unions, broker dealers, clearing organizations, trust companies, custodians of employee benefit plans, insurance companies, mutual funds, pension funds, exchange traded funds, hedge funds, fund of funds, private equity, venture capital funds, investment corporations, partnerships, and trusts including family investment trusts. See IRC, §1471(d) (5).

[350] See IRC, §1471(b).

persons and then to report the account holders' name, TINs, addresses and the account information to IRS on a regular basis.[351]

When an accountholder remains unidentified or recalcitrant for FATCA purposes, the FFI is obliged to withhold 30 per cent of the interest, dividend and investment payments due to those clients and remit the collected proceeds directly to the U.S. government.[352] The registration with IRS is performed in the form of an individual agreement between IRS and a FFI.

The law entails considerable punishment for FFIs, which fail to comply with these requirements; non-compliance with the law would expose them to a 30 % withholding tax on income that they derive from their investments in the U.S. on the gross capital on the sale of those investments.[353] Since all major FFIs have substantial investments in the US financial markets or own assets in other FFIs, which in turn may hold investments in the US financial markets, or at least go though

[351] The report should include: a) the name, address, and TIN of each specified US accountholder. In the case of any account holder that is a United States owned foreign entity, the name, address, and TIN of each substantial United States owner (i.e. one that owns more than 10 per cent of the entity by vote or value) of such entity; b) the account number; c) the account balance or value as of December 31, 2013, or if account was closed after the effective date of the FFI agreement, the balance of such account immediately before closure; d) gross investment income paid to and credited from the account. See IRC, §1471(c)(1).

[352] Recalcitrant accountholders are (a) individual accountholders who fail to provide sufficient information about their identity; (b) institutional accountholders that fail to provide sufficient information about the identity of their substantial owners; and (c) other FFIs, which have not concluded a FATCA agreement with the IRS. The FFI is required to withhold and pay over to the IRS 30 per cent of any payments of US-source income that are to be made to those accountholders.

[353] The withholding tax of 30 per cent applies to (i) any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and (ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States. See IRC, § 1473 (1)(A).

the U.S. banking system, it would be costly for them to downplay the consequences of non-compliance.

Thus, FATCA has caused an outcry among financial institution around the world for multiple reasons. First, the U.S. law imposed unreasonable compliance costs on foreign financial institutions. Second, many foreign countries have taxpayer confidentiality laws that preclude their financial institutions from sharing account information with third parties let alone with foreign governments.[354] Thus, the U.S. law put foreign financial institutions in dilemma of either violating the laws of their home country or being subjected to FATCA penalty.[355]

It was also a question of enforceability of the law on financial institutions over which the U.S. had no jurisdiction. The U.S. experience with UBS and other private banks has already proven that there is a need for an effective onsite oversight to ensure proper administration of such programs.[356]

[354] Reuven Avi-Yonah & Gil Savir, "IGAs vs. MAATM: Has Tax Bilateralism Outlived Its Usefulness?" (2014) 1:1 Law and Economics Working Papers, at 1.

[355] Ibid.

[356] The largest Swiss bank, UBS, was one of the participants of the the U.S. Qualified Intermediary (QI) program (2001). Under this program, UBS agreed to identify and document any of its customer who holds US investments. It also agreed to report to the IRS any of its customers who are US persons and holds US assets. If a US customer refuses to be identified under the QI agreement, UBS is required to withhold US tax at a 28% rate on payments made from U.S. payors to the customer. In March 2006, a former employee of UBS sent a confidential letter to the US tax authorities with an inside account of the bank's conduct. This insider information revealed that UBS had been habitually violating its reporting obligations under the QI regime. The UBS bankers had been advising its U.S. customer to transfer the ownership of their UBS accounts and US securities to shell entities established in offshore locations. These foreign entities would then act as independent, non-transparent beneficial owners of the UBS accounts, thereby shielding the US persons from being disclosed to the IRS. See for more details at J. Weiner, "Disqualifying UBS from the QI Regime " (December 8, 2008) 121:1097 Tax Notes.

Facing a strong backlash both from foreign financial institutions and governments and considering the potential difficulties of administering such regime, the United States approached some major countries (France, Germany, Italy, Spain, and the United Kingdom) to work out a possible solution. On 8 February 2012, the US Treasury announced that it was working with five European countries to explore a government-to-government approach to improving international tax compliance and implementing FATCA. It announced that France, Germany, Italy, Spain, and the United Kingdom (the G5) have supported the intent behind the US law by agreeing to the six-nation joint-statement.[357]

The joint statement envisioned an agreement between the US and any of these ‘‘FATCA partner’’ countries that would provide an alternative mechanism for financial institutions to comply with FATCA. According to the joint-statement, when the framework is finalized, financial institutions of these countries would not be required to enter into separate reporting agreements with the IRS.[358] They are also not required to collect taxes on behalf of the IRS.[359] Instead, they will transfer the required information to their own tax authorities, which then pass it on to the US government. In return, the US government also commits itself to collect similar

[357] US Treasury Department, "Joint Statement from the United States, France, Germany, Italy, Spain, and the United Kingdom regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA" (February 8, 2012). Available at http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf

[358] Ibid. Subparagraph (B)(2)(a).

[359] Ibid. Subparagraph (B)(2)(d).

information from US financial institutions on accounts of European residents and automatically passes it to the relevant national tax authorities of these European countries.[360]

On 26 July 2012, these countries and the U.S. issued a further Joint Statement announcing the publication of the "Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA".[361] Following the statement, the US Department of the Treasury introduced a model IGAs (Model 1 IGA).[362] According to this model, partner governments share account information of the relevant taxpayers on a reciprocal basis. The US signed the first IGA with the UK based on this model on 12 September 2012.[363]

In addition to introducing the reciprocal model of IGA, the U.S. issued Joint Statements with Japan and Switzerland in which the parties indicated their intent to pursue IGA agreements using a slightly different approach. In November 2012, the US Department of the Treasury introduced a second model of IGA (Model 2 IGA).[364] Under this model, partner country's financial institutions report directly to the IRS, and the partner country agrees to mitigate any legal barriers to such reporting. Thus, the model agreement contains no reciprocity or local reporting

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[360] Ibid. Subparagraph (B)(2)(e).

[361] https://www.gov.uk/government/news/joint-communique-on-the-model-intergovernmental-agreement-to-improve-tax-compliance-and-implement-fatca

[362] The Model IGA is available online at https://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf

[363] https://www.gov.uk/government/news/joint-communique-on-the-model-intergovernmental-agreement-to-improve-tax-compliance-and-implement-fatca

[364] For further information visit at http://www.treasury.gov/press-center/press-releases/Pages/tg1825.aspx

provision. The U.S. concluded IGA agreements with Austria, Bermuda, Chile, Japan, and Switzerland based on this model.

In the meantime, the U.S. has introduced a third model IGA (Model 1B IGA). This model is similar to the Model 1 IGA as it contemplates government-to-government information reporting mechanism. So, it requires FFI to pass over the relevant information to their local tax authorities. However, unlike the Model 1 IGA, this model is not reciprocal. It imposes no obligation on the U.S. to extend similar information to its IGA partner jurisdiction.

According to the U.S. Department of Treasury, as of 5 November 2014, the U.S. signed IGAs with 44 countries based on its reciprocal and the non-reciprocal models. Other 56 states have reached agreements in substance on the terms of the agreement. On January 12, 2015, the IRS announced that the number of intergovernmental agreements between the U.S. and other countries had exceeded 110, either signed or agreed in substance.[365] These developments have essentially transformed FATCA from being a domestic law into a bilateral legal framework.

3.2.4.2 Substance of IGA

The IGAs contain a number of key features for effective automatic exchange of information. They place a significant obligation on financial institutions to maintain and report tax relevant information of their non-resident customers to tax authorities for the purpose of exchange.

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[365] Samuel Rubenfeld, "RS Launches Data Exchange Service for FATCA" The Wall Street Journal (12 January 2015). Available at http://blogs.wsj.com/riskandcompliance/2015/01/12/irs-launches-data-exchange-service-for-fatca-compliance/

For the IGA purposes, the financial institutions generally refer to entities that holds financial assets for the account of others as a substantial portion of its business (Custodial Institution); or accepts deposits in the ordinary course of a banking or similar business (Depository Institution); or engages primarily in the business of trading in financial instruments, managing portfolios or otherwise administering or managing funds or money (Investment Entity); or conducts certain business as an insurance company (Specified Insurance Company).[366] Therefore, the definition covers not only banks, insurance companies, and broker-dealers but also trust companies, hedge funds, private equity funds, and pension funds.

The IGA also sets forth complex due diligence procedures to be followed by financial institutions. It requires financial institutions to review new and existing customer accounts to verify whether they are reportable accounts for the IGA purposes. The review must be undertaken with respect to accounts held both by individuals and entities. The IGAs also set out specific due diligence rules with respect to new and pre-existing accounts. Such due diligence procedures typically involves self-certification, electronic data search, paper data search, and application of enhanced KYC/AML rules. For individual accounts, the account review and reporting are not required unless the value (or in the case of a Cash Value Insurance Contract, the Cash Value) of the account exceeds $50,000.[367]

3.2.4.3 Scope of tax information exchange under IGA

The IGA provides that the parties to the agreement must obtain certain specified information with respect to all reportable accounts from their financial institutions and must exchange such

[366] The Model 1 IGA, Art. 1(1)(g).

[367] The Model 1 IGA, Annex I, III (A).

information annually with each other. Under the Model 2 IGA, this obligation is placed on the financial institutions themselves to directly report the relevant information to the IRS. The reportable information generally includes:

1. The name, address, and taxpayer identification number (TIN) of each reportable person (or reportable U.S. person) who is an account holder. With respect to pre-existing accounts the financial institution may provide the date of birth of the reportable person instead of the TIN, if the TIN is not in the records of the financial institution;
2. The account number or functional equivalent;
3. The name and identifying number of the reporting financial institution;
4. The account balance or value at year-end (including in the case of a Cash Value Insurance Contract or Annuity Contract, the cash value or surrender value);
5. In case of any custodial account, the total gross amount of interest, dividends, other income, and total gross proceeds from the sale or redemption of property during the calendar year;
6. In case of any depository account the total amount of interest paid or credited to the account during the calendar year;
7. In case of any other account with respect to which the financial institution is the obligor or debtor, the total gross amount paid or credited during the calendar year, including the aggregate amount of any redemption payments made during the calendar year or any other relevant reporting period.[368]

[368] The Model 1 IGA, Art. 2(2).

Generally, the IGA allows step-by-step transition to the full reporting system, each stage lasting about a year. In the first stage, the information to be exchanged by contracting parties generally covers items 1 through 4. In the second stage, the parties are required to exchange information on all items on the list except for total gross proceeds described in item 5. In the third stage, the parties are required to exchange information on all items on the list.[369]

3.2.4.4 Exemptions under IGA

The IGA generally exempts certain financial institutions from reporting. Central banks, retirement funds, investment entities wholly owned by exempt financial institutions, and international organizations are considered to be such exempt entities. Exemptions are also available for certain institutions which are perceived to present a low risk of tax evasion such as institutions based solely in a single jurisdiction which do not accept or maintain accounts opened by foreign customers.

The IGA also has exemptions for certain accounts. Retirement savings accounts, general insurance products, and tax-exempt savings accounts, which are subject to specific regulatory regime in the jurisdiction where they are opened, are exempt from being reported.

[369] The Model 1 IGA, Art. 3(3)(a).

3.2.4.5 Timing of information exchange under IGA

The IGA have specific rules regarding the dates by which the information must be exchanged or reported. In general, information is to be exchanged or reported within nine months after the end of the calendar year to which the information relates.[370]

3.2.4.6 Legal basis for IGA

The IGAs, more specifically, the IGAs concluded based on the Model 1 IGA, derive their enforcement authority from bilateral tax treaties between the U.S. and respective countries.[371] This can also be evidenced by the fact that so far the U.S. has concluded the Model 1 IGA only with countries with which it has either tax treaty or TIEA. On the other hand, the Model 2 IGA is not limited to jurisdictions that have tax treaty or TIEAs with the U.S.

In the U.S., IGAs do not require congressional ratification and thus can be concluded and put into practice quickly.[372] In this sense, the IGAs are mere administrative and interpretative agreements. However, these aspects of the agreements have been the source of some scholarly debates.[373]

[370] The Model 1 IGA, Art. 3(5).

[371] See the preamble of the Model IGAs.

[372] Paul M Schmidt & Michael W Nydegger, "FATCA Intergovernmental Agreements--Could This Evolve Into the Primary Approach for Global Implementation of FATCA?" (2013) 30:2 Journal of Taxation of Investments.

[373] Allison Christians, "The Dubious Legal Pedigree of IGAs (and Why it Matters)" (2013) 69:6 Tax Notes International; Susan Morse, "Why FATCA Intergovermental Agreements Bind the US Government" (2013) 70:3 Tax Notes International.

3.2.4.7 Issues with IGA

IGA is a relatively new and evolving phenomenon in international taxation. It may be too early to assess its benefits and problems. However, one of the immediate issues with IGAs appears to be its reciprocity "deficiency". The agreements lack de-jure and de-facto reciprocity.

As discussed above, the IGA is essentially a U.S. invention. The country has developed reciprocal and the non-reciprocal model IGAs: the Model 1 IGA (reciprocal), Model 1B IGA and Model 2 IGA (non-reciprocal). The U.S. has concluded bilateral agreements with over 44 jurisdictions based on these models. The last two models are apparently non-reciprocal in their wording. Thus, under these IGAs, the information flows only to one party, i.e. to the U.S.

Then, there is the reciprocal Model 1 IGA. Even though the Model 1 IGA looks reciprocal in its appearance, it is not much so in substance. The reciprocity provision of the Model 1 IGA requires the contracting party to report to the U.S. government on U.S. persons holding relevant accounts in its financial institutions. It also requires the U.S. to provide the other country with information on the financial accounts of that country's residents held by US financial institutions. However, there are certain rules embedded in the U.S. income tax law, which essentially preclude the country from collecting the necessary information for such exchanges. This rule is commonly known as "Qualified Intermediary" rules. Under the Qualified Intermediary regime, the foreign financial institutions who administer non-resident taxpayers' U.S. investments do not need to disclose their clients details to the U.S. treasury as long as the foreign financial institutions themselves collect necessary documentation about the residence and beneficial ownership statuses of their customers and agree to properly determine and remit U.S.

withholding taxes on payments made to these customers by U.S. payers.[374] Thus, the Qualified Intermediary regime effectively shields the identity of non-residents holding U.S. properties from the U.S. tax authorities. An overall effect is that, as long as the U.S. Qualified Intermediary regime remains intact, the government cannot make meaningful information reporting to its IGA partners. This substantially undermines the essence of IGAs for other countries.

3.2.4.8 Concluding remarks

The IGA is a unique phenomenon in automatic information exchange practice. It has compelling theoretical and practical implications. FATCA and subsequently IGA, for the first time, seriously questioned the effectiveness of the existing international tax information exchange frameworks under double tax treaties and tax information exchange agreements. They have got the world's attention to the problem in a very effective way and in a very short period of time. Finally, they acted as a catalyst for the formal move towards automatic exchange of information on a global scale. This global initiative will be discussed in the subsequent chapter.

3.2.5 Concluding remarks

International automatic exchange of information system is taking shape. Over the last few years certain initiatives have been launched at domestic, regional, and international levels to improve and facilitate automatic exchanges of tax information between states. One of the few example of

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[374] J. Ames, "New U.S. Qualified Intermediary Rules and Their Impact on Foreign Financial Institutions" (2001) 15:2 Bank Accounting & Finance 51; S. Nathaniel Zane, "Carrot or Stick?: The Balance of Values in Qualified Intermediary Reform" (2010) 33:2 Boston College International and Comparative Law Review, at 361 (Quoting from the GAO Report "Qualified Intermediary Program Provides Some Assurance That Taxes on Foreign Investors are Withheld and Reported, But Can be Improved", December 2007).

such initiative are the Nordic Convention on Mutual Administrative Assistance in Tax Matters (1972), the Convention on Mutual Administrative Assistance in Tax Matters (1988), EU Savings Directive (2003), and finally FATCA Intergovernmental Agreements (2012).

All these initiatives and international frameworks indicate that countries are attempting to embrace the automatic exchange of tax information system to enforce their tax laws on foreign-source income of their resident taxpayers. However, the limitations of these instruments also need to be recognised. Our analyses identified some common limitations inherent to these legal frameworks:

Geographical scope. Most of these regimes are either bilateral or geographical in nature. They are limited to either bilateral situation (e.g. the IGA) or intra-community situations (e.g. the Nordic Convention, the Multilateral Convention, the EU Savings Directive). They do not apply to foreign-source income in a third country or to the foreign-source income earned in countries located outside the relevant geographical area. One of the biggest challenges with these bilateral and intra-community approach in international automatic tax information is that the taxpayer can simply relocate its assets to non-participating jurisdiction, thus continues tax evasion. Thus, the existing frameworks merely relocate the problem of offshore tax evasion rather than resolving it.

Material scope. There is a lack of uniformity in the material scope of these international instruments. For example, the EU Savings Directive underperforms by requiring automatic exchange of tax information only on interest income, while the IGA somehow over-performs by requiring information exchanges not only on income but also on assets. Moreover, the Model IGA and FATCA provide a threshold amount below which an account does not have to be reported by financial institutions, while the Nordic Convention, the Multilateral Convention, and EU Savings Directive have no such thresholds. In fact, having certain thresholds may reduce the burden for financial institutions where the relevant amounts are insignificant, but it may also add complexity in a multilateral context. For example, the person may hold bank accounts in multiple financial institutions with the amount income flows and financial assets in each account being below the threshold but they might become reportable when the amounts are combined.

There is also the issue of overlaps. Nowadays, some countries may fall under multiple international instruments, applying multiple procedures, and work in multiple formats. For example, a country may be party to the Nordic Convention, the Multilateral Agreement, the Savings Directive, and the IGA. This would potentially impose significant costs both on governments and businesses.

These issues make the existing automatic exchange of tax information regimes still significantly problematic. After all, these problems boil down to the lack of uniformity and multilateralism, which will be explored in the subsequent chapter.

Chapter 4: Global Standard on automatic exchange of financial account information

4.1 Introduction

In April 2013, there was a major event in international taxation. The G20 took a formal move towards automatic exchange of information system by endorsing automatic exchange as the expected new standard for international tax information exchanges.[375] Shortly thereafter, the OECD issued a report, which sets out the concrete steps to be undertaken to put a global model of automatic exchange in practice.[376] In September 2013, the G20 Leaders expressed their interest in working with the OECD to develop a new multilateral framework on automatic exchange of information and to present a new single standard in early 2014. They also called on all other jurisdictions to join this initiative by the earliest possible date.[377]

[375] "We welcome progress made towards automatic exchange of information which is expected to be the standard and urge all jurisdictions to move towards exchanging information automatically with their treaty partners, as appropriate. We look forward to the OECD working with G20 countries to report back on the progress in developing of a new multilateral standard on automatic exchange of information, taking into account country-specific characteristics. The Global Forum will be in charge of monitoring" See the Communiqué of the G20 Finance Ministers and Central Bank Governors in Washington DC on April 19, 2013. Paragraph 14. Available at http://www.g20.utoronto.ca/2013/2013-0419-finance.html

[376] *A Step Change in Tax Transparency: Delivering a Standardised, Secure and Cost Effective Model of Bilateral Automatic Exchange for the Multilateral Context* (France: Paris OECD, 2013).

[377] "We commend the progress recently achieved in the area of tax transparency and we fully endorse the OECD proposal for a truly global model for multilateral and bilateral automatic exchange of information. Calling on all other jurisdictions to join us by the earliest possible date, we are committed to automatic exchange of information as the new global standard which must ensure confidentiality and the proper use of information exchanged, and we fully support the OECD work with G20 countries aimed at presenting such a new single global standard for automatic exchange of information by February 2014 and to finalizing technical modalities of effective automatic exchange by mid-2014. In parallel, we expect to begin to exchange information automatically on tax matters among G20 members by the end of 2015. We call on all countries to join the Multilateral Convention on Mutual Administrative Assistance in Tax Matters without further delay. We look forward to the practical and full implementation of the new standard on a global scale. We encourage the Global Forum to complete the allocation

On 23 February 2014, the OECD finally introduced the Standard for automatic exchange of financial account information.[378] This Standard is expected to complement the earlier global standard of information exchange on request attempting to address its many limitations (See Chapter 4).

In May 2014, all 34 OECD member countries along with Argentina, Brazil, China, Colombia, Costa Rica, India, Indonesia, Latvia, Lithuania, Malaysia, Saudi Arabia, Singapore and South Africa endorsed the proposed standard.[379] More than 65 jurisdictions publicly committed to implement it, with more than 40 having committed to a specific timetable leading to the first automatic information exchanges as early as in 2017.

On 9 July 2014, the OECD released the full version of the Standard for Automatic Exchange of Financial Account Information in Tax Matters.[380] The full version of the Standard includes commentaries, model administrative agreements, guidance, as well as a standard format and

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of comprehensive country ratings regarding the effective implementation of information exchange upon request and ensure that the implementation of the standards are monitored on a continuous basis. We urge all jurisdictions to address the Global Forum recommendations in particular those 14 that have not yet moved to Phase 2. We invite the Global Forum to draw on the work of the FATF with respect to beneficial ownership. We also ask the Global Forum to establish a mechanism to monitor and review the implementation of the new global standard on automatic exchange of information." For more details, visit at http://www.g20.utoronto.ca/2013/2013-0906-declaration.html

[378] Available at http://www.oecd.org/ctp/exchange-of-tax-information/automatic-exchange-financial-account-information-common-reporting-standard.pdf

[379] The OECD's annual Ministerial Council Meeting in Paris in May. The details of the meeting are available at http://www.oecd.org/tax/transparency/AEOIjointstatement.pdf.

[380] The document is available at http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm

requirements for secure transmission of data. The full version of the Standard was endorsed by the G20 Finance Ministers at their meeting in Cairns, Australia in September 2014.

In the meantime, the Global Forum on Transparency and Exchange of Information for Tax Purposes was mandated to establish a mechanism to monitor and review the implementation of the new global standard on automatic exchange of information.[381] In September 2014, the Global Forum also delivered a Roadmap for developing country participation in the new OECD Standard.[382]

In October 2014, 51 countries, 38 of which were represented at ministerial level gathered in Berlin and turned their earlier commitments into action by formally signing the multilateral competent authority agreement that would activate automatic exchange of information, based on Article 6 of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.[383] They indicated to work towards launching their first information exchanges between 2017 and 2018.

The OECD global Standard for automatic exchange of information has two main components:

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[381] "We endorse the finalised global Common Reporting Standard for automatic exchange of tax information on a reciprocal basis which will provide a step-change in our ability to tackle and deter cross-border tax evasion. We will begin exchanging information automatically between each other and with other countries by 2017 or end-2018, subject to the completion of necessary legislative procedures. We call on all financial centres to make this commitment by the time of the Global Forum meeting in Berlin, to be reported at the Brisbane Summit, and support efforts to monitor global implementation of the new global standard". *See* the G20 Communiqué at the Meeting of G20 Finance Ministers and Central Bank Governors, Cairns, September 21, 2014, Paragraph 8. The document can be found at http://www.g20.utoronto.ca/2014/2014-0921-finance.html

[382] The document is available at http://www.oecd.org/ctp/exchange-of-tax-information/global-forum-AEOI-roadmap-for-developing-countries.pdf

[383] The list of the signatory countries can be found at http://www.oecd.org/ctp/exchange-of-tax-information/mcaa-signatories.pdf

a) Common Reporting Standard (CRS), which contains the reporting and due diligence rules to be followed by financial institutions;
b) Competent Authority Agreement (CAA), which contains detailed rules on the exchange of the collected information.

The CRS provides a framework for governments on the financial account information to be collected from financial institutions. It sets our rules on the types of accounts and taxpayers to be reported, as well as common due diligence procedures to be followed by the financial institutions in identifying these accounts and persons.

The CAA, on the other hand, deals with matters such as procedure to exchange the collected information between contracting parties. It also contains the detailed rules on confidentiality, safeguards, the time, and format for such exchanges. Thus, the CAA essentially links the reporting obligations of financial institutions with the exchange obligations of their states.

The implementation of the Standard involves four foundational steps:

a) Incorporating the CRS into domestic law. Jurisdictions will need to have rules in place that require financial institutions to collect, maintain, and report information that are consistent with the Standard;
b) Selecting a legal basis for the exchange of information. Many jurisdictions already have legal instruments that permit automatic exchange of information: bilateral tax treaties and the Multilateral Convention. However, they typically require separate agreements to operationalize the automatic exchange. The bilateral and multilateral Model CAAs can be used for this purposes;

c) Putting in place the administrative and IT infrastructure to collect and exchange information under the Standard. The Standard includes a transmission format to be used for exchange of information. Jurisdictions need to agree on effective transmission methods and encryption standards for the secure exchange of information;

d) Taking necessary measures that ensures confidentiality protection and data safeguards for the exchanged information. The standard contains detailed rules on confidentiality and data safeguards to be in place both on a legal and operational level.

One must note that the new Standard draws extensively on earlier work of the OECD in the area of automatic exchange of information, FATCA intergovernmental agreements, and the EU Savings Directive.

4.2 Common Reporting Standard (2014)

An automatic exchange of information requires countries to have necessary rules and mechanisms in place to collect information for the automatic exchange purpose. It also requires countries to determine the scope of information to be collected and the scope of persons whose information is reported. Finally, the automatic exchange of information requires countries to agree on a set of due diligence procedures to be followed by the reporting institutions in the process of information collection and reporting. The OECD Common Standard on Reporting and Due Diligence for Financial Account Information (CRS) is intended to provide guidance on these matters.

4.2.1 Reporting Financial Institutions

Under the Global Standard released by the OECD in February 2014, jurisdictions automatically obtain the information necessary for automatic exchange from their financial institutions. For the purpose of CRS, a financial institution[384] means a custodial institution,[385] a depository institution,[386] an investment entity,[387] or a specified insurance company.[388] Reporting financial institution (RFI) means any financial institution in the participating jurisdiction that is not a non-reporting financial institution. The CRS generally treats governmental entities, international organizations or central banks, broad participation retirement funds; narrow participation retirement funds; pension funds of a governmental entity, qualified credit card issuers; and any other entities that presents a low risk of being used to evade tax as non-reporting defined in domestic law as a non-reporting financial institutions. Other exemptions apply for exempt collective investment entities, which are regulated, without bearer shares and the interests of which are not held by reportable persons; and trusts, the trustees of which are RFIs. These RFIs which are trustees are obliged to report the same information that the trust would otherwise have

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[384] OECD Common Reporting Standard, Sec. VIII (a)(3).

[385] Custodian institution is any entity that holds, as a substantial portion of its business, financial assets for the account of others. See the OECD Common Reporting Standard, Sec. VIII (a)(4).

[386] Depository institution is any entity that accepts deposits in the ordinary course of a banking or a similar business. See the OECD Common Reporting Standard, Sec. VIII (a)(5).

[387] Investment entity is any entity that primarily conduct as a business investment activities or operations on behalf of other person, and entities that are managed by those entities or other financial institutions. See the OECD Common Reporting Standard, Sec. VIII (a)(6).

[388] Specified insurance company is any entity that is an insurance company that issues or is obliged to make payments with respect to a cash value insurance contract or annuity contract.

to report. Therefore, for a financial institution to be a RFI, it needs, first, to be a participating jurisdiction financial institution and then not be an exempt or non-reporting financial institution.

4.2.2 Reportable Persons

Automatic exchange of information generally aims at ensuring compliance by resident taxpayers with foreign assets and incomes. Therefore, under the Standards, financial institutions are expected to take reasonable efforts to identify residency of their clients. In principle, the reporting must be done on account holders who are individuals or entities that are residents in a reportable jurisdiction. Where the client is an entity, it is considered to be resident in the jurisdiction in which its place of effective management is situated.

However, governments are also mindful of the fact that individual taxpayers may use interposed foreign legal entities or arrangements to circumvent the system. Therefore, CRS require reporting financial institutions to look through foreign shell companies, trusts, foundations, and similar arrangements to establish their controlling persons. Controlling person in the CRS is the equivalent of beneficial owner as defined in the Financial Action Task Force's Anti-Money Laundering Recommendation and its interpretative notes.[389] When none of the above is identified, the controlling person would be the natural person who holds the position of senior managing official.

There are certain exemptions to reporting for certain entities. No information need to be reported

[389] *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - the FATF Recommendations* (France, Paris: Financial Action Task Force 2012). See the interpretative notes for the Recommendation 10, at 60. The report can be found online at http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf

about: a) a corporation listed in an established securities market, b) a governmental entity, c) an international organization, d) a Central Bank, or e) a financial institution (except those investment entities resident in a non-participating jurisdictions and thus treated as a passive NFE).

4.2.3 Reportable items

The CRS stipulates that for a model of automatic exchange of financial account information to be effective, the reporting rules must be specifically designed with residence jurisdiction's tax compliance in mind rather than be a by-product of domestic reporting. The CRS establishes that the information to be reported by RFIs includes:[390]

a) *In case of any individual that is an accountholder and a reportable person: the name, address, TIN, jurisdiction of residence, and date and place of birth;*
b) *In case of any entity that is an accountholder and a reportable person: the name, address, jurisdiction of residence, and TIN;*
c) *In the case of any entity that is an accountholder that is identified as having one or more controlling persons that is a reportable person:*
    a. *the name, address, jurisdiction of residence, and TIN;*
    b. *the name, address, TIN, jurisdiction of residence, and date and place of birth of each controlling person that is reportable person;*
d) *the account number (or its functional equivalent in the absence of an account number);*
e) *the name and identifying number of the reporting financial institution;*

[390] The OECD Common Reporting Standard (OECD, 2014), Sec.1, Paragraph A.

f) *the account balance or value as of the end of the relevant calendar year or other appropriate reporting period or, if the account was closed during such year or period, the closure of the account.*

In addition the following information must also be reported:

a) *In the case of any custodial account:*
   a. *The total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period;*
   b. *The total gross amount of dividends paid or credited to the account during the calendar year or other appropriate reporting period;*
   c. *The total gross amount of other income generated with respect to the assets held in the account paid or credited to the account during the calendar year or other appropriate reporting period;*
   d. *The total gross proceeds from the sale of redemption of Financial Assets paid or credited to the account during the calendar year or other appropriate reporting period with respect to which the RFI acted as a custodian, broker, nominee or otherwise as an agent for the accountholder;*

b) *In the case of any depository account: the total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period;*

c) *In case of any account other than a custodial account or a depository account: the total gross amount paid or credited to the accountholder with respect to the account during the calendar year or other appropriate reporting period with respect to which the RFI is the obligator or debtor, including the aggregate amount of any redemption payments* *made to the accountholder during the calendar year or other appropriate reporting period.*

The CRS exempts certain categories of accounts from reporting. These accounts include retirement and pension accounts, non-retirement tax-favoured accounts, term life insurance contracts, estate accounts, escrow accounts, depository accounts due to not-returned overpayments, and low risk excluded accounts.[391] These accounts need to meet certain eligibility criteria to be excluded from reporting. The reporting requirements also do not apply for non-debt, direct interest in real property, or a commodity.

Moreover, in many cases, the RFI will not have the TIN and date of birth of account holders. In such cases, the CRS requires that the RFI must make 'reasonable efforts' to obtain these from the account holder.[392] Reasonable effort means that at least once a year, during the period between the identification of the pre-existing account as a reportable account and the end of the second calendar year following the year of that identification, an effort is made to acquire this data from the account holder, either by contacting the account holder or by reviewing electronically searchable information maintained by the FI or a related entity of the FI.[393] There is no requirement to limit the use of the account by the account holder during an attempt to obtain the TIN and date of birth.

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[391] The OECD Common Reporting Standard (OECD, 2014), Sec.VIII(C)(17).

[392] The OECD Common Reporting Standard (OECD, 2014), Sec. I(C).

[393] The OECD Common Reporting Standard (OECD, 2014), Commentary for Sec. I(C).

4.2.4 Due deligence requirements

The CRS sets certain due diligence rules to be followed by the RFIs. It requires the RFIs to take certain actions, such as collecting information and/or reviewing information in their possession for the purpose of identifying Reportable Persons and Reportable Accounts. The due diligence procedures is, in many respects, determined by reference to whether a particular account is:

a) An individual or an entity account;

b) A pre-existing or a new account;

c) A low-value or a high-value account.

The pre-existing and new accounts. The pre-existing account is an account, instrument or contract maintained or executed by the RFI prior to the date that the Standard becomes effective in participating jurisdictions. The new account is an account, instrument or contract opened or executed by the RFI after the effective date.

The low value and high value accounts. The RFIs are required to review individual accounts regardless of the amount of the account balance. However, for the pre-existing individual accounts, the level and procedure of due diligence depends on whether these accounts are high value or low value accounts. The CRS considers the individual account that does not exceed $1,000,000 as the low value account, while it considers individual account with a balance or value that exceeds $1,000,000 as high value accounts.[394] The CRS requires a more robust and enhanced review procedure for the latter.

[394] The OECD Common Reporting Standard (OECD, 2014), Sec.VIII(C)(14-15).

Every RFI must keep records that were obtained or created in connection with its obligations under the CRS, such as self-certification and documentary evidence. A financial institution must also keep records of its policies and procedures that establish its governance and due diligence processes. In next sections, we discuss certain common concepts that support the due diligence and identification processes with respect to these accounts.

4.2.4.1 Due diligence for pre-existing individual accounts

Pre-existing low value individual accounts. For low value pre-existing individual accounts, the CRS requires RFIs first to apply *"Residence address test"* and if necessary *"Electronic record test"* for the purpose of determining whether these accounts are reportable accounts and are held by reportable persons.

Residence address test. The CRS requires RFIs to have policies and procedures in place to verify the residence address of the pre-existing individual accounts based on documentary evidence. For low value pre-existing individual accounts, if the RFI has in its records a current residence address for the individual account holder based on documentary evidence, the RFI may treat the individual account holder as being a resident for tax purposes of the jurisdiction in which the address is located for purposes of determining whether such individual account holder is a reportable person.

The RFI may treat such individual as being a resident for tax purposes of the jurisdiction in which an address is located if the following conditions are met:

a) The RFI has in its records a residence address for the individual accountholder. The CRS clarify that "in care of" or post office box is not considered as resident address.

b) Such residence address is current. A residence address is considered as current address where it is the most recent address that was recorded by the reporting financial institution with respect to the individual account;

c) Such residence address is based on documentary evidence. This requirement is satisfied if the RFI policies and procedures ensure that the current residence address in its records is the same address or in the same jurisdiction as that on the documentary evidence (e.g. identity card, driving licence, voting card, or certificate of residence). Recent documentation issued by utility companies that relate to supplies may also serve as documentary evidence.

Electronic record search. If the RFI does not rely on a current residence address for the individual account holder based on documentary evidence, the CRS requires the RFIs to review its electronically searchable data for any of the following indicia:

a) Identification of the accountholder as a resident of a reportable jurisdiction;

b) Current mailing or residence address (including a post office box) in a reportable jurisdiction;

c) One or more telephone numbers in a reportable jurisdiction and no telephone number in the jurisdiction of the reporting financial institution;

d) Standing instructions to transfer funds to an account maintained in a reportable jurisdiction;

e) Currently effective power of attorney or signatory authority granted to a person with an address in a reportable jurisdiction; or

f) A "hold mail" instruction or "in-care-of" address in a reportable jurisdiction if the RFI does not have any other address on file for the accountholder.

If any of the indicia listed above is discovered in the electronic search or if there is change in circumstances that results in one or more indicia being associated with the account, then the RFI must treat the account as a resident for tax purposes of each reportable jurisdiction for which the indicium is identified. If none of the listed indicia are discovered in the electronic search, then no further action is required until there is a change in circumstances that results in one or more indicia being associated with the account, or the account becomes a high value account.

Pre-existing high value individual accounts. The CRS applies enhanced review procedure for the high value accounts. It requires the RFIs to apply "Electronic record test" and "Paper record test" with respect to such accounts to determine reportable persons and reportable accounts.

Electronic record test. The RFI is required to review electronically searchable data maintained by the institution for the same indicia described with respect to low value pre-existing accounts.

Paper record test. If the electronic databases do not capture such information, then the RFI must also review the current customer master file and the following documents associated with the account and obtained by the RFI within the last five years for any of the indicia described above:

a) The most recent documentary evidence collected with respect to the account;

b) The most recent account opening contract or documentation;

c) The most recent documentation obtained by the RFI pursuant to AML/KYC procedures or for other regulatory purposes;
d) Any power of attorney or signature authority forms currently in effect; and
e) Any standing instructions to transfer funds currently in effect.

If any of the indicia listed above is found in the enhanced review or if there is a subsequent change in circumstances that results in one or more indicia being associated with the account, then the RFI must treat the account as reportable account with respect to each reportable jurisdiction for which the indicia is identified. If none of the listed indicia are discovered in the enhanced review of high value accounts, and the account is not identified as held by a reportable person, then further action is not required until there is a change in circumstances that results in one or more indicia being associated with the account.

Any pre-existing individual account that has been identified as a reportable account, must be treated so in all subsequent years, unless the accountholder ceases to be a reportable person.

4.2.4.2 Due diligence for new individual accounts

The CRS requires that upon account opening, the RFI must obtain a self-declaration, which may be part of the account opening documentation that allows the RFI to determine the accountholder's residence for tax purposes and confirm this self-declaration by other means of other documentation collected pursuant to AML/KYC procedures.[395] If the self-declaration establishes the accountholder is a resident in a reportable jurisdiction, such self-declaration must also include the accountholder's TIN and date of birth.

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[395] The OECD Common Reporting Standard (OECD, 2014), Commentary to Section IV(A).

If there is a subsequent change in circumstances with respect to a new individual account that causes the RFI to know, or have reason to know, that the original self-certification is incorrect or unreliable, the RFI must obtain a valid self-certification that establishes the accountholder's residence for tax purposes.

4.2.4.3 Due diligence for pre-existing entity accounts

The due diligence for the entity accounts may involve multiple procedures. First, the RFIs are required to determine whether the entity itself is a reportable person. Furthermore, RFIs are also required to determine whether the entity is a passive non-financial entity and if so, to determine the residency of its controlling persons. Unlike, the due diligence rules applicable for individual accounts, the due diligence rules applicable for pre-existing entity accounts involve de minims threshold.

Generally, a pre-existing entity account with an account balance or value that does not exceed $250,000 as of 31 December is considered as low value entity account and is not required to be reviewed, identified, or reported as a reportable account until the account balance or value exceeds $250,000 as of the last day of any subsequent calendar year.[396] The Tax Justice Network criticizes this de minims rule arguing that this rule may create an opportunity for abuse. It could be easy to get below the threshold by, for example, splitting an account into several accounts across various banks, or by depleting it just before the reporting date, then replenishing it afterwards.[397]

[396] The OECD Common Reporting Standard (OECD, 2014), Sec.V(A).

[397] Tax Justice Network, *OECD's Automatic Information Exchange Standard: A Watershed Moment for Fighting Offshore Tax Evasion?* (United Kingdom: Tax Justice Network 2014), at 13.

Overall, the RFI must apply the necessary review procedures for the accounts exceeding the threshold to determine whether the account is the entity account with respect to which reporting is required. For this purpose, the RFI determines the accountholder's residency based on a place of incorporation or organisation, or its address.

The RFI also determines whether the accountholder is a passive non-financial entity with one or more controlling persons who are reportable persons. All entities are non-financial entities except financial institutions. A passive non-financial entity is any non-financial entity that is not an active non-financial entity. Determining whether an entity is a "passive" or "active" non-financial entity depends on the percentage of its income (more than 50%) constitute either passive or active income. Generally, passive non-financial entities refer to trusts and foundations. The 'controlling persons' refer to the natural persons who exercise control over an entity. In this sense, controlling persons generally refer to beneficial owners of the entity.

In determining whether the accountholder is a passive non-financial institution, the RFI must obtain self-declaration from the accountholder to establish its status. In determining the controlling persons of the passive non-financial institutions and their residency, the FRIs may rely on information collected pursuant to know-your-customer rules.[398]

4.2.4.4 Due diligence for new entity accounts

With respect to new entity accounts, upon account opening, the RFI must determine whether the account is held by one or more reportable persons or by passive non-financial entity with one or more controlling persons who are reportable persons; however, there is no de minims threshold

[398] The OECD Common Reporting Standard (OECD, 2014), Sec.V(D).

applicable. RFIs will therefore be required to report a much greater amount of information to the competent authorities.

To determine whether the entity is a reportable person, the RFI must obtain a self-certification that allows the RFI to determine the accountholder's residence for tax purposes and confirm the accuracy of such self-certification based on the information obtained by the RFI in connection with the opening of the account, including any documentation collected pursuant to AML/KYC procedures.[399] If the entity certifies that it has no residence for tax purposes, the RFI may rely on the address of the principal office of the entity to determine the residence of the accountholder.

In case of a passive NFE, the RFI must determine the controlling persons of the entity and whether these controlling persons are reportable persons.[400] If any of the controlling persons of a passive NFE is a reportable person, then the account must be treated as a reportable account.

4.2.4.5 Special due diligence rules

The CRS stipulates that the RFI may not rely on a self-certification or documentary evidence if it knows or has reason to know that the self-certification or documentary evidence is incorrect or unreliable.[401]

For purposes of determining the aggregate balance or value of financial accounts held by an individual or entity, a RFI is required to aggregate all financial accounts maintained by the RFI or by a related entity, but only to the extent that the RFI's computerized systems link the

[399] The OECD Common Reporting Standard (OECD, 2014), Sec.VI(A)(1).

[400] The OECD Common Reporting Standard (OECD, 2014), Sec.VI(A)(2).

[401] The OECD Common Reporting Standard (OECD, 2014), Sec.V(A). Model CRS, Sec.VII(a).

financial accounts by reference to a data element such as client number or TIN, and allow account balances or values to be aggregated. Each holder of a jointly held financial account shall be attributed the entire balance or value of the jointly held financial account for purposes of applying the aggregation requirements.

The CRS stipulates that a jurisdiction must have rules and administrative procedures in place to ensure effective implementation of, and compliance with, the reporting and due diligence procedures set out in the CRS. Specifically, it must have rules to prevent any financial institutions, persons or intermediaries from adopting practices intended to circumvent the reporting and due diligence procedures; the rules requiring the RFIs to keep records of the steps undertaken and any evidence relied upon for the performance of the above procedures and adequate measures to obtain those records; administrative procedures to verify reporting financial institutions' compliance with the reporting and due diligence procedures; administrative procedures to ensure that the entities and accounts defined in domestic law as non-reporting financial institutions and excluded accounts continue to have a low risk of being used to evade tax; and effective enforcement provisions to address non-compliance.[402]

4.2.5 Legal basis for the CRS

The Global Standard requires formal legal basis for the CRS to get properly up and running. This requires the participating countries to translate the CRS into their domestic laws.[403] These include a) rules to prevent any financial institutions, persons, and intermediaries from adopting

[402] The CRS, Section IX (a).

[403] The Recommendations of the OECD Council on the Standard for Automatic Exchange of Financial Account Information in Tax Matters on July 15, 2014, Paragraph 1.

practices intended to circumvent the reporting and due diligence procedures; b) rules that require RFIs to keep reports of the steps undertaken and any evidence relied for the performance of the above procedures and adequate measures to obtain those records; c) administrative procedures to verify RFIs compliance with the reporting and due diligence procedures; administrative procedures to follow up a RFI when undocumented accounts are reported; d) administrative procedure to ensure that the entities and accounts defined in domestic law as non-reporting financial institutions and excluded accounts continue to have a low risk of being used to evade taxes; and e) effective enforcement provisions to address non-compliance.

4.3 Competent Authority Agreement (2014)

Article 6 of the Multilateral Convention and Article 26 of the OECD and UN Model Tax Conventions already stipulate about the possibility of automatic exchanges of information between contracting parties. However, these instruments do not provide the framework and mechanism to activate automatic exchange of information relations. Therefore, the contracting parties need an additional agreement concluded by their competent authorities specifying the mechanics of exchange and the scope of taxes covered. The OECD designs the CAA to be used for this purpose.

4.3.1 Exchange of information under the CAA

The Model CAA stipulates that the competent authorities of contracting countries annually exchange on an automatic basis the information obtained pursuant to the rules in the agreement and the CRS.[404] The information to be exchanged is generally the information to be reported by

[404] The OECD Model Competent Authority Agreement (OECD, 2014), Section 2(1).

reporting financial institutions under the reporting and due diligence rules of the Common Reporting Standard (See Section 4.2).

4.3.2 Timing, manner, and enforcement of exchanges under the CAA

The tax information under the new Standard is exchanged on an annual basis. However, the information may also be exchanged more frequently than once a year.[405] The Model CAA stipulates that the information is exchanged within nine months after the end of the calendar year to which the information relates.[406] However, this timeline is a minimum standard and jurisdictions are free to agree on shorter timelines.

The CAA sets out that a competent authority notifies the other competent authority when the former has reason to believe that an error may have led to incorrect and incomplete information reporting or there is non-compliance by its reporting financial institution with the applicable reporting requirements and the due diligence procedures. In this case, the notified competent authority takes all appropriate measures available under its domestic law to address the error or non-compliance.[407]

4.3.3 Confidentiality and data safeguards under the CAA

The Model CAA stipulates that information exchanged is subject to the confidentiality rules and other safeguards provided for in the underlying instrument (e.g. the Multilateral Convention or

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[405] *OECD Model Competent Authority Agreement* (France: Paris OECD, 2014), Commentary to Section 2(2).

[406] Ibid. Subsection 3(3).

[407] Ibid. Section 5.

bilateral Tax Conventions), including the provisions limiting the use of the information exchanged and, to the extent needed to ensure the necessary level of protection of personal data, in accordance with the safeguards which may be specified by the supplying competent authority as required under its domestic law. They also have the obligation to notify one another immediately about any breach of confidentiality or failure of safeguards and any sanctions and remedial actions consequently imposed.[408]

4.3.4 Consultation, suspension, or termination of the CAA

The Model CAA provides that parties to the CAA may request consultations to resolve any difficulty in the implementation or implementation of the agreement. They can also amend the agreement by written agreement.[409]

The Model CAA also provides a possibility for parties to the CAA to suspend the exchange of information by giving notice in writing if it determines that there is or has been significant non-compliance by the other party to the agreement. Such suspension will have an immediate effect. Commentary to Section 7 of the Model CAA lists the following situations as examples of significant non-compliance: a) non-compliance with the confidentiality or data safeguard provisions, b) failure to provide adequate and timely information, c) inappropriate definition of excluded accounts or non-reporting financial institutions, d) the lack of rules and administrative procedure to ensure effective implementation of reporting and due diligence procedures.[410]

[408] The OECD Model Competent Authority Agreement (OECD, 2014), Section 5.

[409] The OECD Model Competent Authority Agreement (OECD, 2014), Section 6.

[410] The OECD Model Competent Authority Agreement (OECD, 2014), Commentary to Section 7, Paragraph 2.

A party to the CAA may also terminate the agreement by giving a notice of termination in writing to the other party. Such termination will be effective 12 months after the date of notice of termination.[411]

4.4 Monitoring the implementation of the new Global Standard

4.4.1 The Global Forum on Transparency and Exchange of Information for Tax Purposes

Our discussions in the previous chapter bring us to a next question as to whether there is an international body or mechanism that ensures the participating countries' adherence to the Standard on automatic exchange of tax information. One of the main claimants for this standing is the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum). The Global Forum was established in 2000 by the OECD.[412] It is the continuation of a forum (the Global Forum on Taxation), which was created in the early 1998 in the context of the OECD's fight to harmful tax competition. The main goal of the Global Forum is noted to help jurisdictions to effectively implement the international standards of transparency and exchange of information for tax purposes.[413]

The Global Forum was restructured in September 2009 in response to the G20 call to strengthen implementation of the standards of transparency and information exchange in tax matters.[414] 170

[411] The OECD Model Competent Authority Agreement (OECD, 2014), Sec.7.

[412] The Global Forum's website is located at URL: http://www.oecd.org/tax/transparency/abouttheglobalforum.htm

[413] See at http://www.oecd-ilibrary.org/taxation/global-forum-on-transparency-and-exchange-of-information-for-tax-purposes-peer-reviews_2219469x

[414] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Tax Transparency 2012: Report on Progress* (Paris OECD, 2012), at 14.

delegates from 70 jurisdictions and international organizations met in Mexico to restructure the Global Forum and agreed: [415]

- To open its membership doors to all OECD or non-OECD jurisdictions that commit to implementing the standards on transparency and exchange of information on tax matters, agree to be reviewed by the global forum, and contribute to funding;
- To turn into a consensus-based organization where all members act on an equal footing;
- To start in-depth peer review process to monitor its member countries' compliance with the standards on transparency and exchange of information on tax matters;
- To agreed on a three-year mandate to promote the rapid implementation of the standard through the peer review of all its members and other jurisdictions relevant to its work.

As a result of these reforms, the membership of the Global Forum is now open to all jurisdictions which are willing to: (i) commit to implement the international standard on transparency and exchange of information, (ii) participate and contribute to the peer review process, and (iii) contribute to the budget.

At the moment, the Global Forum is the premier international body for ensuring the implementation of the internationally agreed standards of transparency and exchange of information in the tax matters. As of October 2014, the Global Forum had 122 members on equal footing and the European Union, together with 12 observers, making it the largest tax group in

[415] One of the main restructuring involves the establishment of the Steering Committee and Peer Review Group that conduct in-depth peer review of the implementation of the standards of transparency and exchange of information for tax purposes. See "Summary of Outcomes of the Meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes Held in Mexico on 1-2 September 2009". The document can be downloaded at http://www.oecd.org/ctp/exchange-of-tax-information/43610626.pdf

the world.[416] The original members consisted only of OECD countries and jurisdictions that had agreed to implement transparency and exchange of information for tax purposes.[417] Membership of the Global Forum carries with it the obligation to contribute to the Global Forum Budget (the annual fee. As of September 2014, the fee was either flat EUR 15,300 or progressive for countries whose GNP is above USD 35 billion.

4.4.2 The Global Forum and the Standard on automatic exchange of information

In recognition of the emergence of the automatic exchange of information as a new global standard, the Global Forum was mandated to monitor and review the implementation of the new standard on automatic exchange of information. The Global Forum has two key streams of work in relation to the new Standard: monitoring and reviewing its implementation, and to help developing countries identify their need for technical assistance and capacity building in order to participate in and benefit from the Standard.[418]

To undertake this work, in 2013 the Global Forum established a new voluntary working group on Automatic Exchange of Information Group ("AEOI Group"). The AEOI Group comprises the Global Forum members and observers who wish to come together to work towards a common goal of engaging in automatic exchange of information. The AEOI Group currently comprises 57

[416] See at http://www.oecd.org/tax/transparency

[417] OECD, *A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard* (Paris, France: OECD, 2012), at 14.

[418] For further information visit at http://www.oecd.org/tax/transparency/abouttheglobalforum.htm

Global Forum jurisdictions and three Global Forum observers (i.e. the Commonwealth Secretariat, the European Commission, the World Bank Group).[419]

The AEOI Group's initial duties deriving from its mandate are to establish reference and a methodology for monitoring the implementation of the new Standard on a going-forward basis. To monitor implementation of the Standard, the AEOI Group is creating a peer review process. Work has commenced for the creation of new Terms of Reference and a new Methodology, which will allow for Global Forum member and relevant non-member jurisdictions to be evaluated for the effectiveness of the implementation, including the meeting of confidentiality and data safeguard requirements. These reviews will ensure a globally consistent implementation of the Standard. The monitoring and peer review process is expected to commence a desktop review of legal frameworks in 2016 and a review of practical implementation in 2019. The results of these peer reviews will be available publicly, and can be used to assist jurisdictions to improve their legal and practical frameworks in accordance with best practice.[420]

4.5 Concluding remarks

The OECD's new Standard on automatic exchange of financial account information has raised the international cooperation on tax matters to a new level. It addressed some of the gravest problems of the existing international automatic exchange of information regimes. First, the existing frameworks on automatic exchange of information were unilateral, bilateral, or regional

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[419] For more information, visit at http://www.oecd.org/tax/transparency/automaticexchangeofinformation.htm

[420] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Automatic Exchange of Information: A Roadmap for Developing Country Participation* (France: Paris Global Forum on Transparency and Exchange of Information for Tax Purposes 2014), at 19.

in nature causing tensions and ineffectiveness. Second, there were some inconsistencies within these frameworks in terms of their material, personal, and procedural scopes. Third, in some of these frameworks, operation of the automatic exchange system was dependent on the existence of additional agreement, which has been rarely concluded. The new Standard has addressed most of these problems.

First, it has provided the conceptual and structural foundations for automatic exchange of information system to operate on a multilateral level. Second, it has introduced standard rules that converge the existing practices in the field. Basically, it created a single global standard on automatic exchange of information. Finally, it has introduced a much needed model framework (i.e. CAA) that the Multilateral Convention and bilateral tax conventions contemplated long but they were unable to produce so far.

However, there is a remaining question as to whether the new Standard and its resulting frameworks, e.g. CAA will overtake all or some of the existing frameworks on automatic exchange of information. As far as the IGAs are concerned, this seems unlikely. The IGAs appear to have their own reasons to persist. The agreements are designed to assist the U.S. government to collect information on the worldwide income and assets of its citizens. On the other hand, the OECD's new Standard is designed to assist countries to collect information on the worldwide income and assets of their tax residents. Therefore, unless the U.S. renounces its citizenship based tax system, or the new Standard accommodates the U.S. tax system's specific needs, the latter framework renders less useful. After all, some degree of inconsistency and multiplicity of reporting systems may still persist.

Chapter 5: Challenges and perspectives of automatic exchange of tax information

The automatic exchange of tax information system brings with it huge challenges. One of the early challenges of the new system is to consider how the transition from the world without automatic exchange system on a global scale to the world with such a system occurs.

First, there have been already some opposition to the automatic exchange of information system by some secrecy jurisdictions. They reportedly have no interest, or more precisely, opposing interest to the emerging system. This led to the emergence of an alternative venue to the international automatic exchange of tax information practice, which has become known as 'Rubik model' or 'anonymous tax withholding regime'. Consequently, the automatic exchange of information system has to confront with this alternative system.

Second, the new automatic exchange of information system essentially unveils the foreign assets and income of resident taxpayers that have been stashed abroad and that might have never before been declared and known to their countries of residence. The governments need to find ways to deal with these past tax liabilities in an effective and less controversial manner during their early transition to the new regime. Thus, the regularization of the past tax liabilities becomes a major transitional consideration.

Third, the new Standard on automatic exchange of information was developed largely by the developed world. Therefore, the architects of the new regime must consider the developing country perspectives on the automatic exchange of information if the Standard is to be promoted as a global standard. The standard setting bodies need to understand the challenges and considerations of involving developing world in the new regime.

Fourth, when the countries commence automatic exchange of tax information, the volume and scope of information exchanged between states substantially increase compared to the existing international information exchange regimes. Thus, there is an increased possibility of misinterpretation, misuse, or abuse of exchanged information. This raises taxpayer privacy and confidentiality issues.

This chapter attempts to explore these challenges.

5.1 The Rubik Model: An alternative to automatic exchange of tax information regime?

5.1.1 Introduction

As we have observed in the preceding chapter, international automatic exchange of tax information has emerged as a new phenomenon in international tax law. Now, international pressure is mounting on all countries to adopt this method of information exchange. However, there has been a long-running fundamental difficulty in persuading some countries to take in such regimes.[421] There is a challenging argument that by providing information to the tax authorities of other countries and enabling them to levy tax on the foreign-source income of their residents, some jurisdictions, especially low tax jurisdictions or the jurisdictions with a strong bank secrecy, would make themselves less attractive to foreign capital. Consequently, such

[421] Richard Murphy, *The European Union Savings Directive: Halting Progress* (UK, London: 2011). Available at http://www.taxresearch.org.uk/Blog/2011/05/18/the-european-union-savings-tax-directive-halting-progress/; Ulrich Lehner, "Final Withholding Tax in Switzerland" Diplomat Magazine (7 February 2012). Available at http://diplomatonline.com/mag/2012/02/final-withholding-tax-in-switzerland/

jurisdictions have been concerned that whichever agrees first to exchange information would automatically lose a significant amount of business and investment to those that did not.[422]

These concerns resulted in the emergence of an alternative venue to the international automatic exchange of tax information practice, which has become known as "Rubik model" or "anonymous tax withholding". The Rubik model essentially enables the residence country to collect the necessary taxes on the foreign-source income of its resident taxpayers without the source country having to transmit information on the taxpayers' identity. Under the Rubik model, a country where people hold their foreign assets: 1) withholds taxes at source on the income accrued on the assets; 2) aggregates all the collected tax; and 3) transfers the tax so collected to the tax authorities of the residence country of the taxpayer without disclosing the identity, income, or assets information relating to the taxpayer. As a result, the source country provides the residence country tax revenue instead of tax information. Such an arrangement provides tax revenue for the residence country, while, at the same time, allowing the source country to preserve its banking secrecy and confidentiality laws.

At present, there are the following "Rubik-type" agreements: the European Union-Switzerland[423] (signed on 2 June 2004),[424] the Andorra-European Union (signed on 15 November 2004), the European Union-Lichtenstein (signed on 29 November 2004), the European Union-San Marino

[422] Itai Grinberg, "Battle over Taxing Offshore Accounts, The" (2012) 60 UCLA L. Rev.

[423] P. Pistone, "Exchange of Information and Rubik Agreements: The Perspective of an EU Academic" (2013) 4/5:67 Bulletin for International Taxation.

[424] Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, OJ L 385 (2004) [hereinafter: *E.U.-Switz. Agreement* (2004)].

(signed on 29 November 2004), the European Union-Monaco (signed on 7 December 2004) Agreements,[425] and the Switzerland-United Kingdom (signed on 6 October 2011, then modified on 20 March 2012),[426] and the Austria-Switzerland (signed on 13 April 2012) Rubik Agreements.[427] The Germany–Switzerland Rubik Agreement originally signed on 24 September 2011,[428] but the German Parliament rejected its ratification on 12 December 2012.[429] It has been reported that negotiations for similar agreements are underway between Switzerland and Belgium,[430] Greece,[431] and Italy.[432]

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[425] Eur. Commn. Press Release IP/04/1445, Savings taxation: Commission welcomes signature of agreements with Liechtenstein, San Marino and Monaco (7 Dec. 2004). Aavailable at http://europa.eu/rapid/press-release_IP-04-1445_en.htm.

[426] *Agreement Between the Swiss Confederation and the United Kingdom of Great Britain and Northern Ireland on Cooperation in the Area of Taxation* (6 Oct. 2011), Treaties IBFD [hereinafter: *Switz.-U.K. Rubik Agreement* (2011)], supplemented by *Protocol Amending the Agreement Between the United Kingdom of Great Britain and Northern Ireland and the Swiss Confederation on Cooperation in the Area of Taxation, Signed at London on 6 October 2011* (20 Mar. 2012), Treaties IBFD. Available at www.hmrc.gov.uk/taxtreaties/ukswiss.htm.

[427] *Abkommen Zwischen der Schweizerischen Eidgenossenschaft und der Republik Österreich über die Zusammenarbeit in den Bereichen Steuern und Finanzmarkt* (*Agreement between Switzerland and the Austrian Republic on the Future Tax Treatment of Capital Investment Income and the Treatment of Previously Undeclared Funds*) (13 Apr. 2012), Treaties IBFD [hereinafter: *Austria-Switz. Rubik Agreement* (2012)], also available at www.ris.bka.gv.at/Dokumente/BgblAuth/BGBLA_2012_III_192/COO_2026_100_2_831370.pdf

[428] *Abkommen Zwischen der Schweizerischen Eidgenossenschaft und der Bundesrepublik Deutschland über Zusammenarbeit in den Bereichen Steuern und Finanzmarkt* (21 Sept. 2011), Treaties IBFD, supplemented by *Protokoll zur Änderung des Abkommens Zwischen der Bundesrepublik Deutschland und Schweizerischen Eidgenossenschaft über Zusammenarbeit in den Bereichen Steuern und Finanzmarkt* (5 Apr. 2012), Treaties IBFD.

[429] DE: Ministry of Finance, *Mehrheit von Bundesländern im Bundesrat schützt deutsche Steuerhinterzieher und blockiert mehr Steuergerechtigkeit* 2012.

[430] De Broeck-Van Laere & Partners, *Switzerland Proposes Rubik Agreement with Belgium* (2014), available at www.dvp-law.com/documents/nieuwsarchief/20120913-switzerland-proposes-rubik-agreement-with-belgium.xml?lang=en.

[431] " Greek-Swiss Treaty: Athens Closes in on Wealthy Tax Evaders" Spiegel Online International (28 August 2012). Available at http://www.spiegel.de/international/europe/greece-and-switzerland-set-to-sign-tax-treaty-a-852526.html.

Both Rubik agreements and the Rubik model have been described as "a promising alternative for international automatic exchange of tax information" in scholarly and political circles.[433] It is argued that if the majority of countries adopted such a policy, automatic exchange of information system would not be necessary. The Rubik agreements themselves also uphold that an agreement has "an enduring effect equivalent to the outcome that would be achieved through an agreement regarding the automatic exchange of information".[434]

These arguments raise some important questions. What is the nature of Rubik model? Can the Rubik model really serve as an effective substitute for international automatic exchange of tax information system? What are the overall implications of this model for the residence country or for the source country, and for the integrity of modern international tax system as a whole? This section attempts to answer these questions in the light of prevailing tax doctrines and theories.

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[432] See http://www.srf.ch/news/schweiz/letta-will-jetzt-punkto-steuern-eine-loesung; and https://www.news.admin.ch/message/index.html?lang=fr&msg-id=45740

[433] Haig Simonian, "Swiss Seek Further Bilateral Tax Accords" Financial Times (11 August 2011) 4; Paul Lansing & Neil Vohra, "The Use of Secret Bank Accounts by Foreign National Depositors: The Swiss Bank Secrecy Crisis" (2012) 29:2 International Journal of Management 739; Niels Johannesen & Gabriel Zucman, "The End of Bank Secrecy? An Evaluation of the G20 Tax Haven Crackdown" (2014) 6:1 American Economic Journal: Economic Policy. (Johannesen and Zucman note that taxes withheld on all incomes earned by foreign residents in all tax havens could also make tax evasion impossible, while, at the same time, maintaining some form of bank secrecy. In addition, they raise the question of whether maximized tax revenue would also minimize administrative costs, including the costs of negotiating with tax havens. There is need for more research on this question.), at 89; See also Bär & Karrer, *Rubik/Withholding Tax Agreements: Overview.* Available at http://www.cambridgeforums.com/ww.admin/materials/iwd/13796999875_Rubik_Withholding_tax_agreement.pdf

[434] Preamble of the *Switzerland-U.K. Rubik Agreement* (2011).

5.1.1.1 Concept and purpose of the Rubik model

The term "Rubik" comes from the name of a Hungarian professor of architecture, Erno Rubik, who in 1974 invented a puzzle cube, known as the "Rubik's cube". The Rubik cube could be twisted and turned without breaking or falling apart. The cubes had coloured stickers on them. These were rotated to random points around the cube ("scrambling") and the object of the puzzle was to make each of the cube's six sides all one colour, with all of the cubes correctly oriented. Thirty years later, the Rubik Cube is still one of the world's best-selling puzzle toys.[435] However, the inventor's original purpose was solving the structural problem of moving the parts of the cube independently without the mechanism falling apart, i.e. without losing its integrity.[436]

This may also be regarded as the purpose of the Rubik model or Rubik agreements. The Rubik model attempts to provide a "pragmatic" resolution to the tension between the need for international tax information sharing and maintaining national bank secrecy and confidentiality laws. It allows the residence country to collect tax revenue on its residents' foreign-source income, and simultaneously permits the source country to retain banking and financial secrecy laws, thereby attempting to preserve the integrity of both systems.

5.1.1.2 Genesis of the Rubik model

Everything started with the Savings Directive (2003/48),[437] or to be more precise, in reaction to it. The Savings Directive (2003/48) was adopted on 3 June 2003, entered into force on 16 July 2003

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[435] David Singmaster, *Notes on Rubik's Magic Cube* (Hillside, NJ: Enslow Publishers 1981).

[436] "Rubik's Cube 25 Years on: Crazy Toys, Crazy Times". Available at http://www.independent.co.uk/news/science/rubiks-cube-25-years-on-crazy-toys-crazy-times-461768.html

[437] Council Directive 2003/48/EC of 3 June 2003 on Taxation of Savings Income in the Form of Interest Payments, OJ L 157 (2003) EU Law IBFD [hereinafter: Saving Directive (2003/48)].

and has applied from 1 July 2005. The significance of the Savings Directive (2003/48) lies in its objective of ensuring that each EU Member State has information to tax savings income of its residents, including their savings income from other EU Member States. The primary mechanism for achieving this objective is the imposition of the obligation on each Member State to automatically report the interest payments its residents make to the residents of other Member States.

The EU Member States began to work on this framework in late 1990s. In 1998, the EU Finance Ministers agreed on a common framework for the taxation of savings interest, consisting of exchange of information between the tax authorities of the Member States.[438] The proposal was based on a "coexistence model", whereby each Member State would have either to: (1) provide information automatically to other Member States on the interest paid from that Member State to individuals resident for tax purposes in other Member States, i.e. the automatic exchange regime; or (2) apply a withholding tax of at least 20% on the interest paid from that Member State to resident individuals of other Member States and, then, aggregate and transmit the tax collected to the latter Member States without revealing the names of the taxpayers, i.e. the anonymous withholding tax.[439] The initiative was intended to ensure the effective taxation of interest and similar savings income received by residents from paying agents, for example, banks, investment funds and other financial institutions, in other Member States.

[438] European Community Press Release IP/98/453 Taxation: new proposal on taxation of cross-border savings income (20 May 1998). Available at http://europa.eu/rapid/press-release_IP-98-453_en.htm

[439] Ibid. At Paragraph 4.

Three Member States, i.e. Austria, Belgium and Luxembourg, indicated their preference for the "anonymous withholding tax regime" over the "automatic information exchange regime" from the outset, given that their economies relied heavily on the performance of their financial sector and bank industry, and, most importantly, on banking secrecy as protection for foreign incoming investment.

Recognizing that these frameworks could give rise to a sizeable outflow of funds from the European Union, the Member States instructed the European Commission to start exploratory discussions with some non-EU countries, notably with Switzerland, to induce them to adopt similar measures. One of the earliest exploratory discussions took place between the European Union and the Swiss authorities on 2 March 1999.[440]

Following numerous rounds of exploratory discussions between 1999 and 2002, the European Commission convinced a number of non-EU countries, i.e. Switzerland, Andorra, Lichtenstein, San Marino and Monaco, to adopt measures equivalent to those to be applied within the European Union to ensure the effective taxation of savings income. However, as with Austria, Belgium and Luxembourg, these countries also indicated their preference for the anonymous withholding tax regime as opposed to the automatic exchange of information regime. In the meantime, the European Union had adopted the Savings Directive (2003/48) in June 2003, which was to enter into force in 2005. Between June and December 2004, the European Commission

[440] Delaloye, Habib & Ziegler. *Supra* note 324, at 147-48.

concluded specific agreements with Switzerland, Andorra, Lichtenstein, San Marino and Monaco on measures equivalent to those to be applied in the Savings Directive (2003/48).[441]

The basic purpose of the agreements was straightforward. Instead of extending the automatic provision of information to other Member States, these countries have been allowed to withhold tax on interest payments made by paying agents in their territories to beneficial owners who are individuals resident in EU Member States. The revenue received from the withholding tax is then shared between the withholding country and the residence Member State of the taxpayer in the ratio of 25:75. Consequently, the country that withholds the tax retains 25% of the proceeds and anonymously transfers 75% to the residence Member State of the recipient of the savings income. The rate of withholding tax was set at 15% for first three years of the agreement starting on 1 July 2005, 20% for the next three years and 35% thereafter.[442] Alternatively, subject to the agreement of the non-resident investor, these countries could provide the general details of the investor, including the nature and amount of the assets invested, thereby waiving the obligation to withhold tax at source.

Thus, EU Member states began to withhold tax on payments made by their paying agents (e.g. banks and financial institutions) to the residents of the other Member States. Between mid 2005 and the end of 2007, Switzerland collected and remitted to the other EU Member States EUR 631.4 million, Luxembourg - EUR 313.5 million, Austria - only EUR 113.3 million, Jersey - EUR 83.75 million, Belgium - EUR 53.4 million, Guernsey - EUR 21.76 million (for the years

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[441] For the various agreements between the European Union and these countries providing for measures equivalent to those set out in the Saving Directive (2003/48), see EU Law IBFD, also available at http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/legal_bases/index_en.htm

[442] Article 1, *E.U.-Switzerland Agreement* (2004).

2005-2006) and Liechtenstein - EUR 18.8 million.[443] The largest recipients of these withholding tax proceeds during this period were Germany (which received EUR 192.7 million), Italy (EUR 112.9 million), Spain (EUR 98.7 million), followed by France (EUR 62.8 million) and the United Kingdom (EUR 94.9 million).[444] Belgium received more than EUR 71 million, mainly from Luxemburg (74% of the total).[445]

On 17 September 2009, the Swiss Bankers Association issued its "Rubik agreement" proposal, which essentially proposed broadening the scope of the anonymous withholding tax agreements so as to cover other types of income and envisioned the implementation of a system the scope of which went beyond that of the Savings Directive (2003/48).[446]

However, shortly thereafter, some Member States began to call for the renegotiation of the existing EU agreements on the anonymous withholding tax. It appears that the payments generated from these agreements did not match the initial expectations of the Member States. The EU anonymous withholding tax arrangement was also too restricted in only covering interest and not applying to some of the most common other types of income, i.e. capital gains and

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[443] Hemmelgarn & Nicodème. *Supra* note at 339. Available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_18.pdf

[444] Ibid., at 26.

[445] European Commission. Report from the Commission to the Council in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, at 3. Available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/implementation/com%282008%29552_en.pdf

[446] The Swiss Bankers Association's report is available at www.swissbanking.org/en/20091210-4730-dok-rubik_businesscase_sbvg-uka-final.pdf.

dividends. However, the possibility for renegotiation was made impossible as a result of the veto of Austria and Luxembourg.[447]

These developments eventually resulted in the adoption of a next generation of anonymous withholding tax agreements. In 2011, Germany and the United Kingdom, and, in 2012, Austria, concluded another form of anonymous withholding tax agreements with Switzerland in addition to the European Union-Switzerland Agreement (2004), but this time, on a bilateral basis. These agreements are commonly referred to as Rubik Agreements.

These Rubik Agreements extended the anonymous withholding to capital gains, dividends, inheritance tax, interest and other passive income with the exception of royalties.[448] Algirdas Semeta, the European Commission's Commissioner for Taxation, has, however, criticized these bilateral agreements by noting that they overlap with the European Union-Switzerland Agreement (2004) that already deals with anonymous withholding for interest payments.[449] He argues that bilateral Rubik Agreements must be renegotiated to carve out and remove "interest" from the scope of application of these agreements. Consequently, the Germany-Switzerland (2011) and the Switzerland-United Kingdom (2011) Rubik Agreements have been amended to make them compatible with the Savings Directive (2003/48), though, of course, the Germany-

[447] Greggi. *Supra* note 196. Available at www.academia.edu/3397286/Understanding_Rubik_Agreements_and_their_impact_on_EU_Law_Do_Germans_and_Brits_do_it_better_.

[448] The *Switerland-Germany Rubik Agreement* (2011) also covers inheritance tax at a rate of 50%.

[449] "Switzerland Puzzled by Brussels Warning" SWI (6 March 2012). Available at http://www.swissinfo.ch/eng/switzerland-puzzled-by-brussels-warning/32241930. (European Commission's Commissioner for Taxation, Algirdas Semeta, emphasized that the (then) 27 Member States "should refrain from negotiating, initialling or ratifying Rubik agreements with Switzerland" as such agreements interfere with EU legislation).

Switzerland Rubik Agreement (2011) has not entered into force, due to Germany's failure to ratify the Agreement.

5.1.2 Substance and scope of Rubik agreements

As discussed earlier, the concept behind the Rubik Model is simple, i.e. resident individuals who derive relevant foreign-source income must choose between the following two alternatives:

(1) to opt to pay a special withholding tax regularly deducted from their accounts and transferred anonymously to their residence country in exchange for an assurance that their names, the foreign assets and incomes are kept secret (anonymous withholding tax, *see* section 5.1.2.1); or

(2) to allow the paying agent to disclose their personal and relevant financial details to the domestic tax authorities, which, in turn, transmit this information to their residence country, with the consent for the disclosure thereby relieving both the paying agent and the taxpayer from the anonymous withholding tax at source (voluntary disclosure, *see* section 5.1.2.2).[450]

In order to determine the identity and residence of the relevant persons, paying agents are supposed to obtain and retain records of the relevant name, birth date, and address and residence details when establishing a business relationship.[451] Paying agents generally include banks and securities dealers, as well as all natural and legal persons residing in the territories of the

[450] Swiss Banking Association, *Project - Flate Rate Tax: Flat Rate Tax on Assets Held with Banks on a Cross-border Basis* (Basel: 2009). *See also* articles 5(1), 9, 10 and 19 of the *Switzerland-U.K. Rubik Agreement* (2011) and articles 4, 7, 9 and 17 of the *Austria-Switzerland Rubik Agreement* (2012).

[451] Article 3(1), *Switzerland-U.K. Rubik Agreement* (2011).

contracting parties who accept assets from third parties on a regular basis or pay income or gains or make their payments within the framework of their economic activity.[452]

It should be noted that the European Union-Switzerland Agreement (2004) covers only interest income, while the subsequent bilateral Rubik Agreements considerably extended the scope of withholding tax, i.e. these agreements apply to capital gains and losses, dividends, interest and assets on which some Member States levy a wealth tax. Rubik Agreements also apply to both current and future relevant income, as well as to previously undeclared income.

5.1.2.1 Anonymous withholding tax

Under the first option in section 5.1.2, the paying agent located in the source country deducts at source a final withholding tax at a specified flat rate from the income of the taxpayer concerned and transfers the proceeds to domestic tax authorities.[453] The amount on which the withholding tax is levied is normally the amount before any deductions.[454]

The rate of the final withholding tax obviously differs between Rubik agreements. In the Switzerland-United Kingdom Rubik Agreement (2011), the rates of the final withholding tax are 48% in respect of interest, 40% in respect of dividends and 27% in respect of the other capital income, while, under the Switzerland-Austria Rubik Agreement (2012), there is a single rate of 25% in respect of all types of income.

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[452] Ibid. Article 2(1)(e).

[453] Article 19(1), *Switzerland-U.K. Rubik Agreement* (2011) and article 17, the *Austria-Switzerland Rubik Agreement* (2012).

[454] Article 24, *Switzerland-U.K. Rubik Agreement* (2011).

Rubik agreements also attempt to deal with the situations that relate to the past or, to be more specific, otherwise previously undeclared income. With regard to this, the standard Rubik agreements offer to make a one-off lump-sum payment to regularize matters, i.e. the regularization of past tax obligations.[455] Such a one-off payment is intended to be an approximate proxy of the accumulated taxes regarding past tax obligations. In this sense, Rubik agreements are a form of tax amnesty.

The tax in respect of past liabilities is determined according to a given mathematical formula that is explained in the annexes of the relevant Rubik agreement.[456] The formula takes into account various parameters, notably including the duration of the banking relationship and the difference between the account's initial and final capital.

The tax rate for the regularization of the past tax obligations was established at 19%-34% in the Switzerland-United Kingdom Rubik Agreement (2011), and 15%-38% in the Switzerland-Austria Rubik Agreement (2012) on the assets concerned.

In the Switzerland-United Kingdom Rubik Agreement (2011), Switzerland promised the United Kingdom an upfront payment of CHF 500 million within one month of the date of entry into force of the agreement, i.e. by 1 February 2013, as security in respect of the minimum tax revenue from anonymous retroactive taxation.[457] In this regard, in January 2013, the UK tax authorities confirmed that they had received GBP 340 million from the Swiss government as a

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[455] Article 5-9, *Switzerland-U.K. Rubik Agreement* (2011) and Article 7, *Austria-Switzerland Rubik Agreement* (2012).

[456] Article 9(2), *Switzerland-U.K. Rubik Agreement* (2011).

[457] Ibid., Article 17(2).

first instalment of the payment agreed under the Switzerland-United Kingdom Rubik Agreement (2011).[458] On the other hand, the Austria-Switzerland Rubik Agreement (2012) has no provision for such an upfront payment.

Once the tax revenue is collected, the domestic tax authorities transfer the revenue, be it a one-off or a regular payment, anonymously to the residence country of the taxpayer. However, Rubik agreements entitle the source country to retain a part of the tax collected on a pre-agreed ratio of 25:75.

The contracting parties should also without delay inform each other in writing regarding any relevant changes to their domestic laws regarding the tax rates on income and gains on relevant assets.[459]

It should be noted that once the anonymous withholding tax is paid, all of the tax liabilities in respect of the taxable period for the relevant income due to the residence country are regarded as cleared.[460] With regard to past tax liabilities, the one-off payment includes, without limitation, interest, penalties and extra charges. As a result, the resident taxpayer has no obligation to declare the relevant income on past or current income tax returns filed in the residence country. The tax clearance is confirmed by the withholding agent in the form of a tax clearance certificate, which confirms that the taxpayer is no longer liable in respect of the tax on these

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[458] David Milliken, "Government Gets Initial 340 million Pounds from Swiss Tax Deal" Reuters (29 January 2013). Available at http://uk.reuters.com/article/2013/01/29/uk-britain-swiss-tax-idUKBRE90S0LA20130129

[459] Article 20(1), *Switzerland-U.K. Rubik Agreement* (2011) and article 18(1), *Austria-Switzerland Rubik Agreement* (2012).

[460] Article 9(4) and (7) *Switzerland-U.K. Rubik Agreement* (2011).

assets for the periods in question.[461] However, the European Union-Switzerland Agreement (2004) differs in this respect from its bilateral counterparts in that it does not offer a definitive settlement with regard to the past tax liabilities. Consequently, for the taxpayer, a risk of investigation in respect of past tax liabilities remains.

5.1.2.2 Voluntary disclosure

Alternatively, a taxpayer who holds accounts in an offshore bank has the option of voluntary disclosure instead of paying the anonymous withholding tax in the source country.[462] If the taxpayer opts for the voluntary disclosure, the process is the same as for the normal tax information reporting process under automatic exchange of information regimes.[463] In this case, the taxpayer concerned must communicate the decision to the paying agent in writing. Once the decision has been made and communicated to the relevant paying agent in the acceptable form, the decision is irrevocable.[464]

Generally, the information to be disclosed is the following: (1) the identity, i.e. the name, first name and date of birth; (2) the address; (3) the tax reference number, if known; (4) the name and address of the paying agent; (5) the customer number of the account or deposit holder, i.e. the customer, account or deposit number and IBAN code; and (6) from the time of the account's or

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[461] Ibid., Article 30.

[462] Article 10, 22, *Switzerland-U.K. Rubik Agreement* (2011); Article 20, *Austria-Switzerland Rubik Agreement* (2012); and article 2(1) *E.U.-Switzerland Agreement* (2004).

[463] Article 29(4), *Switzerland-U.K. Rubik Agreement* (2011) and article 9(3) *Austria-Switzerland Rubik Agreement* (2012).

[464] Article 7(1), *Switzerland-U.K. Rubik Agreement* (2011).

deposit's existence, the annual account balance and statement of assets.[465] Once the taxpayer's consent for the disclosure has been obtained and the information is transmitted to the residence country, no anonymous withholding tax is necessary at source. Subsequently, taxpayers would, for their own part, also have to declare the foreign income and assets in their residence countries. As an example of this, the number of voluntary declarations submitted to Lichtenstein paying agents by EU residents under the European Union-Liechtenstein Agreement (2004) was 1,043 for 2009 and 1,238 for the 2010.[466]

5.1.2.3 Neither the anonymous withholding tax, nor the voluntary disclosure

Under the various Rubik agreements, non-resident taxpayers who do not accept either the anonymous withholding tax or voluntary disclosure must close their accounts or terminate their deposits at the latest on the date of implementation of the relevant agreement. Such taxpayers must transfer their assets to a third jurisdiction with no legal, technical or administrative support from the existing financial institution. The Austria-Switzerland (2012) and the Switzerland-United Kingdom (2011) Rubik Agreements state that, in such cases, Switzerland should advise the Austrian and UK tax authorities of the 10 states or jurisdictions to which such individuals who have closed their accounts or deposits transferred the largest amount(s) of relevant assets.[467] The report should also include the number of relevant persons concerned in respect of each state or jurisdiction. This requirement is regarded as an important step in identifying the key locations

[465] Article 10(1), *Switzerland-U.K. Rubik Agreement* (2011); Article 9(1), *Austria-Switzerland Rubik Agreement* (2012); and article 2(2), *E.U.-Switzerland Agreement* (2004).

[466] Ulrika Lomas, "Liechtenstein Presents EU Withholding Tax Figures" Global Tax News (6 July 2011). Available at http://www.tax-news.com/news/Liechtenstein_Presents_EU_Withholding_Tax_Figures____50233.html

[467] Article 18, *Switzerland-U.K. Rubik Agreement* (2011) and articles 15-16, *Austrai-Switzerland Rubik Agreement* (2012).

that will be subject to future initiatives by the tax authorities of the residence countries. The contracting states have committed themselves not making such data public.

5.1.2.4 Compliance with Rubik Agreements

The Rubik agreements require that the source country should regularly audit its paying agents to assess whether or not and how they are fulfilling their obligations under the agreement. This ensures that the necessary sanctions are applied by a country in the case of an infringement of a Rubik agreement by its paying agents.[468]

Rubik agreements also state that the paying agents of the contracting parties must not knowingly manage or encourage the use of artificial arrangements the sole or main purpose of which is the avoidance of taxation. Any paying agent that does not respect this clause is required to pay to the competent authority an amount equivalent to the tax due.[469] However, Rubik agreements make it clear that this rule applies only to individual cases where clear, direct evidence is presented.

5.1.3 Other accompanying measures to the Rubik agreements

5.1.3.1 Exchange of tax information upon request

In order to safeguard the exchange of tax information, Rubik agreements generally state that the competent authorities should, on request, provide information to the competent authorities of the contracting party, provided that the identity of a taxpayer and plausible grounds are provided.

[468] Article 32, *Switzerland-U.K. Rubik Agreement* (2011).

[469] Ibid., at Article 33.

The request does not have to include the name of the paying agent.[470] For this purpose, the requesting party must provide the name, address, and, if known, date of birth, professional activity and other information identifying the taxpayer. Plausible grounds for the request exist where the competent authority has identified on a case-by-case basis a tax risk in relation to a taxpayer based on an analysis of a range of information, such as previous tax returns, the level of income, third-party information and knowledge of the persons who were involved in completing a tax return.[471] Based on this request, the other contracting party must communicate the name of the paying agent concerned and the number of accounts held if the concerned person holds an account in the territory of the contracting party.

However, Rubik agreements establish certain limits to such requests. For instance, under the Switzerland-United Kingdom Rubik Agreement (2011), the maximum number of requests must be proportionate to the perceived risk of non-compliance by investors and, in the first three years, that number should be in the low to mid hundreds and should not exceed 500 per year.[472] The Switzerland-United Kingdom Rubik Agreement (2011) also states that the maximum number of requests per calendar year should be subject to an annual review and may be adjusted based on the number of previous requests. If a certain percentage of the previous information requests prove to be unsuccessful, the maximum number of the permissible requests may be reduced.[473]

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[470] Ibid., at Article 32(1).

[471] Ibid., at Article 32(3).

[472] Ibid., at Article 32(11).

[473] Ibid., at Article 32(12).

It should be noted that this form of administrative assistance is beyond the standard exchange of tax information frameworks provided under tax treaties and tax information and exchange agreements (TIEAs). Not all Rubik agreements contain such a provision. For instance, the Austria-Switzerland Rubik Agreement (2012) does not include it. In this case, exchange of tax information must be based solely on the Austria-Switzerland Income and Capital Tax Treaty (1974).[474]

5.1.3.2 Declaration not to seek for stolen bank information

In a side letter to their Rubik agreements, some countries have also declared that they would not actively seek to acquire customer data stolen from relevant foreign financial institutions; for example, data obtained from a tax whistle-blower stolen from a bank.[475] This is intended to restrain the contracting states from the active purchase of stolen tax information. However, the provision suggests that the competent authorities are not restrained from the passive acquisition of tax information; for example, use of a CD that is placed anonymously in a letterbox.

5.1.4 Issues with the Rubik model and agreements

The Rubik model attempts to strike a balance between the interest of the residence country in taxing the foreign-source income of its resident taxpayers and that of the source country in maintaining its banking secrecy and privacy laws. However, the model has been subject to some serious scholarly and political criticisms worldwide.

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[474] *Convention between the Swiss Confederation and the Republic of Austria for the Avoidance of Double Taxation with respect to Taxes on Income and on Capital* (30 Jan. 1974) (as amended through 2012).

[475] UK: Declaration of the United Kingdom concerning the acquisition of customer data stolen from Swiss banks, available at www.hmrc.gov.uk/taxtreaties/declaration-acquisition.pdf.

For instance, Perdelwitz argues that, as the one-off payment option results in the clearance of all tax liabilities in respect of previously undeclared income and assets in the residence country, a Rubik agreement basically constitutes a tax amnesty. However, it is offered only to a specific group of persons who have otherwise previously undeclared assets in specific countries. Therefore, the Rubik agreements may infringe the principles of equity and the rule of law.[476]

According to Greggi, Rubik agreements cause a conflict of law issue in European Union. He argues that when the European Union enters into an international agreement with a third country by exercising exclusive external competence, the Member States no longer have the right to conclude similar agreements in the area concerned. Since the Savings Directive (2003/48) and the European Union-Switzerland Agreement (2004) together constitute such an agreement, it is questionable as to whether or not the Member States had the competence to conclude separate agreements with Switzerland relating to the same issue.[477]

Grinberg provides further reasons why Rubik agreements are controversial. He argues that the anonymous withholding prevents the taxation of the principal, corrupts tax morale, and restricts the policy flexibility of the residence country.[478]

The Tax Justice Network (TJN) has also identified a number of technical, but critical, loopholes in Rubik agreements.[479] It argues that Rubik agreements deliberately and explicitly omit

[476] Andreas Perdelwitz, "Rubik Agreement between Switzerland and Germany – Milestone or Selling of Indulgences?" (2011) 51:12 European Taxation.

[477] Greggi. *Supra* note 196.

[478] Grinberg. *Supra* note 435.

foundations, discretionary trusts and other "ownerless" structures from their scope. These entities are traditionally used as standard tax evasion vehicles.[480] Moreover, the TJN asserts that the countries are overoptimistic in their estimation of potential tax revenue arising from Rubik agreements.[481]

The author's analysis adds to the foregoing by focusing on the Rubik model's implications from pure theoretical perspective under tax justice principles, particularly in relation to the principles of tax equity and tax transparency.

5.1.4.1 Flat tax for the wealthy and progressive tax for the rest

Tax equity is the most often cited principle in income taxation. It is a set of doctrines and principles that is intended to realize balance and fairness in tax systems. Generally, tax equity is measured by reference to the ability-to-pay doctrine. The ability-to-pay doctrine attempts to address the question of how to equitably distribute the overall tax burden among the members of society. It argues that the total tax burden must be distributed among individuals according to their capacity to bear it, taking into account of all relevant personal characteristics.

The earliest proponents of the ability-to-pay doctrine were Adam Smith (1723-1790) and John Stuart Mills (1806-1873). In his *The Wealth of Nations*, Adam Smith argues that:

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[479] The Tax Justice Network, *TJN Background Note: European money in Switzerland*, available at www.taxjustice.net/cms/upload/pdf/Italy_-_Rubik_background.pdf.

[480] Ibid.

[481] Ibid.

> subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities: that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation ... .[482]

Consequently, Adam Smith holds that the burden of taxation must be distributed equitably in relation to the ability of the taxpayers to bear it.

Later, John Stuart Mills developed this idea into the "equal sacrifice" doctrine.[483] The equal sacrifice doctrine holds that the contribution of each person towards the expenses of government must be determined in such a way that the person should feel neither more nor less inconvenience in respect of the share of the payment than every other person. It is argued that, as a dollar of tax falls more lightly on a person with high income than on a person with low income, it appears right that the high-income earner should pay at a heavier rate of taxation than the low-income earner if all are to feel equal sacrifice.

These doctrines have shaped current income tax systems. They also paved the way for the development of more specific and modern tax equity principles, commonly referred to as "vertical equity" and "horizontal equity". Horizontal equity means that taxpayers with equal

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[482] Smith. *Supra* note 58 (book V, chapter II, On the Sources of the General or Public Revenue of the Society).

[483] Mill. *Supra* note 58.

amounts of income (or property) should pay an equal amount of tax.[484] In other words, the tax system should treat similarly situated taxpayers in the same way. On the other hand, vertical equity refers to the idea that the tax burden should increase as the ability of a taxpayer to pay increases. Vertical equity is also often associated with redistribution of wealth within society.[485] However, one of the main questions of the vertical equity principle is at what point should tax rates change between taxpayers with higher, middle, or lower income.[486] In this regard, economists employ a variety of techniques to assess the extent to which tax burdens should change from one income level to another.[487]

Overall, all of these equity doctrines and principles form a basis for, and reflect themselves in, modern systems of progressive income taxation. Under a progressive tax system, the applicable tax rate increases as taxable income increases. Such a system is generally applied in individual income taxation. Generally, individual taxpayers are broken down into a few categories based on the amount of their taxable income and the more they earn, the more tax they have to pay once they have crossed the thresholds between the different tax brackets.

Proponents of the progressive taxation also argue that the ability-to-pay, or vertical equity, cannot be accurately applied without fully identifying a taxpayer and taking into consideration

[484] Musgrave. *Supra* note 52.

[485] Richard Musgrave, "Progressive Taxation, Equity, and Tax Design" (1996) Tax Progressivity and Income Inequality.

[486] *Guiding Principles for Tax Equity and Fairness* (New York American Institute of Certified Public Accountants, 2007).

[487] Daniel Suits, "Measurement of Tax Progressivity" (1977) 67:4 The American Economic Review.; John E Anderson, Atrayee Ghosh Roy & Paul A Shoemaker, "Confidence Intervals for the Suits Index" (2003) 56:1 National Tax Journal.

income from all sources, i.e. from domestic and foreign. In this respect, Tillinghas (1984) notes that:

> in the international context, the 'ability-to-pay' is meaningless until one has identified the persons or the enterprises whose wealth is to be taken into account ...[488]

International automatic exchange of tax information system serves this purpose. Under this system, when the tax authorities of residence country receives information on the foreign-source income of the resident taxpayer from the tax authorities of source country, they aggregate the amount with the taxpayer's domestic-source income, if any, and determine applicable marginal and effective tax rates based on the aggregated worldwide income of the taxpayer.

However, under the Rubik model or Rubik agreements, this is virtually impossible. Once the anonymous withholding tax is applied at source country at a pre-agreed flat rate, the taxpayer has no further obligation to declare the relevant income to the residence country. Nor does the residence country have a viable system to discover and verify the taxpayer's relevant foreign-source income. In fact, Rubik agreements restrict the residence country's attempts to obtain the relevant information from other possible sources.

After all, the residence country assesses an applicable marginal tax rate or, theoretically speaking, determines the taxpayer's ability-to-pay, without taking into consideration his or her relevant foreign-source income. As a result, the residence country's tax assessment would be defective from the ability-to-pay perspective. An overall effect is that only taxpayers with domestic-source income pay taxes based on their ability-to-pay, while the overall tax liability of

[488] David Tillinghast, *Tax aspects of international transactions* (New York, N.Y. : M. Bender, 1984).

taxpayers with foreign-source income is determined without much reference to their true ability-to-pay. The latter, basically, enjoy the privilege of a flat-rate tax on their foreign-source income.

For instance, in Austria, the marginal income tax rates for individuals in 2013 ranged from 0% to 50%,[489]while the withholding tax under the Austria-Switzerland Rubik Agreement (2012) is 25% flat-rate tax for all types of relevant income. A basic computation reveals that an Austrian resident taxpayer who has EUR 150,000 of dividends from domestic-sources normally bears a tax burden of EUR 65,235, while another Austrian resident taxpayer who has similar income, but received via a Swiss bank account, would only bear tax of EUR 37,500 under the anonymous withholding tax arrangement according to the Austria-Switzerland Rubik Agreement (2012), resulting in a tax "saving" of EUR 27,735.

Consequently, resident taxpayers, whose foreign-source income has been subject to withholding tax under the Austria-Switzerland Rubik Agreement (2012), may have a lower tax burden than those who have similar income realized in a purely domestic context. It can be argued that the countries may attempt to address this problem by negotiating a correspondingly higher anonymous withholding tax rate. However, it is impossible for both the residence and the source countries to agree on an appropriate flat-rate tax without knowing a particular taxpayer's constantly changing income range. In any case, the anonymous withholding tax results in either under-taxation or over-taxation of the relevant foreign-source income.

5.1.4.2 Secrecy for the wealthy and disclosure for the rest

[489] Income up to EUR 11,000 at 0%; EUR 11,001-Eur 25,000 at 36.5%; EUR 25,001-EUR 60,000 at 43.2143%; and over EUR 60,000 at 50%. *See* Y. Schuchter & A. Kras, *Austria - Individual Taxatio*n sec. 1.9.1., Country Surveys IBFD.

Transparency is an essential attribute of a good tax system. It is regarded as a way a taxpayer and a government communicate their attitudes to tax system and a measure of the amount of tax to be paid by each member of society. Transparency in taxation also gives other taxpayers confidence that a fair share of tax is being paid by each member of the society. In this regard, Adam Smith notes that:

> the tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person…the certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.[490]

The Rubik model is questionable from this perspective. It affords secrecy for a resident taxpayer who earns foreign-source income through foreign financial institutions. In contrast, the identity and assets of a resident taxpayer who earns similar income from domestic sources is generally subject to full disclosure for tax purposes.

In his *Nicomachean Ethics*, written more than two thousand years ago, Aristotle notes that, in a just system "equals are to be treated equally and un-equals unequally".[491] In a complex economic and social environment, it may not be possible to design and administer an Aristotelian tax system that is fair in an absolute sense. However, the Rubik model purposefully attempts to

[490] Smith. *Supra* note 58 (book V, chapter II, On the Sources of the General or Public Revenue of the Society).

[491] W. Von Leyden, *Aristotle on Equality and Justice: His Political Argument* (UK, London: Macmillan, 1985).

establish an unfair system. As Aristotle further notes, the differential treatment of un-equals is allowed, but such a treatment should be based on some legitimate reason(s). It may well be wondered if there is any legitimate justification for affording a taxpayer with foreign-income secrecy protection. In fact, for the following four reasons, general logic dictates the contrary.

First, paying taxes is a public duty and this duty is often required constitutionally. This well may entail that a government unquestionably ensures, on behalf of all citizens, that every beneficiary of society fulfils his or her tax obligation properly. Consequently, a state has a legitimate interest in requiring all of its citizens to disclose the relevant tax information. In its current form, the Rubik model recognizes the residence country's tax jurisdiction over the foreign-source income of its resident taxpayers, but it does not recognize the residence country's jurisdiction over the tax assessment and collection processes. In fact, under the Rubik model the residence country must approach the foreign jurisdictions to reach its own taxpayers. This undermines the direct interaction between a government and its residents.

Second, allowing residents secrecy in respect of foreign bank accounts may well encourage some residents who derive their income primarily from illegal practices, for example, drug and people trafficking, smuggling, embezzlement and corruption, to continue and promote their illegal practices. Rubik agreements may facilitate the preservation of this illegitimate power and wealth by providing a foreign financial refuge.

Third, the disclosure of the identity and the income level of a resident taxpayer are critical not only for tax collection, but also for the distribution of benefits, which is the obverse of taxation, i.e. the redistribution of tax collected in society. For instance, a government may have a variety of social programmes, for example, childcare assistance, pensions, unemployment insurance benefit, financial assistance for education and healthcare, which require some form of moral accountability on the part of the recipients in the form of personal financial disclosure. In fact, a person's entitlement to such social programmes and the amount of benefit entitlement may well require a recipient to disclose current income to the appropriate government agencies.[492] Based on this information, the government agency then determines the appropriate type and level of social assistance to which the person is entitled. However, government redistribution decisions will be rendered defective if a taxpayer does not fully disclose current income. The Rubik model appears to have overlooked this potential problem to which it gives rise. It allows the taxpayer with foreign income to apply and benefit from social programmes without fully disclosing income.

Last but not least, tax laws are generally one of the largest and most complex sets of laws in a country. Though potentially not that significantly different, every country has its own set of tax rules. As a result, the amount of tax payable as determined under one jurisdiction's tax laws may not necessarily match that tax payable as determined under another jurisdiction's tax law for the same income and under the same tax rate. Under the Rubik model, even though the anonymously withheld tax revenue belongs, mostly, to the residence country, the determination of income and the application of tax is regulated by the source country's tax laws. This may well give rise to another breach of equity between domestic and foreign-source-income-earning taxpayers due to jurisdictional differences in income determination and tax computation. In contrast, under

[492] For instance, Canada has a wide range of government social programmes and transfer payments to individuals, which totalled CAD 176.6 billion in 2009. *See* Statistics Canada, *Government transfer payments to persons*, available at www.statcan.gc.ca.

automatic exchange of tax information, the relevant tax information is communicated to the residence country, thereby allowing it to exercise its tax jurisdiction and to apply its own tax laws with regard to the foreign-source income of its resident taxpayers.

5.1.4.3 Legitimation of the illegitimate practice

Jurisdictions, such as Lichtenstein and Switzerland have long been criticized for their excessive bank secrecy policies.[493] There is also a well-founded view taken by the international community that any national bank secrecy law or financial privacy claim should be disregarded when yield when international tax information exchange is involved.[494]

In its Report on "Improving Access to Bank Information for Tax Purposes" in 2000, the OECD stated that all OECD member countries should permit access to bank information, directly or indirectly, for all tax purposes so that tax authorities can fully discharge their revenue raising responsibilities and engage in effective exchange of information with their treaty partners".[495] In its subsequent progress report in 2003, the OECD announced that some positive developments

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[493] Olivier Dunant & Michele Wassmer, "Swiss Bank Secrecy: Its Limits Under Swiss and International Laws" (1988) 20 Case W. Res. J. Int'l L; Sebastien Guex, "The Origins of the Swiss Banking Secrecy Law and Its Repercussions for Swiss Federal Policy" (2000) 74:02 Business History Review;Mencken. *Supra* note 185, at 495; Pierre M. Picard & Patrice Pieretti, "Bank Secrecy, Illicit Money and Offshore Financial Centers" (2011) 95:7–8 Journal of Public Economics; Todd Jones. *Supra* note 195.

[494] Johannesen & Zucman. *Supra* note 417, at 65-66; Tony Ferrers, "An Australian Court on Confidentiality: Getting the Bank to Tell" (2000) 28:2 Intertax. Jason Campbell Sharman, "Privacy as Roguery: Personal Financial Information in an Age of Transparency" (2009) 87:4 Public Administration, at 728 (Sharman notes that the right to financial privacy has been substantially eroded due to fiscal objectives and this is justified on the grounds of a "nothing to hide, nothing to fear' logics); Blum. *Supra* note 182, at 648 (Blum argues that concerns about financial privacy should be balanced with fiscal objectives. The concern should be to have strong safeguards to ensure that the received information is not misused by governments).

[495] OECD, *Report on Improving Access to Bank Information for Tax Purposes* (Paris: OECD, 2000), at 45. Available at http://www.oecd.org/tax/exchange-of-tax-information/2497487.pdf

have occurred in OECD member and non-member countries since the first report had been published, i.e. anonymous accounts could no longer be opened in any OECD country, customer identification requirements had been established in all OECD countries, and there was no longer any OECD country that requires a domestic tax interest to obtain information for a treaty partner. However, the 2003 report argued that there was still little progress in the area of access to bank information for regular tax enforcement purposes.[496]

In 2004, the OECD moved from studies to address the issue. Specially, a new paragraph 5 to Article 26 of the OECD Model Tax Convention (2005) was added, which deals with the issue of domestic banking secrecy laws in tax information exchange relations. The new provision expressly states that, in no case, is a treaty partner permitted to decline the tax information request of its treaty partner solely because the requested information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or it relates to ownership interests in a person.[497] In 2008, the United Nations followed the suit, and adopted similar revisions to its Model Tax Convention (2011).[498] The message was clear that no restriction to international exchange of tax information could be caused by application of a domestic bank secrecy laws.

However, the Rubik model represents an apparent deviation from these general tendencies. In fact, it gives an impression that some governments are disregarding the long-fought for efforts to

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[496] OECD, *Improving Access to Bank Information for Tax Purposes: The 2003 Progress Report* (Paris OECD, 2003), at 6. Available at http://www.oecd.org/ctp/exchange-of-tax-information/14943184.pdf

[497] Article 26(5) of the OECD Model Tax Convention on Income and on Capital (Paris: OECD, 2005).

[498] The Committee of Experts on International Cooperation in & Tax Matters, *Report on the Fourth Session* (New York: United Nations 2008), at Paragraphs 51-60. Available at http://www.un.org/esa/ffd/tax/fourthsession/

end illegitimate bank secrecy practices in favour of immediate cash in the face of budgetary pressures. This also means that some countries are losing in the global campaign regarding financial transparency for tax purposes.

5.1.4.4 Lack of genuine reciprocity

The concept of reciprocity is vital in international relations. It is a condition theoretically attached to every legal norm of international law.[499] It implies actions that are contingent on rewarding actions. In international relations, it generally means that favours and benefits that are granted by one state to another state, to its citizens or legal entities, should be returned by corresponding favours and benefits to that state, to its citizens, or legal entities.

Even though the Rubik agreements appear reciprocal agreements in that they are designed to serve the interests of both parties, they lack certain attributes of genuine reciprocity. Specifically, under Rubik agreements, anonymous tax withholding or tax information reporting (i.e. as a result of voluntary disclosures) are performed only by one party, i.e. Switzerland, for the benefit of the other countries. Rubik agreements do not include the identical obligations on the part of the other parties to the agreements for the benefit of Switzerland. The reciprocal obligation of the other parties from Rubik agreements generally consists of their commitment to withdraw from their initial demands that Switzerland must exchange tax information with them automatically.

Generally, the lack of identical obligations is acceptable to the meaning of reciprocity, as states in reciprocal relationships with one another sometimes do not have the same interests.[500]

[499] Elisabeth Zoller, *Peacetime Unilateral Remedies: an Analysis of Countermeasures* (Dobbs Ferry, N.Y.: Transnational Publishers, 1984), at 15.

[500] Ibid., at 20.

However, reciprocity under Rubik agreements entails "certain action of one party in order to avoid certain action from another". There is something odd in this reciprocal relationship. Given the fact that the initial demand, i.e. automatic exchange of tax information, is a single dominant strategy that the international community has chosen and assuming that this results in an efficient outcome for all states in the long run, the offer of the implementation of anonymous tax withholding by Switzerland may sound like a bribe to silence this legitimate demand. After all, it is hard to consider the Rubik agreements as genuinely reciprocal.

On the other hand, automatic exchange of tax information is based on a genuine reciprocal relationship. It suggests each contracting party exchanges tax information relevant to the tax residents of the other. The reciprocal benefits may not be balanced in the short term, as countries do not have equal tax administration capacities and equal flow of capital. However, the system eliminates opportunism and promises a satisfactory overall outcome acceptable to all countries in the long run.

5.1.5 Concluding remarks

On the basis of the preceding analysis, some conclusions are possible. The Rubik model is an ingenious and unique phenomenon. It has brought international tax cooperation to a new level in that (some) countries began to collect taxes on behalf of another country on regular basis. This phenomenon is unprecedented. However, the problem with the Rubik model lies in the fact that it has been used as a bargaining counter to avoid international automatic exchange of tax information.

This is questionable when it is observed from the perspective fundamental income tax principles, such as tax equity and justice. The Rubik model provides protection via secrecy for taxpayers with foreign assets and foreign-source income, whereas the assets and the identity of taxpayers with domestic-source income are generally subject to full disclosure for tax purposes. It also provides flat rate tax for the foreign-source income earning resident taxpayers, while resident taxpayers who earn similar income from domestic-sources are taxed at progressive rates. These constitute a clear infringement of the fundamental income tax principles.

By its nature, the Rubik model attempts to institutionalize a privilege for wealthy and affluent over the rest of society in tax matters. Given these considerations, it is questionable whether or not the Rubik model is sustainable in the long run and can serve as a true substitute for automatic exchange of tax information regimes.

5.2 Tax amnesty as a bridge of transition to automatic exchange of information regime

Transition to automatic exchange of information system presents significant challenges. One of the early considerations of the system is to establish how the transition from the world without automatic exchange to the world with it occurs. The automatic exchange of information system is not intended to be retroactive in that it does not, by default, require participating states to automatically exchange the relevant information for past years. However, the system essentially reveals the foreign assets and incomes of residents that might have never been declared and known to their countries of residence before. This may give raise to the questions of when and how these fund were transferred offshore in the first place and how to deal with the accrued tax liabilities on these assets for the past years. For instance, the Tax Justice Network estimates that, as of 2012, at lest USD 21 to USD 32 trillion of global wealth was secretly held offshore.[501] Thus, the question of regularization of the past tax liabilities will become an important consideration.

This transition may technically turn some residents into tax criminals overnight, thereby resulting in a significant number of prosecutions and increased anxiety for taxpayers. The reality is that taxpayers with undeclared foreign assets and income are less likely to accept the new regime if it entails them being confronted with harsh criminal sanctions. Such taxpayers may lobby and pressure foreign governments not to submit to the new international tax regime. After all, why would anyone cooperate with the new regime only to risk criminal prosecution and imprisonment?

The idea is that this one-off transition to the new international tax enforcement regime should be

[501] James Henry, *The Price of Offshore Revisited: New Estimates for 'Missing" Global Private Wealth, Income, Inequality, and Lost Taxes* (Unpublished: Tax Justice Network 2012).

timely, smooth, and fair offering reasonable settlement for past-due tax liabilities. In other words, there is a need for some transitional rules that encourage previously non-compliant taxpayers to join the ranks of compliant fellow taxpayers without unnecessary delays and harsh victimization.

One of the potential venues for such a smooth transition may rest in the use of tax amnesties. They could potentially serve as a "transitional bridge" to the new international tax regime. In this section, I explore the aspects of the new automatic tax information exchange system and analyses tax amnesties as a transitional measure towards the new international tax regime.

5.2.1 Introduction to tax amnesty

5.2.1.1 Concept, scope, and purpose of tax amnesty

In general, a tax amnesty is a government programme that permits taxpayers to declare their past unpaid taxes and to pay a defined amount in exchange for forgiveness from prosecution and penalties. Tax amnesties have a long history. The first documented tax amnesty was found on the Rosetta Stone (200 BCE) in Egypt.[502] It provided the temple priests of the day with a waiver from prison for their past tax evasion and restored the tax privileges they had traditionally enjoyed in more ancient times.

Currently, a tax amnesty is a time-limited offer by a government to a specific group of unnamed taxpayers to voluntarily disclose previously undeclared and unpaid tax liabilities in exchange for a defined forgiveness from the statutory consequences of the tax offence.[503] Thus, a tax amnesty

[502] Katherine Baer & Eric Le Borgne, *Tax Amnesties: Theory, Trends, and Some Alternatives* International Monetary Fund Washington, 2008).

[503] Ibid.

essentially constitutes a special agreement between a government and its taxpayers, whereby the latter agree to disclose their failure to declare and to pay past tax liabilities, while the former agrees not to prosecute the taxpayers in respect of the offence, provided that certain conditions are met. This permits the delinquent taxpayers to regularize their past tax liabilities without incurring criminal and civil consequences, while at the same time allowing the government to recapture past tax that might otherwise be uncollectible due to the limited availability of enforcement resources. Such programmes are also referred to as "voluntary disclosure programmes".

A tax amnesty is generally initiated when a government perceives that the tax revenue it has collected or is about to collect does not match its expectations. The government assumes that certain categories of taxpayers have under-reported their taxable income or not reported it at all. Consequently, a tax amnesty is initiated to recapture the "missing tax revenue".

A tax amnesty may be general or specific. As the name denotes, a general tax amnesty is offered to the general public and targets past tax liabilities of all kinds. This permits any taxpayer to participate in the tax amnesty, provided that the tax administration was unaware of the unpaid tax liabilities at the time of the application of the tax amnesty. A specific tax amnesty only relates to certain categories of taxpayers and/or certain sources of income, for example, foreign-source and corporate income.

The most important feature of a tax amnesty is that it is offered to the public or to a category of persons, rather than to an individual. This distinguishes a tax amnesty from a pardon, which waives the legal consequences of the offence on a case-by-case and individual bases.

Recently, tax amnesties have been adopted in many countries, both developed and developing. For instance, among OECD member countries, tax amnesties have been used in Austria, Belgium, Canada, France, Germany, Greece, Hungary, Italy, the Netherlands, Portugal, Spain, Switzerland, the United Kingdom and the United States. Among developing countries, tax amnesties have been employed in recent decades, often repeatedly, in Argentina, Colombia, Mexico and South Africa.[504]

Tax amnesties may yield both short-term and long-term revenue benefits. In the short term, tax amnesties may give rise to immediate and additional sources of revenue without states having to amend their tax laws or the applicable tax rates. In the long term, tax amnesties are expected to encourage previously delinquent taxpayers to declare assets and income, to improve taxpayer compliance and, therefore, to increase future revenue collection. In some cases, they have also been used to induce the repatriation of capital.[505]

5.2.1.2 Types of tax amnesty

Generally, tax amnesties fall into the following two categories: (1) financial; and (2) legal.[506] A financial tax amnesty involves waiving a portion of a taxpayer's declared and undeclared past tax liabilities as part of the amnesty. This is typically realized through a reduction in tax, cancellation of interest, and forgiveness from the civil penalties due from a taxpayer on past tax liabilities. In certain cases, the tax administration also offers waivers in regard to those back years for which unpaid tax is demanded.

[504] Ibid.

[505] Ibid., at 2.

[506] Ibid., at 5.

On the other hand, a legal tax amnesty involves an outright waiver of administrative and criminal sanctions for past tax non-compliance.[507] However, it does not involve a reduction in, or the waiver of, relevant tax debts and related civil penalties.

Another type of tax amnesty that states often use is an audit amnesty. In general, this is a government guarantee not to audit taxpayers who voluntarily disclose their previously undeclared tax liabilities for a particular period.

As discussed previously in this section, financial, legal and audit amnesties have distinct features. However, a tax amnesty can be so structured that it combines more than one or, indeed, all of these features.

5.2.1.3 Conditions of eligibility

Tax amnesty programs have a set of eligibility conditions. Generally, the participation in a tax amnesty must be voluntary; disclosure must be complete; and an application to participate in tax amnesty must be for the first time. Only those who meet these conditions may benefit from the tax amnesty.

Voluntary nature of the disclosure. One of the most common eligibility requirements for a tax amnesty is the voluntary nature of the disclosure. Generally, a disclosure does not qualify as voluntary if a taxpayer was aware of or had knowledge of an audit, investigation or other enforcement action to be conducted by the tax administration or any other authority or administration with regard to the information being disclosed. As a result, there can be a civil

[507] Ibid., at 8.

examination, for example, a tax audit, or a criminal investigation initiated or pending against the taxpayer regarding the discovery of the tax offence, but the taxpayer cannot know or should not reasonably have known of the discovery. One important rationale for this condition is that, if the tax administration has started an investigation with regard to the information being disclosed or has knowledge regarding it, any revenue to be collected by the government from the taxpayer during the tax amnesty would most likely have been received by the government in any event.

Completeness of the disclosure. Tax amnesties also require that, in order to benefit from them, a taxpayer must fully cooperate with the tax administration by making reasonable best efforts to disclose all relevant tax debts in full, to provide all necessary information to determine the amount due, and to settle that amount. In other words, the taxpayer must provide full and accurate facts and documentation in respect of the relevant periods where there was previously inaccurate, incomplete or unreported tax information. The tax administration may ask the taxpayer to provide additional information for verification purposes, and the taxpayer must comply with such requests. This means that, if a taxpayer participates in a tax amnesty but does not provide all of the information regarding all relevant tax liabilities prior to the amnesty, any post-amnesty disclosure regarding such tax liabilities entails general statutory implications.

These mean that when a taxpayer participates in an amnesty program but does not bring up all information about all relevant tax liabilities occurred prior to the amnesty, any post-amnesty disclosure about these tax liabilities will entail general statutory implications.

Limited participation. Some tax amnesties establish that taxpayers can benefit from the amnesty only once during a lifetime.[508] Consequently, a second participation or an additional post-amnesty disclosure made by the taxpayer regarding the post-amnesty tax evasion cannot be accepted and is subject to the general rules. This requires the taxpayer to disclose all previous tax offences and remain compliant thereafter.

Provided that all of these eligibility criteria met, tax amnesties generally protect the taxpayer against any charges or prosecution in respect of any tax-related offences that are relevant to the disclosure. However, tax amnesties do not provide immunity from prosecution against non-tax related offences, such as money laundering.

5.2.2 Controversies over tax amnesty programs

Not surprisingly, considerable controversy has arisen over whether and how tax policy should make use of tax amnesty programs. Legal scholarship has often challenged programs under tax equity, justice, and moral hazard grounds. Generally, they argue that the perceived benefit of tax amnesties is often overstated, while their negative implications are understated. Below, we explore some of these arguments.

5.2.2.1 Tax amnesty and tax compliance

Tax amnesty programs have often been criticized with regard to their negative effect on overall tax compliance.[509] It has been argued that the effect of tax amnesties on overall tax compliance is

[508] Jacques Malherbe, *Tax Amnesties* (Alphen aan den Rijn; Frederick, MD: Kluwer Law International, 2011). See the author's discussion on Swiss and Canadian tax amnesty programs.

[509] James Alm, Michael McKEE & William Beck, "Amazing Grace: Tax Amnesties and Compliance " (1990) 43:1 National Tax Journal; Arun S Malik & Robert M Schwab, "The Economics of Tax Amnesties" (1991) 46:1 Journal of

negative, i.e. the average level of tax compliance falls in the post-amnesty period. As a result, in the long run, the most significant cost of a tax amnesty may be the decline of tax compliance.

5.2.2.2 Tax amnesty and taxpayer equity

Another argument that challenges tax amnesties is tax equity. Tax equity proponents hold that tax amnesties distort the competitive balance between honest and dishonest taxpayers.[510] The main argument is that, if the honest taxpayers have complied with tax laws all the way long and have paid all due taxes, the option offered to a group of non-compliant taxpayers to become compliant taxpayers "on the way" without any legal consequences or accountability for their past tax non-compliance can be understood as a violation of equity.[511] This may give compliant taxpayers the impression that they paid too much tax to the government in the past compared to tax evaders who ultimately received "free passes" to obviate their past tax delinquencies. This may ultimately reduce the future tax compliance of such taxpayers in response to this perceived unfairness. This may explain the decline in tax compliance discussed in the preceding paragraph.

5.2.2.3 Tax amnesty and moral hazard

Tax amnesties have also been criticized on the grounds of moral hazard.[512] It has been argued

Public Economics; Michael Graetz & Louis Wilde, "The Decision by Strategic Nonfilers to Participate in Income Tax Amnesties" (1993) 13:3 International Review of Law and Economics.

[510] John Hasseldine, "Tax Amnesties: An International Review" (1998):52 Bulletin for International Taxation; Benno Torgler & Christoph Schaltegger, "Tax Amnesties and Political Participation" (2005) 33:3 Public Finance Review.

[511] Torgler & Christoph Schaltegger. Ibid. at 404.

[512] Ross Justin & Buckwalter Neal, "Strategic Tax Planning for State Tax Amnesties: Evidence from Eligibility Period Restrictions" (2013) 41:3 Public Financ. Rev. Public Finance Review. (Buckwalter and Ross argue that tax amnesties give rise to moral hazard. Specifically, they argue that the repeated nature of tax amnesties may cause some compliant taxpayers to become strategically delinquent, effectively treating the state as a source of short-term

that the introduction of a tax amnesty may send a signal to taxpayers that a government has not been able to enforce its tax laws using the regular enforcement mechanisms, thus, has resorted to such programmes. This may ultimately erode the credibility of the tax administration and tax system as a whole.[513]

In addition, the full or partial waiving of the penalties usually associated with tax amnesties may encourage some taxpayers to use amnesties as an unconventional tax strategy.[514] Knowing that the state will initiate a tax amnesty again at some future date, taxpayers could decide to hold onto their money to invest it or spend it and then take advantage of a tax amnesty when the state offers this at a later stage.[515]

5.2.3 Justifications for transitional tax amnesty programs

Given the criticisms over tax amnesty set out in the preceding section, any proposal to introduce tax amnesties requires sufficient and overriding justifications. In this section, we consider some of these possible justifications.

5.2.3.1 Transitional tax amnesty and tax compliance

As discussed in the preceding section, economic studies indicate that tax amnesties have a

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loans); See also Arindam Das-Gupta & Dilip Mookherjee, "Tax Amnesties as Asset-Laundering Devices" (1996) 12:2 Journal of Law Economics and Organization.

[513] Benno Torgler, *Tax Compliance and Tax Morale: a Theoretical and Empirical Analysis* (Bodmin, Cornwall: Edward Elgar Publishing, 2007).

[514] Ross Justin & Buckwalter Neal, "Strategic Tax Planning for State Tax Amnesties: Evidence from Eligibility Period Restrictions" (2013) 41:3 Public Financ. Rev. Public Finance Review, at 295-296.

[515] Das-Gupta & Mookherjee. *Supra* note 525, at 410.

negative effect on tax compliance in the post-amnesty period. However, these studies have also found that when a tax amnesty is accompanied by other fiscal measures, such as an enhancement in tax administration or enforcement, the amnesty might actually generate revenue and increase compliance in the post-amnesty period.[516]

This appears to be a more complete and coherent conclusion. It should be noted that tax evasion is a product of rational decision-making.[517] It is illegal for a person, organization or corporation deliberately to evade paying taxes by exploiting imperfections in a tax administration or tax enforcement system. Consequently, if it were rational for the person to evade taxes under these circumstances, it would still be rational to continue the delinquency even when the government introduces a tax amnesty, as long as there can be no expected improvement in the tax administration and enforcement system. As a result, it is difficult to imagine a tax amnesty generating substantial revenue or having a positive effect on overall tax compliance, unless taxpayers realize that there is an anticipated improvement in the enforcement and there is an expected possibility that non-compliance would be detected. In fact, it is often not the level of sanctions, but rather the likelihood of detection, that influences the compliance behaviour of taxpayers.

[516] Ines Macho-Stadler, Pau Olivella & David Perez-Castrillo, "Tax Amnesties In A Dynamic Model of Tax Evasion" (1999) 1:4 Journal of Public Economic Theory. at 459; James Alm, Michael McKee & William Beck, "Amazing Grace: Tax Amnesties and Compliance" (1990) National Tax Journal, at 34.

[517] Allingham & Sandmo. Supra note 79. (Allingham and Sandmo argue that taxpayers normally decide to evade taxes when the benefit of evasion, for example, the savings from evasion, exceeds the related cost, i.e. the risk of detection and punishment).

The introduction of international automatic exchange of tax information system would constitute such an improvement in tax administration and enforcement. A new automatic exchange regime implies that tax enforcement conditions will soon change and what had worked for offshore tax evaders in the past will most likely not work in the future.

Under a new system, the residence state of the taxpayer would regularly receive information on the foreign assets and income of its resident taxpayer from foreign tax administrations. This could cause international tax evaders to rethink their fiscal behaviour. Such persons would know that one crucial element contributing to their decision so far, i.e. the probability of detection, would be substantially improved. As transitional tax amnesties would be instituted in the shadow of such improvements, it is very likely that a rational taxpayer with undeclared foreign assets and income would respond to the amnesties quickly and positively.

5.2.3.2 Transitional tax amnesty and tax equity

The equity opponents of tax amnesties generally argue that the public has an interest in deterring tax evasion, and the costs of attaining this benefit should be accepted (see section 5.2.2.2). Consequently, those who evade paying taxes should be held accountable for their delinquencies. In other words, government should not allow these persons to escape from the general legal consequences of their past tax delinquencies by offering them tax amnesties.

However, it should be noted that tax amnesties are not about letting tax evaders get away with their tax offences and tax obligations. In general, tax evaders pay a price for their non-compliance, even under tax amnesties. In fact, tax amnesties rarely forgive the basic tax liability owed on the relevant income for the relevant period.[518] Depending on the design of a tax amnesty, tax evaders who participate in the amnesty are normally required to pay the amount of tax due in full on the previously undisclosed income, often with interest and penalties. As a result, the primary benefit of participating in a tax amnesty for taxpayers would be the waiver of the general administrative and criminal law implications of the delinquency.

The waiver of administrative and criminal prosecution in the context of a tax amnesty can be justified on the following four grounds: (1) if the delinquent taxpayers pay past taxes to the extent that they retain no accrued tax benefit from the past tax evasion; (2) if the delinquent taxpayers are willing to pay interest and penalties on top of the accrued taxes; (3) if the delinquent taxpayers show remorse and commitment to remain compliant in the future; and (4) if the new tax enforcement system reduces or eliminates opportunities for such offences in the future, it is hard to see the point of inflicting further penalties or criminal sanctions on taxpayers who have remedied their past mistakes and who have also committed to transform themselves into compliant taxpayers in the future. These are actually the main purposes of the administrative and criminal justice systems.

In fact, there should be a balance between the best interest of the public in terms of retribution and their ultimate interest in terms of ending long-endured tax non-compliance by their fellow residents and recovering missing tax revenue. The longer non-compliance continues, the more resources must be expended to deal with it and the greater the cost that compliant taxpayers have to bear. Instead, it is in the best interest of all taxpayers to have tax evaders voluntarily pay back

[518] OECD, *Offshore Voluntary Disclosure: Comparative Analysis, Guidance and Policy Advice* (Paris OECD, 2010). This is the OECD study of voluntary disclosure programmes in 36 countries.

taxes and to become compliant. This brings about a more perfect form of tax equity.

5.2.3.3 Transitional tax amnesty and moral hazard

Scholars also condemn tax amnesties on the ground of moral hazard (see section 5.2.2.3), arguing that the introduction of tax amnesties may give taxpayers the impression that the government has been unable to enforce tax laws using regular enforcement mechanisms. Consequently, the government has had to resort to provisional measures. As the enforcement problems that gave rise to the tax amnesty in the first place are still there, the government will be forced to offer similar amnesties in the future. This may erode the credibility of tax administration and ultimately tax system.

It is true that governments often resort to tax amnesties when regular enforcement measures fail to persuade a certain group of taxpayers to meet their tax obligations. However, transitional tax amnesties are peculiar in this regard. They have a broader purpose and a slightly different rationale. As the name suggests, transitional tax amnesties are offered not necessarily because regular enforcement measures do not work, but rather to facilitate the transition to the new system and to give non-compliant taxpayers a final opportunity to clear their delinquent past in a reasonable manner. Such taxpayers would understand that the automatic exchange system would provide governments with greater enforcement capacities and, whether or not they participate in the tax amnesty, their non-compliance would be brought to scrutiny. In this context, it is very unlikely that transitional tax amnesties would give rise to substantial moral hazard problem.

In fact, transitional tax amnesties would enable governments to better control tax evasion in the future. Tax amnesties and cooperation of participants could produce much information on past tax evasion, its structures and the jurisdictions used by residents for offshore evasion. Governments could analyse and use such data to enhance future tax enforcement.

5.2.3.4 Statistical justifications

The primary objective of tax amnesties is to raise revenue, which would otherwise not have been collected under regular enforcement mechanisms. Although it is difficult to speculate how events might have transpired in the past, it is plausible to say that a number of previous cases of international tax evasion would have continued, and much-needed revenue would not have been recovered if the governments had not initiated tax amnesties.

One apparent example is Italy's tax amnesties (*scudo fiscale*). In November 2001, Italy introduced a six-month tax amnesty, targeting undeclared offshore assets held by Italian residents. The tax amnesty generated EUR 1.4 billion in additional tax revenue, or approximately 0.4% of the total tax revenue. In addition, during the tax amnesty, some EUR 56 billion of offshore money returned to Italy.[519]

Another example may be the various offshore voluntary disclosure programmes offered by the US government between 2009 and 2011. The United States has used tax amnesties for many years, and it recently used the prospect of an amnesty once again to convince residents with undeclared foreign accounts to come forward and declare them. In 2009, the US Internal Revenue Service (IRS) initiated a series of tax amnesties referred to as offshore voluntary disclosure programmes, as it was negotiating an enhanced exchange of tax information

[519] Torgler & Schaltegger. *Supra* note 523, at 404.

agreement with the Swiss government.[520] These programmes allowed US taxpayers with foreign bank accounts or entities to file and amend their tax returns going back to 2003 without facing criminal prosecution. In lieu of various penalties attributable to the failure to timely filing, the amnesty programmes offered penalties based on the value of the taxpayer's undisclosed assets. The programmes required taxpayers to pay penalties equal to 20% (under the 2009 Offshore Voluntary Disclosure Program) and 25% (under the 2011 Offshore Voluntary Disclosure Program) of the highest aggregate balance in foreign bank accounts or entities or value of foreign assets during the period prior to disclosure. Some taxpayers were eligible for 5% or 12.5% penalties in certain limited circumstances.[521]

Soon after the closure of the 2009 Offshore Voluntary Disclosure Program, the IRS announced that approximately 15,000 voluntary disclosures were filed with regard to accounts at banks in more than 60 countries, resulting in an average of USD 200,000 in back tax, interest and penalties per case.[522]

One of the longest-running tax amnesties is Project Wickenby, which was initiated by the Australian government in 2006. This is the first time the full range of the Australian government's resources had been used to address the significant threat that illegal offshore schemes posed to the integrity of Australia's financial and regulatory systems. The project involves initiating enhanced cooperation between several government powers to counter such

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[520] *See* www.irs.gov/uac/2009-Offshore-Voluntary-Disclosure-Program and www.irs.gov/uac/2011-Offshore-Voluntary-Disclosure-Initiative.

[521] Ibid.

[522] Treasury Inspector General for Tax Administration, *The 2009 Offshore Voluntary Disclosure Initiative Increased Taxpayer Compliance, but Some Improvements Are Needed* (Washington DC: US Treasury Department 2011), at 5-7.

schemes. The project also involves encouraging taxpayers to review the information in the tax returns and activity statements that they provided to the Australian Taxation Office (ATO). If a taxpayer made a voluntary disclosure of mistakes in relation to past declarations that results in a greater tax liability, he is eligible for a significant reduction in penalties. The voluntary disclosure programme is offered in the shadow of enhanced tax enforcement measures, such as intelligence sharing, tax audits, criminal investigations, prosecutions and education programmes.[523] According to the ATO, as of 31 August 2014, this tax amnesty had generated over AUD 1.991 billion in total revenue.[524]

Overall, these examples indicate that tax amnesties have enabled some governments to collect past tax debts that would not otherwise have been collected. Here, one may argue that with the enhanced international tax enforcement under the new automatic information exchange system, most tax evasion cases may be detected without resorting to tax amnesty programs. However, with such tax amnesty programs the relevant tax revenue would be collected sooner and at lower administrative costs let alone the amnesty programs' role in easing the transition.

5.2.4 Some design considerations of transitional tax amnesty programs

Given the arguments against (see section 5.2.2) and in favour of (see section 5.2.3) tax amnesties, there remains the question of how transitional tax amnesties should be designed. It is not easy to discuss design considerations for a tax amnesty without a sufficient study of the jurisdiction and

[523] For further details, *see* www.ato.gov.au/General/The-fight-against-tax-crime/In-detail/Tax-crime/Project-Wickenby/.

[524] For further details, *see* www.ato.gov.au/General/The-fight-against-tax-crime/News-and-results/Project-Wickenby---getting-results/.

the context in which the amnesty would be offered. Nonetheless, some general comments can be made. In this section, the author discusses some fundamental considerations in designing transitional tax amnesties.

5.2.4.1 Hard on past tax liabilities but soft on criminal sanctions

A tax amnesty entails trading of one good, i.e. retribution, for another good, i.e. recovery of back taxes and bringing the non-compliant taxpayer into compliance. In designing tax amnesty programs, countries must always carefully consider whether their amnesty strikes the appropriate balance between these two goods. This is a very delicate balance to achieve. However, it must be recognized that in many cases, a properly crafted tax amnesty program could accommodate both of these competing interests and realize an optimal result. An ideal transitional tax amnesty program would be one that eliminates the accrued benefits of past tax-noncompliance on the part of the delinquent taxpayer, but that also eventually brings such a taxpayer permanently into the ranks of compliant taxpayers.

As a result, the tax amnesty program should make the participants accountable for their past tax non-compliance by requiring them to pay, to the greatest extent possible, all of the relevant taxes evaded. The states could also applying administrative and civil penalties in respect of the past noncompliance. However, once the participants have met these demands imposed on them and commit themselves to remain compliant in the future, there is little reason to inflict criminal sanctions on them. Instead, the system should leave these taxpayers with a feeling of appreciation of this one-time public compassion.

5.2.4.2 Anonymity and confidentiality

Participation in a tax amnesty is a multistage and often complex process. A typical tax amnesty participation process involves a) verification of an applicant's eligibility for the amnesty; b) determination and assessment of the relevant income and tax liabilities, and c) clearing these tax liabilities and penalties. There is a need to observe some degree of anonymity and confidentiality in these processes.

The anonymous screening. Taxpayers may be willing to participate in an amnesty program but they may be unsure whether they are eligible because of often complex but strict eligibility requirements of most amnesty programs. This uncertainty and the fear from finding oneself non-eligible after disclosing potentially self-incriminating information may often prevent them from coming forward for an amnesty program.

Therefore, the transitional amnesty programs must allow potential applicants to have a preliminary discussion with the competent tax authorities on an anonymous basis. Such preliminary screening provides potential participants an opportunity to verify their eligibility for the program, to understand possible implications of their participation (as well as their non-participation) and to learn the relief available under the amnesty program.

With regard to such preliminary screening, applicant would have to provide all necessary information with the exception of their identity. The information would have to be sufficient for tax authorities to make a preliminary assessment. The disclosure may include, for example, the applicant's profession and business activity, age, marital status, tax periods in question, the amounts involved in the disclosure, and reasons for the omission. The tax administration could then review the information, advise the applicant regarding eligibility for the program, provide details on the potential implications for the information furnished, and give an insight into the process. The complete application can be filed within a predetermined period if the applicant decided to take part in the tax amnesty.

As anonymity is a delicate matter, the preliminary application can be effectively dealt with by employing a third-party representative. The representative should possess the professional right of confidentiality in respect of third-party information. As the concept of lawyer-client privilege is integral to the lawyer-client relationship, the preparation of the preliminary application can be better managed with the assistance of lawyers.

5.2.4.3 Public awareness

The success of transitional tax amnesties would largely depend on public awareness of the implications of the upcoming global tax information exchange regime. The more people know about the automatic exchange of information system, the more likely they are to respond favourably to tax amnesties. Specifically, the public would need to appreciate that the new system would allow their residence state to discover secretly held foreign assets and income of resident taxpayers by way of routine information exchange with foreign governments.

In order to maximize public awareness of this, governments would have to initiate widespread publicity regarding the implications of the recent OECD initiative on automatic tax information exchange. They would also have to inform residents of government's on-going and expected negotiations, the agreements with foreign governments on this matter and the reliefs available under the tax amnesty to mitigate undesired consequences. In addition, the more it was publicized that the government would be obtaining access to offshore information, the more likely it is that people would be encouraged to make voluntary disclosures.

Governments could communicate this information to taxpayers through conventional and electronic media, i.e. newspapers, radio, and television broadcasts. It could also include such information in annual tax return bulletins and guides to taxpayers. These are the most effective means of communication between a government and its residents.

It should be also considered that, even after people have learned about the possibility of international automatic exchange of information and the announcement of transitional tax amnesty programs, they do not immediately rush to tax office to make amnesty disclosure. The people would normally go to a professional, for example, a lawyer, financial adviser or accountant, in whom they could put their trust to discuss their concerns and plans. The outcome would depend on how they are advised and guided in these discussions, as this is often how they become tax avoiders and evaders in the first place. Therefore, public awareness would have to focus on certain professionals so that they have a clear understanding of the events, as well as their responsibilities, and ethical obligations.

5.2.4 Concluding remarks

Tax amnesties are more relevant than ever. The new global standard on automatic exchange of information on financial accounts should soon enable governments to receive information regarding the foreign financial assets and foreign-source income of their residents on a regular basis. This is expected to be key in countering offshore tax evasion. At the initial stage, the transition would entail states dealing with a vast amount of previously undeclared offshore assets and income in respect of resident taxpayers. In this context, tax amnesties could play a crucial role. Specifically, tax amnesties could help in settling tax liabilities regarding these assets and provide a much-needed transitional bridge to the new international tax regime for both resident taxpayers and states.

For taxpayers, transitional tax amnesties would provide a fair warning and an opportunity to come forward to settle their past tax liabilities on foreign-source incomes in a relatively amicable manner before the enhanced international tax information sharing regime took effect. For states, tax amnesties would serve as an effective way to transition to the greater tax enforcement regime in a fast and efficient manner. Overall, transitional tax amnesties would, therefore, facilitate the transition to the new world of enhanced international tax enforcement.

5.3 Developing country perspectives on automatic exchange of information

Soon after the G20 endorsement of automatic exchange of information as a next global standard and the OECD's release of the Standard on automatic exchange of information on financial account, the representatives of over 51 jurisdictions came together in Berlin to sign the first-ever multilateral agreement (the Multilateral Competent Authority Agreement) implementing the Standard in 29 October 2014.[525] The signatories pledged to work towards implementation of the Standard by 2017, with the first international automatic exchanges to take place in 2018.[526]

This was a great step towards realizing the long waited automatic exchange of tax information on a global scale. This Multilateral Competent Authority Agreement also marks one of the very few multilateral agreements in the field of taxation. However, from more than 140 developing countries around the world only a half a dozen signed the agreement.[527] Surprisingly, even the BRIC countries: Brazil, China, India, and Russia, were missing from the signatory list. There were also only a few developing countries among another 42 jurisdictions, which have not yet signed the agreement but have committed to commence exchanging information automatically,

[525] The details on the agenda and the participants of the meeting are available at http://www.oecd.org/tax/exchange-of-tax-information/multilateral-competent-authority-agreement.htm

[526] The list of signatory countries can be found online at http://www.oecd.org/tax/exchange-of-tax-information/MCAA-Signatories.pdf

[527] The signatory developing countries are Albania, Argentina, Colombia, Mauritius, Mexico, Romania, and Sauth Africa. The developing countries are defined according to their Gross National Income (GNI) per capita per year. Countries with a GNI of US$ 11,905 and less are defined as developing countries. For the complete list, see the International Statistical Institute's online data at http://www.isi-web.org/component/content/article/5-root/root/81-developing; The OECD list of developing countries can be found online at http://www.oecd.org/development/stats/daclistofodarecipients.htm

by 2018 at the latest.[528]

This raises an important question whether the emerging international automatic exchange of information regime has anything to offer the developing world. This paper explores this question by analyzing the automatic exchange of information system from the developing country perspective. I also study the risks of not involving developing countries in the new automatic exchange of information system; and the challenges and obstacles that developing countries may confront when participating in the system. Finally, I propose some options to resolve some of these challenges.

5.3.1 Implications of excluding or not including developing countries

5.3.1.1 Illicit financial outflows

There is a critical problem that almost every developing country confronts in today's globalized world: illicit financial flows.[529] Generally, illicit financial flows (IFFs) are defined as capital flows that are illegal in the way they are created, transferred, or utilized.[530] The Global Financial Integrity describes IFFs also as unrecorded money. It describes the unrecorded money as money acquired from corruption, crime such as drug trading, human trafficking, counterfeiting, contraband, and manipulative commercial dealings such as proceeds arising from import and export transactions conducted so as to manipulate customs duties, VAT taxes, income taxes,

[528] The list of countries committed to implement the OECD's new Standard on automatic exchange of financial account information can be found online at http://www.oecd.org/tax/transparency/AEOI-commitments.pdf

[529] Dev Kar & Joseph Spanjers, *Illicit Financial Flows from Developing Countries: 2003-2012* (Washington DC Global Financial Integrity 2014); Martin Hearson, *Tax-motivated Illicit Financial Flows: A Guide for Development Practitioners* (Norway, Bergen: U4, 2014).

[530] Hearson. ibid., at 1.

excise taxes.[531] The money leaves the country to hide abroad. The illicit financial flight is a catalyst for tax evasion and vice versa.

According to a recent study conducted by the Global Financial Integrity (GFI), illicit financial flows from the developing and emerging economies totalled a staggering $6.6 trillion between 2003 and 2012.[532] This is almost ten times more than what these countries received in official development aid during this period.[533] In 2012 alone, GFI estimates that these countries lost $991.2 billion in unrecorded money. The study notes that this number is steadily growing by an average of 9.4 per cent per year - roughly twice as fast as global GDP.

The GIF study also analyses illicit financial flows from developing countries on a regional basis. Asia was the region of the developing world with the highest outflow, comprising 40.3 per cent of the world total. It is followed by Developing Europe at 21.0 per cent, the Western Hemisphere at 19.9 per cent, the Middle East and North Africa at 10.8 per cent, and Sub-Saharan Africa at 8.0 per cent.[534] As for country analysis, China, Russia, Mexico, India, Malaysia were reported to be the major exporters of such unreported money.[535]

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[531] *Illicit Financial Flows: Analytical Methodologies Utilized By Global Financial Integrity* Global Financial Integrity 2014), at 1. Available at http://www.gfintegrity.org/wp-content/uploads/2014/09/GFI-Analytics.pdf

[532] Kar & Spanjers, *Supra note* 542, at vii (The study notes that this i extremely conservative estimate and the actual numbers may be higher).

[533] Ibid. at 12 (The cumulative total of official development assistance to the developing countries from 2003 to 2012 was US$809 billion).

[534] Ibid., at 8.

[535] Ibid., at 9.

One of the most common form of illicit financial flow is fraudulent misinvoicing of trade transactions, also known as trade mispricing or trade-based money laundering. Trade misinvoicing is the intentional misreporting of the actual value, quantity, or composition of goods on customs declaration forms and invoices for tax evasion or money-laundering purposes.[536] According to the GFI study, it accounted for nearly 78 per cent of illicit flows in 2012.[537] Developing countries lose $470 billion per year due to trade misinvoicing. The trade misinvoicing normally occurs in two forms: over-invoicing and under-invoicing.

Resident taxpayers often use trade over-invoicing to siphon their profits from developing countries. This can be achieved by inflating and over-invoicing the actual cost of imported inputs or equipment, so that the taxpayer can report lower taxable income in the source country. The taxpayer may also use a reverse strategy – under invoicing. A person exporting goods from a developing country can deliberately undervalue what is being exported, so that profits are once again shifted abroad. Once the money is shifted abroad tax free, it is diverted to an offshore bank account owned directly or indirectly by the taxpayer. Here, the cross-border nature of the transactions and the lack of extraterritorial information make hard for tax authorities of developing countries to detect the true amount of the profits made in their country.

Overall, the GFI study makes a comprehensive observation of the illicit financial flows from developing countries. What the study does not explain is where these assets are flowing? Where are their favourite destinations? Why are they flowing there?

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[536] Further details on basic mechanism of trade misinvoicing can be found at http://www.gfintegrity.org/issue/trade-misinvoicing/

[537] Kar & Spanjers. *Supra* note 542, at 22.

In fact, answers to these questions are fairly obvious given that there are only two major symbolic "poles" in the world – developing and developed; and even within the developed world, there is only a few jurisdictions where such money can find safe and tax-free haven.[538] In these jurisdictions, the money generally does not have to disclose its true source, purpose, or even its owner.[539] Once the money arrives there, it rarely returns to the country of its origin. Overall, such illicit movement of capital and tax revenue loss from developing countries is actively facilitated by secrecy regimes in many jurisdictions.

The main concern is that this outflow deprives businesses, healthcare, education, and infrastructure in developing countries of vital funding. They are already underfinanced and often in critical conditions. The outflow also strips the developing countries of necessary tax revenue that can be spent to improve lives and to alleviate poverty.[540]

These alarming statistics may indicate that the developing world has greater reasons to engage in automatic exchange of information. They would benefit greatly from being able to receive information from developed countries, particularly from secrecy jurisdictions. Their general public and citizens have been victims of the illicit capital flight for a long time and they will continue to suffer it until this problem is addressed at national and international levels.

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[538] Palan, Murphy & Chavagneux. *Supra* note 19; Prem Sikka, "The Role of Offshore Financial Centres in Globalization" (2003) 27:4 Accounting Forum.

[539] Jane G Gravelle, "Tax Havens: International Tax Avoidance and Evasion" (2009) National Tax Journal, at 20.

[540] Sri Mulyani Indrawati, "Dirty Money and Development" Project Syndicate. Available at http://www.project-syndicate.org/commentary/money-laundering-corruption-trafficking-and-development-by-sri-mulyani-indrawati-2015-01

5.3.1.2 Developing countries as potential tax havens

The international initiative on automatic exchange of information, in its current form, is intended to establish a platform for regular flow of information mainly between tax havens and developed countries. It, by and large, ignores developing countries' needs in this process. In October 2014, the OECD, for the first time, convinced Bermuda, British Virgin Islands, Cayman Islands, Cyprus, Faroe Islands, Gibraltar, Guernsey, Isle of Man, Jersey, Liechtenstein, Luxembourg, San Marino, Switzerland, and the Turks and Caicos to be part of automatic exchange of information system on a multilateral basis. These countries and territories were commonly referred to as tax havens and were staunch defenders of banking secrecy in the past. But by 2014, they all signed the Multilateral Competent Authority Agreement along with other 38 countries. Other secrecy jurisdictions such as Singapore, Hong Kong, and UAE are expected to follow the suit.[541] This means that all these jurisdictions, which consistently opposed automatic exchange of information regimes in the past, are finally yielding to these regimes. This eventually leaves offshore tax evaders with two possible options: either to abandon tax evasion, or to move their assets to other jurisdictions, which are not or will not be part of such regimes any time soon. Developing countries provide an interesting opportunity in this context. Traditionally, offshore tax evaders are assumed to seek jurisdictions, which do not regulate much, which do not tax much, and finally, which do not share information. Alternatively, they might seek jurisdictions, which cannot effectively do these things. Developing countries often belong to the latter category. Generally, they have weaknesses in regulation and tax administration due to financial constraints.

[541] "China, Hong Kong Committed to Global Alliance to End Banking Secrecy" South China Morning Post (30 October 2014) Available at http://www.scmp.com/news/china/article/1628574/china-hong-kong-committed-global-alliance-end-banking-secrecy; Singapore Ministry of Finance, *Singapore's Implementation of Global Standard for Automatic Exchange of Financial Account Information* (Singapore Ministry of Finance 2014).

The majority of them are not now and will not in the near future be part of automatic exchange of information regime. The Global Forum's recent survey can provide a strong evidence for this premise. The survey responses received from 37 developing countries on their state of readiness for automatic exchange of information reveals that currently only 3 developing countries are sending information automatically to other countries. More than 48% of these countries indicated that they have plans to start automatic exchange of information but do not know when they would be able to do so. 14% of the respondents clearly indicated that they have no such plans.[542]

At the end of the day, for would-be tax evaders, opportunities are there. Indeed, in their current capacities, developing countries cannot promise the same level of political stability, governance, infrastructure, skilled workforce, financial and telecommunication services as are offered in tax havens.[543] However, most of them have reasonable legislative and financial infrastructure. What they can offer more though is an extensive tax treaty network, which is usually absent in the case of tax havens and secrecy jurisdictions. The latter can provide an essential benefit for tax evaders.

After all, the current marginalization of developing countries from the automatic exchange of information system may potentially turn some of them into future tax havens or secrecy jurisdictions. It may allow some developing countries to become the next Bermuda, Cayman Islands, or Singapore as far as offshore tax evasion and bank secrecy is concerned.

[542] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Automatic Exchange of Information: A Roadmap for Developing Country Participation* (France: Paris Global Forum on Transparency and Exchange of Information for Tax Purposes 2014), at 12.

[543] Dharmapala Dhammika & James R Hines, *Which Countries Become Tax Havens?* (Cambridge: MA: National Bureau of Economic Research, 2006).

5.3.2 Challenges for developing countries

Given these reasons, one may wonder why the developing countries are holding back from automatic exchange of information; or more precisely, what is holding them back. This section explores these questions.

5.3.2.1 Hidden multi-bilateralism within the promised multilateralism

The OECD anticipates that the new standard on automatic exchange of information can be implemented either through the existing frameworks under double tax treaties or the Convention on Mutual Administrative Assistance in Tax Matters ("Multilateral Convention").[544]

Double tax treaties, by their very nature, are bilateral agreements. A double tax treaty is a reciprocal arrangement between two parties that aim at eliminating the double taxation of income or gains arising in one territory and paid to residents of another territory. It generally resolves the conflict of tax jurisdiction claims of the treaty partners over the same income and gains. It also addresses international tax evasion. Article 26 of most double tax treaties allows treaty partners to automatically exchange information. However, the parties interested in automatic exchange of information will need to conclude an additional agreement by their competent authorities, thereby agreeing on the procedure and the scope of such exchanges. Such an administrative agreement typically sets forth the types of information to be exchanged automatically, procedures for sending and receiving the information, and the appropriate format for the exchanges. Since tax treaties are bilateral agreements, the OECD found it more efficient to

[544] The OECD Standard for Automatic Exchange of Financial Account Information in Tax Matters (2014), Introduction, Paragraph 11, at 13.

implement the new Standard through the Multilateral Convention and encouraged all countries to sign the Convention.

The Multilateral Convention also allows its member states to exchange information automatically. However, signing the Multilateral Convention does not by itself mean that the member state may receive and send information automatically. The Convention has a similar prerequisite as in double tax treaties: this form of exchange under the Convention is possible only through an additional agreement between the competent authorities of the member states that establishes the modalities and procedures for automatically exchanging information. Such a competent authority agreement then activates automatic exchanges between the participants. Without such an administrative agreement, the member states have no obligation to engage in automatic exchange of information. The commentary to the Multilateral Convention stipulates that such agreement may be concluded by two or more parties (with actual exchanges always taking place on a bilateral basis).[545] The OECD recently introduced its bilateral and multilateral model competent authority agreements (CAAs) to serve this function. The OECD recommends the member states to follow the multilateral model.

In October 2014, this multilateral agreement has become a reality. 51 jurisdictions around the world came together in Berlin and signed the Multilateral Competent Authority Agreement (MCAA) based on the OECD model. This marks these countries' the first-ever formal commitment to collect and automatically exchange information with each other under the Multilateral Convention. The signatories to the agreement include major European Union states,

[545] The Multilateral Convention on the Mutual Administrative Assistance in Tax Matters (amended by the 2010 Protocol), commentaries (Paragraphs 64-65) on Article 6.

a few developing countries, and even Liechtenstein, British Virgin Island, the Cayman Islands, Luxembourg, and Switzerland, which systematically opposed such a regime until very recently.[546] However, there are two problems in this multilateral approach.

First, paradoxically, some major developed countries such as the United States, Canada, and Japan have not yet sign the agreement. In relation to the United States, the OECD stated that there is a considerable overlap between the multilateral Competent Authority Agreement and FATCA intergovernmental agreements (IGAs) that the country was already in the process of concluding with other countries. This means that the U.S. has no plans to join the MCAA.

At the end of the day, any country that intends to engage in automatic exchange of information with these countries has to discuss it in a bilateral context. There are a number of compelling challenges for developing countries in such bilateral approaches.

It is very important to note that bilateral agreements often involve power relationship. Generally, large and politically powerful countries do not easily agree to enter into such deals with small and less powerful countries.[547] For example, Mexico has repeatedly requested the United States to enter into an agreement on automatic exchange of information concerning interest paid by U.S. banks to the residents of Mexico and vice versa since 2009. It noted that such information

[546] See the signatories of the Multilateral Competent Authority Agreement as of 19 November 2014. The list can be found online at http://www.oecd.org/tax/exchange-of-tax-information/MCAA-Signatories.pdf

[547] Allison Christians, "Tax Treaties for Investment and Aid to Sub-Saharan Africa: A Case Study" (2005) Northwestern Law Legal Working Paper Series.

sharing would help the Mexican government identify and prevent tax evasion, money laundering, drug trafficking, and organized crime.[548]

This was essentially the same information that the United States demanded and received from Switzerland after the UBS scandal. Yet, the United States systematically ignored the Mexico's request out of fear of possible capital flight from its banking sector [549] until very recently when the country finally decided to agree on such information exchanges with Mexico in response to its own demand for information under FATCA.[550] Ironically, the United States has had a law in place to automatic exchange exact same type of information with a developed country, Canada, on a regular basis since 1997.[551]

Let's assume that such requests have been accepted. This may not yet mean success. The powerful countries may use such requests as a leverage to demand something more.[552] The countries often have other agendas. In March 2007, Argentina made a request for a tax information exchange agreement (TIEA) with the United States. However, the U.S. government conditioned the negotiation on Argentina's willingness to enter into a broader bilateral income

[548] Kevin Preslan, "Turnabout is Fair Play: The US Response to Mexico's Request for Bank Account Information" (2010) 1 Global Bus. L. Rev., at 204.

[549] Ibid.

[550] Agreement between the Department of the Treasury of the United States of America and the Ministry of Finance and Public Credit of the United Mexican States to Improve International Tax Compliance Including with Respect to FATCA (November 2012). Available at http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-Mexico-11-19-2012.pdf

[551] Preslan. *Supra* note 561.

[552] Christian Aid, *Automatic for the People: Automatic Information Exchange, Tax Justice and Developing Countries* (UK: Christian Aid 2013); Ibid.

tax treaty with the country.[553] There was nothing wrong with this condition except the fact that Argentina essentially would have to accept all that the U.S. would require in its proposed bilateral income tax treaty giving up much of its taxing rights,[554] if the country wants to receive tax information from the United States. The United States has its own model income tax convention since 1976.[555]

Finally, concluding a bilateral agreement is a time and resource consuming process. It involves significant costs. The cost is incurred not only in terms of money, but also in terms of time and efforts. These costs may relate to initiation, planning, negotiation, conclusion, and finally obtaining parliamentary approval.[556] Even though this is an indispensable part of every international agreement, engaging in negotiations for bilateral agreements on the same matter with multiple jurisdictions have prohibitive cost and time implications for countries with scarce budget and resources. It remains unclear how long would it take for developing countries to enter into bilateral agreements on automatic exchange of information with all tax havens and secrecy jurisdictions. Definitely, it would take long, if not forever, as these countries have neither significant power, nor abundant resources.

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[553] Martin Hearson, *Why the US and Argentina Have no Tax Information Exchange Agreement* (UK: 2013).

[554] Christians. *Supra* note 531. (The author provides a comprehensive analysis of the US policy of entering into double tax treaties with less developed countries).

[555] The U.S. has had its own model income tax convention since 1976. See Klaus Vogel, "Double Tax Treaties and Their Interpretation" (1986) 4 Int'l Tax & Bus. Law. (The U.S. Model Convention was revised in 1977, 1981, 1996, and 2006. The most recent version of the Convention is available at http://www.irs.gov/Individuals/International-Taxpayers/The-U.S.-Model-Income-Tax-Convention-and-Model-Technical-Explanation).

[556] Paul Reese, "United States Tax Treaty Policy Toward Developing Countries: The China Example" (1987) 35 UCLA L. Rev.

Given these considerations, it is very unlikely that developing countries would have sufficient leverage to strike a reasonable agreement on automatic exchange of information with major developed countries, if this is not to be achieved in a multilateral setting.

Second, it is worrying to think that there may be room for discretion and unilateralism even under the Multilateral Competent Authority Agreement. In its press release on 19 November 2014 on Switzerland's joining the Multilateral Competent Authority Agreement (MCCA), the Swiss government announced that "the question regarding the countries with which Switzerland should introduce this exchange of data is not affected by the signing of the multilateral agreement… the bilateral activation of the automatic exchange of information will be submitted to the Federal Assembly separately for approval".[557] This implies that signing the MCAA and its approval cannot not, by itself, oblige Switzerland to begin automatic exchange of information with the other signatory parties. The country may still choose the states among the signatory parties with which it wants to exchange information automatically.

When signing the MCAA, all signatory parties multilaterally commit to automatic exchange information with all other signatory parties after they have put all the necessary rules in place to implement the agreement.[558] Most of these "precondition" rules relate to the availability of

[557] The Swiss Federal Council and Federal Department of Finance, *Switzerland Takes Further Step Towards Introduction of Automatic Exchange of Information* (Switzerland: Bern Swiss State Secretariat for International Financial Matters 2014). The document is available at https://www.news.admin.ch/message/index.html?lang=en&msg-id=55327

[558] Section 7(1) of the MCAA. The agreement can be found online at http://www.oecd.org/ctp/exchange-of-tax-information/multilateral-competent-authority-agreement.pdf; also see Commentary to Section 7(1) of the OECD Model CAA. The document can be found online at http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/standard-for-automatic-exchange-of-financial-account-information-for-tax-matters_9789264216525-en#page92

domestic legislation on due diligence and data collection by financial institutions, on taxpayer confidentiality, data safeguards, and the proper use requirements for sending and receiving information. Specifically, the MCCA stipulates that a signatory party must provide, at the time of signature of the agreement or as soon as possible after its jurisdiction has the necessary laws (e.g. to implement the OECD's CRS, to ensure confidentiality and data protection safeguards) in place to implement the OECD' Common Reporting Standard, a notification to the Coordinating Body's Secretariat.[559] However, the MCAA also allows the signatory parties make a list of the member states with respect to which they intend to have automatic exchange in effect.[560] Section 2.1 of the MCAA states that the agreement will come into effect between two competent authorities on the later of the following dates: (i) the date on which the second of the two competent authorities has provided notification to the Co-ordinating Body Secretariat, including listing the other competent authority's jurisdiction, and, if applicable, (ii) the date on which the MCAA has entered into force and is in effect for both jurisdictions.

These provisions raise some critical questions: what is the value placed on the Multilateral Competent Authority Agreement, if its signatory countries would still have the discretion to unilaterally choose the states among the signatory parties with which they want to exchange information? What is the value of the agreement for those signatory parties, which cannot find themselves on the selection lists of the other signatory parties? Do signatory parties still confront arbitrary selection and need to fight for information even after signing so many layers of

[559] Section 7 of the MCAA.

[560] Section 7(1)(f) of the MCAA.

multilateral agreements? Finally, what would be the next selection criteria for the signatory parties to decide with whom they want to exchange information?

In fact, there are sufficient numbers of the signatory parties, which are still looking for every possible opportunity to resist information exchange even under the MCAA. A recent article on Bahamas' position on the MCAA quotes the country's minister of financial services reporting that the country "got everything it wanted out of the MCAA".[561] In its meeting on 8 October 2014, the Swiss Federal Council also noted that the country contributed actively in the design of the Standard on automatic exchange of information and stated that "in an initial phase, consideration will be given to countries with which there are close economic and political ties and which, if appropriate, provide their taxpayers with sufficient scope for regularisation".[562]

After all, there is a hidden and dangerous bilateralism within the promised multilateralism. This problem is of general nature and does not specifically target developing countries but the potential victims of this bilateralism are very likely developing countries as they are vulnerable particularly in such bilateral arrangements. Despite all these facts, the Multilateral Convention and the Multilateral Competent Authority Agreement still appear to be the best possible venue for developing countries to move forward to automatic exchange of information practice at the moment.

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[561] Neil Hartnell, "Bahamas 'Got Everything Needed' On Tax Exchange" Tribune 242 (31 October 2014). Available at http://www.tribune242.com/news/2014/oct/31/bahamas-got-everything-needed-on-tax-exchange/; See also Ryan Pinder, The Bahamas' Position on the Automatic Exchange of Financial Information (Bahamas: Bahamas Financial Service Board, 2014). Available at http://www.bfsb-bahamas.com/news.php?cmd=view&id=3326 and http://www.step.org/bahamas-speaks-out-against-multilateral-automatic-sharing

[562] *Automatic Exchange of Information in Tax Matters: Federal Council Adopts Negotiation Mandates with Partner States* (Switzerland, Bern: Swiss Federal Council 2014). The press release available at http://www.admin.ch/aktuell/00089/index.html?lang=en&msg-id=54768

5.3.2.2 Issues in the standard on automatic exchange of information

The Tax Justice Network (TJN) is one of the few independent international groups, which has evaluated the Standard from developed country perspective at its early stages of development.[563] It outlines some specific concerns over the new Standard:

Reciprocity. In its current form, the Standard requires reciprocity. This means that if a state receives information automatically, it will need to do same favour to the state from which it receives information. As a result, states are not required to supply information to its partner if the latter is not be able to obtain and supply similar information in return under its laws and administration. This appears a fair deal. However, this principle may also prevent most developing countries to participate in the automatic exchange of information system. For example, Singapore has recently declared that it can accept the Standard, with some other conditions, only if there is reciprocity with its partners in terms of information exchanged.[564] This requires most developing countries to undergo a massive and swift reprioritisation of effort towards putting in place a necessary system that enable them to supply information automatically to its treaty partner in order to meet the Standard's reciprocity condition. At the moment, this is

[563] Tax Justice Network, *OECD's Automatic Information Exchange Standard: A Watershed Moment for Fighting Offshore Tax Evasion?* Tax Justice Network 2014). Available at http://www.internationaltaxreview.com/pdfs/TJN2014_OECD-AIE-Report.pdf; See also Andres Knobel & Markus Mainzer, *Automatic Exchange of Information: An Opportunity for Developing Countries to Tackle Tax Evasion and Corruption* Tax Justice Network 2014). Available at http://www.taxjustice.net/wp-content/uploads/2013/04/AIE-An-opportunity-for-developing-countries.pdf

[564] Singapore Ministry of Finance, *Singapore's Implementation of Global Standard for Automatic Exchange of Financial Account Information* (Singapore Ministry of Finance 2014). The press release can be found online at http://www.mof.gov.sg/news-reader/articleid/1405/parentId/59/year/2014?category=Parliamentary%20Replies

beyond the capacity of most developing countries due to their limited financial, administrative, and technological constraints.[565]

One possible solution suggested by TJN is the "staged reciprocity". It calls for the waiver of the reciprocity requirement for developing countries at the initial stage.[566] That is, the Standard would initially focus on information transfer, not the information exchange with developing countries. Developing countries would be granted a specified grace period to build their capacity to meet the reciprocity requirement eventually.

Confidentiality. TJN also notes that developing countries may confront a similar obstacle by virtue of strict confidentiality requirements of the Standard. Section 5 of the OECD Model CAA allows the information providing signatory party to impose its own domestic confidentiality law requirements on the receiving signatory party if the former's domestic confidentiality requirements are stricter than those of the receiving country. Section 7 of the Model CAA allows the parties to suspend the agreement if these confidentiality requirements are not complied with. Problem is that developing countries may not have administrative capacities to provide the exact same mechanism of confidentiality as provided, for example, in secrecy jurisdictions. TJN argues that while the confidentiality provisions could help overcome constitutional problems for exchanging data in some cases, it opens the way for potential abuse by tax havens to use these requirements as pretext for generally not to share information with lower income countries.[567]

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[565] Richard M Bird & Eric M Zolt, "Technology and Taxation in Developing Countries: from Hand to Mouse" (2008) National Tax Journal.

[566] Tax Justice Network. *Supra* note 576, at 5.

[567] Ibid., at 7-8.

Bilateralism. The Standard emphasizes bilateral agreements and makes it optional to sigh a multilateral agreement. Bilateral agreements create unnecessary obstacle and open possibilities for tax havens to demand additional concessions from developing countries. TJN suggests that the Standards should make it the norm, rather than just an option, for the CAA to be signed on a multilateral basis.[568]

Capacity building. TJN argues that revenue authorities in developing countries in many cases will need to develop capacity to handle automatic information. Therefore, it calls for the OECD, G20, and the Global Forum to provide material and technical support to help developing countries benefit from the automatic exchange system, such as training, IT infrastructure and helping with legal and regulatory changes.[569]

5.3.2.3 Democracy deficit in the design of the rules

The preceding section indicates that the new Standard on automatic exchange of financial account information, in its current form, may not necessarily reflect the capacities and constraints of developing countries to participate in the automatic exchange of information system. These concerns raise one seemingly important question: why this is so?

The Standard was initiated by the G20 and developed by the OECD modelling it closely after the United States' Act on Foreign Account Tax Compliance (FATCA). The OECD is essentially a club of 34 influential and wealthy countries. The organization provides a platform for its members to exchange policy experiences, seeking answers to common problems, identify good

[568] Ibid., at 8.

[569] Ibid., at 8.

practices, and coordinate domestic and international policies. The organization's mandate covers economic, financial, environmental, and social issues.

Lately, the organization has also taken the de-facto role of drafting international tax rules and standards.[570] It provides recommendations, model conventions, standards, and guides to best practices.[571] The states other than the OECD member states may have observer status in this process. They can observe the discussions, deliberations, and development process of the OECD tax rules and standards. Nevertheless, the experience has shown that the non-OECD states would ultimately be expected to comply with these rules and standards at a later date, often under peer pressure that involves the combination of formal recommendations, public scrutiny, black-listing, or other forms of influence.[572] The Standard on automatic exchange of financial account information has been a result of such typical process. Yet, particularity of this Standard is that it was obvious from its very beginning that it is intended to apply within and beyond the OECD states.

The TJN argues that ideally the design and creation of such international tax rules must have been delegated to another international body, namely, the UN, particularly its Committee of Experts on International Cooperation in Tax Matters (the UN Committee on Taxation), which has legitimacy to do this mandate. It argues that this committee must be upgraded to a more

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[570] Arthur Cockfield, "Rise of the OECD as Informal World Tax Organization through National Responses to E-Commerce Tax Challenges, The" (2005) 8 Yale JL & Tech.

[571] Tony Porter & Michael Webb, "The Role of the OECD in the Orchestration of Global Knowledge Networks" in Rianne Mahon & Stephen McBridge, eds., *The OECD and Transnational Governance* (Canada, Vancouver: UBC Press 2008) 43-59.

[572] The details of the OECD's peer pressure policy is available at http://www.oecd.org/site/peerreview/peerpressurearelatedconcept.htm

influential, intergovernmental committee.[573] However, there are some practical difficulties to realize this proposal.

The UN Committee on Taxation is comprised of 25 members: 10 from developed and 15 from developing countries. The Committee members convene annually. The Committee's work programme is carried out by its working parties that operate throughout the year.[574] The Committee's mandate is broad covering all forms of international tax policy making.[575] However, despite its broad mandate, the UN Committee on Taxation has had relatively low proven record in addressing international tax issues. This is largely due to its understaffing, scarce resources, and funding. The most of the Committee's work has been centered on the UN Model Tax Convention and its periodical reviews and updates. Even these review and updates often replicate the corresponding updates in the OECD Model Tax Convention.

The OECD Committee on Fiscal Affaires (the OECD Tax Committee), on the other hand, is increasingly active international body. The Tax Committee is well resourced and funded. It sets

[573] Tax Justice Network, *supra note 567*, at 5-6.

[574] UN Financing for Development Office, *Committee of Experts on International Cooperation in Tax Matters: Mandate* (US: New York: UN Financing for Development Office, 2011).

[575] The mandate of the UN Committee on Taxation constitutes: 1) to keep under review and update as necessary the United Nations Model Double Taxation Convention between Developed and Developing Countries; 2) to provide a framework for dialogue with a view to enhancing and promoting international tax cooperation among national tax authorities; 3) to consider how new and emerging issues could affect international cooperation in tax matters and develop assessments, commentaries and appropriate recommendations; 4) to make recommendations on capacity - building and the provision of technical assistance to developing countries and countries with economies in transition; and 5) to give special attention to developing countries and countries with economies in transition in dealing with all the above issues. See ibid.

the OECD work programme in the tax area and provides a forum for the member states to exchange views on international tax policy and administration issues.[576]

The OECD Tax Committee is comprised of a permanent secretariat and a rotating cast of mid-level national tax officials working in various sub-committees and working groups. The Committee also has the Centre for Tax Policy and Administration (CTP), which offers the Committee technical expertise, focusing on domestic and international tax policy and tax administration issues.[577] It has a staff of approximately 100 people. The CTP holds 80 events annually on the full range of OECD's tax work, bringing together also almost 100 non-OECD economies.[578] In the past few years alone, the Committee initiated and led a number of high profile projects on harmful tax competition, transparency, and bank secrecy issues. As a result, it designed and diffused corresponding international frameworks.

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[576] The mandate of the OECD Tax Committee constitutes: 1) to facilitate the negotiation of bilateral tax treaties and the design and administration of related domestic legislation; 2) to promote communication between countries and the adoption of appropriate policies to prevent international double taxation and to counteract tax avoidance and evasion; 3) to encourage the elimination of tax measures which distort international trade and investment flows; 4) to promote a climate that encourages mutual assistance between countries and establish procedures whereby potentially conflicting tax policies and administrative practices can be discussed and resolved; 5) to support domestic tax policy design through the development of high quality economic analysis of tax policy issues, comparative statistics and comparisons of country experiences in the design of tax systems; 6) to improve the efficiency and effectiveness of tax administrations, both in terms of taxpayer services and enforcement; 7) to support the integration of non-OECD economies into the international economy by strengthening policy dialogue with them to increase their awareness of and contribution to the committee's standards, guidelines and best practices. See OECD, *OECD's Current Tax Agenda* (France: Paris: Organization for Economic Cooperation and Development 2012), at 14-15.

[577] OECD, *Secretary-General's Report to Ministers 2014* (France: Paris: OECD, 2014).

[578] OECD, at 17-18.

In 2011, the UN Secretary General asked the UN member states to submit their views on the question of upgrading and strengthening the Committee and improving its funding capacity.[579] All developing countries, namely the Group of 77 and China voted in support of strengthening the UN Committee on Taxation.[580] Notably, all OECD member states (except Chile and Mexico) voted against the upgrading. Among the objections given to the possible reform of the Committee were that an upgrade would distract the Committee from its valuable work on the UN Model Convention; a cost and benefit analysis are necessary; there is no guarantee of a representative body; upgrading would duplicate the OECD's work and could lead to the establishment of multiple and mutually-inconsistent international standards in international taxation; there is a risk of redundancy, i.e. the OECD has already made sufficient progress in the area of tax taxation and tax cooperation.[581]

At the end of the day, despite their numerical majority, the balance of power was not in the developing countries' favor. Thus, the debate over the Committee's upgrading is still hanging in the UN agenda. This raises an important questions: Can the OECD then provide a space for in-house representation for developing countries, at least, in its global tax policy discussions?

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[579] Hamrawit Abebe *et al.*, *A Research and Policy Brief for the Use of the NGO Committee on Financing for Development: The United Nations' Role in International Tax Policy* (Italy: Milano: Milano School of International Affairs, 2012), at 8.

[580] The Group of 77 at the United Nations is a loose coalition of developing nations, designed to promote its members' collective economic interests and create an enhanced joint negotiating capacity in the United Nations. Ibid, at 9.

[581] Ibid, at 10-11, 18.

One commentator argues that when the OECD expands its membership, it becomes a low-common-denominator organization.[582] He notes that the work cannot be left to the UN for the same reason.[583] There is a concern that the bigger the group, the harder it would become to come to real consensus on any issues. However, there is also another legitimate concern that without sufficient representation and democratic process, any international tax policy discussion or standard may very likely be biased and directed to the benefit of those who were present around the discussion table.

Given these competing considerations, at the moment, it appears not viable to reverse course as the TJN advocates, at least, as far as the Standard on automatic exchange of information is concerned. If so, what are the possible options for developing countries to have their voices heard and to have their concerns addressed? Is there a pragmatic solution to the problem? Is it still possible for developing countries to have their interests on the "discussion table" even though there are no "chairs" for them around that table? And finally, is it possible to make the Standard work for all countries, or at least, for most of them? These are hard questions. In the next section, I will analyse the OECD's approach to address these problems.

5.3.3 OECD's approach to address the issues

Recognizing the importance of all countries participation in the new automatic exchange of tax information system, during their meeting in Saint Petersburg in September 2013, the G20 leaders

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[582] See the U.S. Professor David Rosenbloom's testimony to the Standing Committee on Finance in the House of Commons of the Canadian Parliament on February 7, 2013. The testimony can be found at http://www.parl.gc.ca/HousePublications/Publication.aspx?DocId=5971039&Language=E&Mode=1&Parl=41&Ses=1#Int-7875192

[583] Ibid.

called on the Development Working Group to work with the Global Forum and other international organizations to develop a roadmap showing how developing countries can participate in the emerging Standard.[584] The Development Working Group invited the Global Forum Secretariat to lead the project. On 22 September 2014, the Global Forum finally released a report on "Automatic exchange of information: a roadmap for developing country participation" (Roadmap).[585] The Roadmap evaluates developing countries' current state of readiness for the new Standard and identifies the benefits, costs and the fundamental building blocks that developing countries need in order to meet the new standard.

5.3.3.1 Evaluation of benefits and costs for developing countries

The Global Forum lists four key benefits of automatic exchange of information for developing countries: a) detection of tax evasion and offshore wealth; b) deterrence from future non-compliance; c) supporting domestic synergies; d) enhancing reputation.[586]

The Global Forum recognizes that the percentage of the offshore wealth belonging to developing countries is more than the world average and notes that automatic exchange of information can help tax administrators to achieve efficiencies in information gathering and applying taxes on these assets.[587] It also contends that the implementation of automatic exchange of information may provide an opportunity for tax administrations to strengthen and enhance overall tax

[584] G20 Leaders' Declaration 2013. *Supra* note 261, Paragraph 52.

[585] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Automatic Exchange of Information: A Roadmap for Developing Country Participation* (France: Paris Global Forum on Transparency and Exchange of Information for Tax Purposes 2014).

[586] Ibid., at 9-10.

[587] Ibid., at 10 (The Global Forum quotes from the Boston Consulting Group's study on "Global Wealth in 2013").

administration in developing countries, i.e. rendering "spill-over" effect. Finally, the Global Forum notes that the developing countries' adherence to the Standard demonstrates their commitment to transparency and improvement in tax compliance thereby enhancing their reputation.[588]

The Global Forum also recognizes that automatic exchange of information has substantial cost implications. It notes that the most costly aspects of the regime are expected to be information technology investments and human resources.[589]

5.3.3.2 Evaluation of developing countries' state of readiness

The Global Forum also undertook a survey among developing countries on the state of their readiness for the automatic exchange of information. The Global Forum indicates that it received responses from over 100 jurisdictions at the time of report.[590] The survey results revealed that many developing countries are not currently in a position to benefit from automatic exchange of information; only 3 developing countries are currently sending information automatically, compared to 50 developed countries.[591] 17 developing countries had received information automatically in the past but could not effectively use it due to their limited capacity to match the information. 48% of the survey participants indicated their willingness to engage in automatic exchange but did not known when they would be able to do it, while 14% of them indicated that they had no such plan any time soon. The World Bank Group indicated the developing country's

[588] Ibid., at 10.

[589] Ibid., at 10.

[590] Ibid., at 10.

[591] Ibid., at 12.

main challenges to implement the standard to be information technology infrastructure, staff training, organizational structure, liaising with banks, legal changes.[592]

5.3.3.3 Global Forum's proposed solutions

The Global Forum proposed a number of key principles in approaching these problems. The proposed principles are: the problems require a tailor-made approach for each country; the participation in the Standard must be considered as part of a process that is complementary to a developing country's long-term resource mobilization and capacity building efforts; developing countries must be allowed to have sufficient time and appropriate support; and capacity building in developing countries which are also financial centres should be undertaken as priority.[593]

The Global Forum also provides a stepped approach to ensuring that developing countries can overcome obstacles in implementing the new Standard. It proposes necessary **steps to be taken by three key stakeholders in this process**: a) developing countries; b) the Global Forum, with support from international organizations such as the World Bank Group; c) the G20 and other developed countries.[594]

Steps for developing countries:

The first proposed step for developing countries is to become a Global Forum member.[595] In so doing, developing countries are expected to ensure effective implementation of the standard of

[592] Ibid., at 12.

[593] Ibid., at 13.

[594] Ibid., at 14.

[595] Ibid., at 14-15.

exchange of information upon request and participate in the peer review process. They are also expected to build exchange of information network, including the Multilateral Convention. The membership in the Global Forum would also allow them to benefit from automatic exchange of information pilot projects.

Second, developing countries are expected to build a high level of political support to make the required changes. The Global Forum recognizes that without this it will be difficult for the necessary changes to be made in an efficient manner.[596]

Third, all developing countries that are Global Forum members are invited to volunteer to participate in a pilot project.[597] The pilot project is intended to assess how implementation of the Standard could be achieved in a given developing country in an efficient manner. It would occur in the following steps: (1) selection of participants; (2) initial feasibility study; (3) preparation of action plan; (4) implementation of action plan; (5) feedback. Each step would build on the experience gained and feedback received from the prior steps. A pilot project would be designed in close consultation with the developing country and the developed country participants to ensure that the country's specific needs are taken into account.

Fourth, developing countries are expected to build capacity for the Standard in ways that are consistent with their domestic revenue mobilization needs and other tax administration reforms. This is referred to as "developing building blocks".[598] It is consisted of a series progressive steps

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[596] Ibid., at p.15.

[597] Ibid., at 15 and 27-31 (Annex 1: Global Forum Pilot Project Outline).

[598] ibid., at 16.

that a developing country chooses to commence the implementation process: a) understanding the Standard; b) consultation with the financial industry and other relevant private sector stakeholders; c) having legislation and internal agreements; d) technology and training.

Fifth, following successful completion of testing procedure, developing countries are expected to commence automatic exchange of information with their treaty partners.[599] The Global Forum has been tasked with developing a mechanism for monitoring and reviewing this implementation process.

Steps for the Global Forum:

The roadmap also sets out the following three main tasks for the Global Forum. The Forum is expected to carry out these tasks in partnership with other international and regional organizations such as the World Bank Group.[600]

Building awareness. The Global Forum indicates that its survey and other consultations have demonstrated a lack of awareness of the new Standard and its benefits amongst developing countries. Therefore, the Global Forum tasked its AEOI Group to increase awareness of the new Standard and its benefits for developing countries.[601] This includes encouraging more developing countries to participate in the AEOI Group, and holding annual Competent Authority meetings to create an opportunity for sharing experience and training between tax officials.

[599] Ibid., p.19.

[600] Ibid., Paragraphs 60-70, at 19-20.

[601] Ibid., pp.19-20.

Producing and disseminating resource materials. The Global Forum also undertakes creating resource and training materials, and to hold training events. It can also provide advisory services, to advise on draft legislation and best practices.[602]

Administering and conducting pilot projects. The Global Forum is also expected to administer and conduct pilot projects in consultation with the World Bank Group and other interested partners, and the G20 Development Working Group. The pilot project essentially matches a developing with a developed country in order to test the actual exchange mechanism on a temporary and non-reciprocal basis. The Forum anticipates that this would raise awareness amongst developed countries as to how they can support developing countries in their progressive implementation of the Standard.[603]

Steps for the G20 and other developed countries

In the Roadmap, the Global Forum makes a number of recommendations for the G20 and other developed countries to support developing countries in implementing the Standard. They include to encourage all jurisdictions to join the Global Forum and the Multilateral Convention; to create awareness to AEI by holding regional forums, to consider spontaneously sharing of aggregate or detailed data with a specific developing country, to deploy resources, funding, technology packages, and send staff to a developing country tax administration that is implementing the Standard.[604]

[602] Ibid., at 20.

[603] Ibid., at 20.

[604] Ibid., at 21-23.

The Global Forum's Roadmap appears a good starting point to consider developing countries' integration into the process. However, in its current form, the Roadmap makes fairly demanding and resource-intensive recommendations for developing countries to implement the Standard,[605] while it prescribes fairly minimal and formalistic recommendations for the G20 and other developed countries to support developing countries in the process.[606] None of these recommendations, however, address the reciprocity, bilateralism, confidentiality (*see* Section 5.3.2.2)) concerns that have been raised by developing countries and international NGOs on the Standard.

5.3.4 A proposed solution: mandatory preliminary disclosure of aggregate data

As discussed in the preceding sections, an automatic exchange of information system helps to maintain the integrity of tax system. However, the biggest noted challenges of implementing automatic exchange of information regime in developing countries are their limited financial, administrative, and technological capacities to implement the system. Even if they can overcome these obstacles, there is often another significant obstacle: a reluctance mainly at the level of political elite to join the system the reason of which is fairly clear for most people. Thus, the problem is multifaceted and requires thorough consideration.

However, there is one possible solution that may mitigate or even resolve some of the discussed problems. It involves neither providing direct financial support, nor immediate technical

[605] Ibid., Paragraphs 41-59, at 14-19.

[606] Ibid., Paragraphs 71-79, at 21-23.

assistance, but providing a genuine motivation and confidence to developing countries to take part in the emerging automatic exchange of information regime.

When discussing possible steps for the developed countries to support developing countries' participation in the new standard, the Global Forum recommends stakeholders to consider spontaneous sharing of aggregate data with a specific developing country.[607] This essentially means that a developed country partners with a developing country and would inform the developing country on the aggregate value of accounts held in its financial institutions by the residents of the latter country. The Global Forum notes that such spontaneous transfer of aggregate data would be voluntary and occurs to the extent that the recipient country would adhere to the Standard's requirement on confidentiality and data protection.[608] The alleged purpose of such unilateral actions is a) to demonstrate developing countries the possible revenue benefits of automatic exchange of information; b) to increase the prioritization of automatic exchange of information; and finally c) to elicit political commitment for cooperation from developing countries.[609]

Even though such cooperation would be extremely beneficial for any recipient country (i.e. not only for developing countries), one may wonder if countries have sufficient motivation to initiate such actions voluntarily. It is naïve to believe that a country would come out to voluntarily disclose or share with another country an aggregate value or number of accounts held in its financial institutions by the latter's residents. In practice, such voluntary and spontaneous

[607] Ibid., Paragraph 74, at 22.

[608] Ibid., Paragraph 75, at 22.

[609] Ibid., Paragraph 74, at 22.

transfer of massive information occurred only when the information in question related to accounts held in third countries.[610] Thus, the initiator or the data transferring countries were in a relatively neutral position with respect to the information shared and the potential implications of the transfer.

Overall, it is highly unlikely that a country will initiate such aggregate data transfer voluntarily when the information concerns non-resident accounts held in financial institutions in its own territory. However, such self-disclosure is essential. This is actually what the whole automatic exchange of information system is about. The automatic exchange of information system requires countries to self-report certain tax-relevant information of non-residents obtained from their financial institutions to these non-residents' countries of domicile. In fact, the automatic exchange of information system goes one step further than the aggregate data sharing by requiring countries to self-report detailed asset and identification information on a regular basis.

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[610] In the summer of 2007, a computer technician of a Lichtenstein bank, LGT, sold the German tax authorities CDs with customer data stolen from the bank. The CDs contained confidential information on thousands of German and non-German residents suspected of holding millions of euros in undeclared accounts with the bank. Germany paid the informant roughly €4.2 million in remuneration and shared the information spontaneously with the tax authorities of other countries such as Belgium, Denmark, Greece, Ireland, Italy, Norway, and Sweden. This has broken open one of the massive tax evasion investigations across the globe. See C. Dougherty & M. Landler, "Tax Scandal in Germany Fans Complaints of Inequity " New York Times (18 February 2008).

Another similar case was the UBS scandal. In April 2007, Brad Birkenfeld, a former U.S. employee of a Swiss bank, UBS, delivered the US Internal Revenue Service (IRS) a stolen bank data from the bank in Switzerland. The US government shared some of the data with relevant foreign governments. See L. Saunders & R. Sidel, "Whistleblower Gets $104 Million" The Wall Street Journal (11 September 2012).

In 2008, a former employee of the Geneva office of HSBC, Hervé Falciani, offered the French government confidential bank data concerning about 130,000 customers of HSBC. Acquiring the information, France's finance minister, Christine Lagarde, shared the list with other countries including Germany, Greece, Italy, and the US. This list was often referred to as the "Lagarde list". On the strength of the information provided, HBSC was forced to pay a $1.9 billion settlement fee to the US government. See Martin Hesse, " Swiss Bank Leaker: 'Money Is Easy to Hide'" Spiegel International (16 July 2013).

Since most developing countries may not be yet ready for such automatic exchanges, the public disclosure of aggregate data appears as an appropriate venue to begin the transition. In other words, countries must begin to make preliminary public disclose of aggregate value of accounts held in their financial institutions by the residents of other countries. Such disclosure of aggregate data must be required at least from all countries labeled as tax havens and secrecy jurisdictions, and at least, in relation to developing countries (because most developed countries have already entered or would soon enter into automatic exchange of information agreement with most tax havens. This may eliminate the need for such disclosures with respect to developed countries). The disclosure must be mandatory whether a particular developing country requests for it or not.

This sounds an overwhelming and unreasonable demand on tax havens and secrecy jurisdictions. However, when we consider this proposition in comparison with the new Standard and its requirements, this proposition appears more, or at least, equally reasonable.

First, the Standard requires countries to collect detailed information about accounts held by non-residents in their financial institutions and transfer it to the account holders' countries of residence. However, the public disclosure of aggregate data does not involve detailed information, nor does it involve its actual transfer. What it requires is the preliminary public disclosure of the overall value of potentially reportable accounts to relevant jurisdictions. Thus, it entails neither confidentiality, nor privacy implications at this stage.

Second, most tax havens have or will soon have access to such information by virtue of the OECD' Common Standard on Reporting and Due Diligence for Financial Account Information

(CRS) that they have consented or would soon consent to implement. The CRS requires countries to have necessary legislative and administrative mechanisms in place to ensure availability of relevant information and government's access to such information through its financial institutions. If such information is already available to tax authorities of source countries by virtue of CRS, then the only thing that the countries do is to aggregate, package, and disclose the data country-by-country.

Overall, the policy of preliminary disclosure of aggregate data is consistent with the G8 countries' declaration made to developing countries in their 2013 Lough Erne Summit. Then, the G8 countries declared, "developing countries should have the information and capacity to collect the taxes owed them – and other countries have a duty to help them".[611]

Such public disclosure of aggregate data would be a tremendous help for developing countries. It would give them an unparalleled motivation and necessary confidence to speed up the process of joining in the emerging regime. It also resolves the situation where a developing country's government is reluctant to engage in automatic exchange of information. Such aggregate data disclosure would expose such governments to immense pressure from their general public and from international community to take action. Thus, the proposed regime would serve as a driving force for developing countries to fight against corruption, illicit capital flows, and offshore tax evasion.

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611 *G8 Lough Erne Declaration* (Northern Ireland, Lough Erne 2013). The text of the Declaration can be found online at http://www.g8.utoronto.ca/summit/2013lougherne/lough-erne-declaration.html

Finally, it would also provide an opportunity for the developed world to demonstrate that it does genuinely care about these countries' development and progress, resolving much distrust and skepticism, and bringing international cooperation to a new level.

5.3.5 Concluding remarks

The current studies indicate that developing countries suffer significantly from illicit capital flight and offshore tax evasion. The emerging automatic exchange of information regime has a great potential to address these problems. However, there is a legitimate concern that in their current capacities most developing countries may not be able to participate in the new regime due to their budgetary, administrative, and technological constraints. Some rigid eligibility requirements in the new Standard and persistent bilateralism within and beyond the Multilateral Competent Authority Agreement contribute to these obstacles. These certainly lead to the marginalization of more than 140 countries from the new international tax regime. Thus, there is a risk that what is intended to become a global standard may not become really so. Overall, there is a possibility that not only might the original offshore tax evasion problem remain unresolved but also the countries, which have initiated the regime, might themselves become the victims of the initiative due to potential transfer of the assets to non-participating jurisdictions.

There is one possible venue to effectively integrate the developing world in the emerging regime.

The G20 and the OECD must convince all secrecy jurisdictions to make a public disclosure of the aggregate value of potentially reportable accounts held by the residents of developing countries in their financial institutions. Such preliminary disclosure is made ideally for each developing country, or at least, for some of them determined based on some legitimate criteria (e.g. Global Forum membership).

The implications of such disclosure would be immense for the developing world: it gives them an unparalleled motivation and necessary confidence to join the emerging system and to begin automatic exchange of information. It also resolves the lack of political will in some developing countries to engage in automatic exchange of information. The preliminary public disclosure of aggregate data would expose such governments to immense pressure from their general public and from international community to take action. Overall, it would provide a faster and more inclusive venue to achieve automatic exchange of information system and transparency on a global scale.

5.4 Automatic exchange of information and taxpayer confidentiality

When the new OECD Standard on automatic exchange of financial account information takes effect, the volume and scope of information exchanges between states substantially increase compared to the existing standard of information exchange "upon request".[612] Under the new standard, participating countries are expected to automatically and routinely transfer personal details (e.g. name, date and place of birth, address, tax identification number) and financial information (e.g. account number, account balance or value, types and amounts of income credited to the account during the relevant period) of non-residents who hold accounts in their financial institutions to their countries of residence.[613] Thus, there will be massive potentially

[612] An exchange of information "upon request" refers to a situation where the tax authority of one jurisdiction, under the provisions of a tax treaty or TIEA, asks for particular information concerning its taxpayer from the tax authority of another jurisdiction where such information is located. However, the information request must meet "Foreseeable relevance" requirement. That is, the information request must be made with the greatest degree of specificity regarding the taxpayer(s) about whom the information is sought. There is often an official checklist of items that a requesting state generally has to provide in order to meet this requirement: a) name of taxpayer (for individuals and legal entities); b) Registration number (in the case of a legal entity); c) tax identification number and address (to the extent known); d) statement of the information sought, including its nature; e) tax purpose for which the information is sought; f) reasons for believing that the information sought is held by the requested party or is in the possession or control of a persona within the jurisdiction of the requested party; g) name and address of any person believed to be in possession of the requested information (to the extent known); h) a statement that the requesting party has pursued all means available in its territory to obtain the information, except those giving rise to disproportionate difficulties. The primary shortcoming of the standard is that the requesting jurisdiction must possess specific and detailed information regarding the taxpayer in question to be able to make an information request; otherwise, the request could be denied for being a "fishing expedition". The term fishing expedition is metaphoric. It generally refers to unspecified information requests. See OECD, *Overview of the OECD's Work on Countering International Tax Evasion* (France: Paris OECD, 2009). See also Paragraph 5 of the Manual on the Implementation of Exchange of Information Provisions for Tax Purposes in the OECD Model Double Taxation Convention.

[613] The OECD's Common Reporting Standard (2014), Section 1(A). The document can be found online at http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/standard-for-automatic-exchange-of-financial-account-information-for-tax-matters_9789264216525-en#page31

sensitive taxpayer personal and financial information constantly flowing between national tax authorities around the world.

As the volume and frequency of information exchange increase, the possibility of misuse or abuse of this information increases. As a result, taxpayer privacy and confidentiality would become a major concern. This may eventually force taxpayers to feel deeply protective of their information from the new system. This raises some important questions as to what extend confidentiality and safety of the exchanged information is protected under the emerging automatic exchange of information system; whether there will be mechanisms that adequately assure the confidentiality and safety of exchanged information; how these mechanisms work; and finally, how they can be improved. In this section I explore these questions.

5.4.1 Concept and purpose of taxpayer confidentiality

5.4.1.1 Concept of taxpayer confidentiality

Today privacy is not anymore a valid excuse for taxpayers or third parties to refuse tax authorities' requests for disclosure to the extent that such information is necessary for proper application of taxes;[614] nor it is a valid justification for countries to refuse transferring tax-relevant information of non-residents to their countries of residence.[615] The international tax system is moving in a direction where a government has fairly unfettered access to its resident taxpayers' financial information regardless of where it is located.

[614] Sharman. *Supra* note 507 (Sharman notes that the right to financial privacy has been substantially eroded due to fiscal objectives and this is justified on the grounds of a "nothing to hide, nothing to fear' logics).

[615] Sasako. *Supra* note 217 (Sasako argues that the tradition of banking secrecy has come to an end in fiscal context. He derives this conclusion from recent attacks on Swiss banking secrecy); Szarmach. *Supra* note 208.

This tendency has many privacy implications, some of which have been extensively discussed by Blum, Christians, Cockfield, Kristoffersson, Sharman in their recent scholarly works.[616] These scholarly works focus on the privacy implications of the taxpayer information disclosure to tax authorities for the purpose of exchange. Another immediate concern, however, is how to ensure that the taxpayer information that has been obtained by governments, more precisely by tax authorities, under the new automatic exchange of information regime is adequately protected from unauthorized use, disclosure, or abuse. In other words, how the confidentiality of the reportable or reported information is ensured in the hands of competent authorities.

Confidentiality generally refers to a relationship in which the information communicated between parties is kept in confidence. This relationship is based on the recognition that persons who are entrusted with information ought, as a general principle, to respect that trust. In practice, such confidentiality and trust relationship may be established based on ethical duty, contract, or statutory requirement.[617] Taxpayer confidentiality generally belongs to the latter category; generally it is protected under legislative and statutory schemes.

[616] Arthur Cockfield, "FATCA and the Erosion of Canadian Taxpayer Privacy" (2014) Report to the Office of the Privacy Commissioner of Canada, at 11-17 (the author discusses some undesired privacy implications of FATCA Intergovernmental agreement in the Canada – the US context); Sharman. *Supra* note 477; Arthur Cockfield & Allison Christians, "How the U.S. Pulled off the Great Canadian Privacy Giveaway" Globe and Mail (10 April 2014). Available at http://www.theglobeandmail.com/globe-debate/how-the-us-pulled-off-the-great-canadian-privacy-giveaway/article17916327/; Blum. *Supra* note 180 (Blum argues that concerns about financial privacy should be balanced with fiscal objectives. The concern should be to have strong safeguards to ensure that the received information is not misused by governments); Eleonor Kristoffersson, "Tax Secrecy and Tax Transparency : the Relevance of Confidentiality in Tax Law" (2013).

[617] R. G. Toulson & Charles Phipps, *Confidentiality*, Third edition ed. (UK, London: Sweet & Maxwell, 2012), at 15-16, 24, 47.

The notion of confidentiality often accompanies with the notion of privacy.[618] At first glance, they appear interchangeable. However, confidentiality is different from privacy in that the latter generally refers to a “claim of an individual to determine what information about himself or herself should be known to others”.[619] Confidentiality, on the other hand, constitutes a relationship, in which the person to whom some of this private information is disclosed, takes ethical, contractual, or statutory obligation to keep them in confidence. Hence, the confidentiality is essentially a full or partial recognition of the other person’s privacy claims and affording them a necessary protection. Thus, we can describe confidentiality as a mechanism through which some privacy claims become rights under ethical, contractual arrangements, or statutory rules.

However, it must be noted that no obligation of confidentiality can be said to be absolute in all circumstances.[620] Contracts and statutory provisions generally include exemptions in which the confidentiality may be lifted. Public interest is one of such exceptions. Broadly speaking, any measure that has been taken for the purpose of protecting public interest may override the confidentiality arrangements.[621]

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[618] States United & Paperwork Commission on Federal, "Confidentiality and Privacy a Report of the Commission on Federal Paperwork" (1977); Mark A. Rothstein, *Genetic Secrets: Protecting Privacy and Confidentiality in the Genetic Era* (New Haven: Yale University Press, 1997).

[619] Alan F Westin, "Social and Political Dimensions of Privacy" (2003) 59:2 Journal of Social Issues, at 431.

[620] Rose-Marie Belle Antoine, *Confidentiality in Offshore Financial Law*, 2 ed. (Oxford; New York: Oxford University Press, 2014), at 21.

[621] Cynthia Blum, "Sharing Bank Deposit Information with Other Countries: Should Tax Compliance or Privacy Claims Prevail?" (2004) 6:6 Florida Tax Review 579; Osita Mba, "Transparency and Accountability of Tax Administration in the UK: The Nature and Scope of Taxpayer Confidentiality" (2012):2 British Tax Review, at 199; Joseph J Darby, "Confidentiality and the Law of Taxation" (1998) 46 Am. J. Comp. L. Supp.

5.4.1.2 Rationales for protecting taxpayer confidentiality

Generally, tax authorities possess more private information about more persons than any other government agency. They are essentially repositories of people' personal information consisting of their personal and financial records (e.g. names, date of birth, marital status, children, address, occupation, assets, revenues, expenses, incomes, losses) for any given period for which tax reporting is made. These items of information can easily reveal who the taxpayers are; what they do; what they have or own; and finally how they obtained them. As Professor Arthur Cockfield argues such detailed personal information can also be used, if necessary, to construct a detailed profile of a person's identity, including her religious beliefs, political alliances, and personal behaviors.[622] Therefore, it may be dangerous for individuals as well as for businesses if such information is inappropriately disclosed or used.

For individuals, such disclosure may entail personal safety issues: political oppressors, blackmailers, and kidnappers may use such information to harass their victims. Or at least, the disclosure of such information may change other peoples' attitudes to the person in a way that the person does not want (e.g. marginalization, favouritism, or undesired popularity or unpopularity). For business, inappropriate disclosure of its confidential information may cost unfair competition. Its competitors may use the obtained information to get business advantages that they would not have gotten if the information had been kept secret.[623]

[622] Arthur Cockfield, "Protecting Taxpayer Privacy Rights Under Enhanced Cross-Border Tax Information Exchange: Toward a Multilateral Tax-Payer Bill of Rights" (2009) 42:2 University of British Columbia law review, at 437-438.

[623] Jon E Bischel, "Protection of Confidential Information in Tax Matters" (1993) 19 Int'l Tax J., at 60-62.

Confidentiality of tax information is also considered to be one of the essential pillars of building and developing trust and collaboration between government and taxpayers. If taxpayers do not have confidence in their tax administration, which potentially handles their sensitive financial information, they may feel deeply reluctant to share it.[624] As a result, voluntary compliance may be jeopardized. This problem may aggravate when taxpayers view the tax administration as a resource centre for a variety of other interests.[625] In such cases, the taxpayers may be worried to provide their financial information fearing where the supplied information might ultimately land or for what purposes it may be used.

Overall, ensuring confidentiality of taxpayer information and using it only for appropriate and stated purposes allow for a more collaborative way of working between taxpayers and tax administrations.

5.3.2 Confidentiality rules applicable in international exchanges of tax information

Confidentiality of taxpayer information has always been a fundamental principle of international tax information exchange relations. The existing exchange of information provisions of double tax conventions (TCs), tax information exchange agreements (TIEAs), the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention), and

[624] Andrew Goodall, "MPs Ask HMRC to Justify Taxpayer Confidentiality " (14 October 2014). Available at http://www.accountingweb.co.uk/article/mps-ask-hmrc-justify-taxpayer-confidentiality/566738?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+co%2FFxiZ+%28AccountingWeb+UK+-+All%29

[625] Office of Tax Policy Department of the Treasury, *Scope and Use of Taxpayer Confidentiality and Disclosure Provisions* (US, Washington DC: Office of Tax Policy Department of the Treasury, 2000).

the Nordic Convention on Mutual Assistance in Tax Matters (Nordic Convention),[626] all generally contain confidentiality requirements. They are included in Article 26(2) of the OECD Model Tax Convention; Article 8 of the OECD Model Agreement on Exchange of Information on Tax Matters; Article 22 of the Multilateral Convention, and Article 21 of the Nordic Convention.

5.3.2.1 Taxpayer confidentiality under TCs

The OECD Model Tax Convention sets out certain confidentiality rules applicable to international information exchanges under double tax treaties. Paragraph 2 of Article 26 of the Model tax Convention (2014 update) states:

> *Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws*

[626] Article 21 of the Nordic Convention ("With respect to any inquiries, information, statements and other communications supplied to one of the Contracting States in accordance with this Convention, the provisions of the laws of that State concerning secrecy shall apply").

of both States and the competent authority of the supplying State authorises such use.[627]

Hence, the Model Tax Convention requires that taxpayer information received by a competent authority must be treated as secret in the same manner as taxpayer information obtained under the receiving jurisdiction's domestic laws. The disclosure of such information is restricted to persons and authorities (including courts and administrative bodies) involved in assessment, collection, administration, or enforcement of covered taxes, or in related prosecutions, appeals and oversights. These persons or authorities can use the supplied information only for such purposes.

However, in certain circumstances this condition may undesirably limit the usefulness of the information and the receiving country's ability to use it for other legitimate purposes (e.g., to combat money laundering, terrorism financing, corruption). Therefore, the 2014 update on the OECD Model Tax Convention added an exemption clause to the confidentiality provision.[628] The new clause essentially allows the receiving state to use of the supplied information for other than tax enforcement purposes when two conditions are satisfied: (a) such use is authorized by both competent authorities; and (b) the laws of both states permit such use. This allows the tax administration of an information receiving state to share the received information with other government agencies and judicial authorities in that state for other than tax purposes. The

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[627] The OECD Model Tax Convention on Income and Capital (updated in 2014). The document is available at http://www.oecd.org/ctp/treaties/2014-update-model-tax-convention.htm

[628] The OECD Model Convention on Taxation of Income and Capital with commentaries (updated in 16 July 2014), Commentary 12.3 to Article 26(2). The document is available at http://www.oecd.org/ctp/treaties/2014-update-model-tax-concention.pdf

Commentary to the OECD Model Tax Convention (the 2014 update) clarifies that when a receiving state desires to use the information for an additional purpose, it should specify to the supplying state the other purpose for which it wishes to use the information and confirm that the receiving state can use the information for such other purpose under its laws.[629]

Finally, a party to a double tax convention may generally suspend the information exchanges if the other party does not adhere to the confidentiality rules or if there has been a breach of the rules and the supplying state is not satisfied that the situation has been appropriately addressed by its treaty partner after its remark.[630]

5.3.2.2 Taxpayer confidentiality under TIEAs

TIEAs contain similar confidentiality rules as in TCs. Article 8 of the OECD Model Tax Information Exchange Agreement stipulates:

> *Any information received by a Contracting Party under this Agreement shall be treated as confidential and may be disclosed only to persons or authorities (including courts and administrative bodies) in the jurisdiction of the Contracting Party concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by this Agreement. Such persons or authorities shall use such information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. The information may not be disclosed to any other person or*

[629] Ibid.

[630] Ibid.

entity or authority or any other jurisdiction without the express written consent of the competent authority of the requested Party.[631]

The formulation of the confidentiality provisions of the OECD Model TIEA is fundamentally similar to that of the OECD Model Tax Convention. Both require that the information received must be treated as confidential. They also establish the allowed purposes of disclosure and the scope of persons to whom the information can be disclosed.

However, the confidentiality provisions of the OECD Model TIEA do not make reference to the domestic law of the receiving state as the OECD Model tax Convention does. The Model TIEA implicitly deduces that the receiving county have laws and safeguards in places to ensure the confidentiality of the supplied information and thus, the country treats the received information as secret in the same manner as taxpayer information obtained under its domestic laws. The OECD Model TIEA also does not have express provisions or conditions under which the supplied information can be used for non-tax purposes in the receiving country. It simply state that the information may not be disclosed to any other person or entity or authority or any other jurisdiction without the express written consent of the competent authority of the information supplying party.

[631] The OECD Model Agreement on Exchange of Information on Tax Matters (2002). The document is available at http://www.oecd.org/ctp/exchange-of-tax-information/2082215.pdf

5.3.2.3 Taxpayer confidentiality under the Multilateral Convention

The Multilateral Convention on Mutual Administrative Assistance in Tax Matters provides one of the most comprehensive and stricter confidentiality provisions for international information exchanges. Article 22 of the Multilateral Convention (2011 update) stipulates:

> *Any information obtained by a Party under this Convention shall be treated as secret and protected in the same manner as information obtained under the domestic law of that Party and, to the extent needed to ensure the necessary level of protection of personal data, in accordance with the safeguards which may be specified by the supplying Party as required under its domestic law.*
>
> *Such information shall in any case be disclosed only to persons or authorities (including courts and administrative or supervisory bodies) concerned with the assessment, collection or recovery of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, taxes of that Party, or the oversight of the above. Only the persons or authorities mentioned above may use the information and then only for such purposes. They may, notwithstanding the provisions of paragraph 1, disclose it in public court proceedings or in judicial decisions relating to such taxes.*
>
> *If a Party has made a reservation provided for in sab-paragraph a. of paragraph 1 of Article 30, any other party obtaining information from that Party shall not use it for the purpose of a tax in a category of tax subject to the reservation. Similarly, the*

> *party making such a reservation shall not use information obtained under this Convention for the purpose of a tax in a category subject to the reservation.*
>
> *Notwithstanding the provisions of paragraphs 1,2 and 3, information received by a Party may be used for other purposes under the laws of the supplying Party and the competent authority of that Party authorizes such use. Information provided by a Party to another Party may be transmitted by the latter to a third Party, subject to prior authorization by the competent authority of the first mentioned Party.*[632]

Hence, the Multilateral Convention includes all the general confidentiality rules as in the OECD's Model Tax Convention and the Model TIEA and add the following provisions and conditions.

The Multilateral Convention requires that the information received by a competent authority must be treated as secret in the same manner as taxpayer information obtained under the jurisdiction's domestic laws, **and to the extent needed to ensure the necessary level of protection of personal data, in accordance with the safeguards which may be specified by the supplying party as required under its domestic law**. Hence, when attempting to ensure the confidentiality of exchanged information, the Multilateral Convention not only refers to the receiving country's relevant domestic laws, but also to that of the supplying country. It essentially requires that the confidentiality law that is applicable to the exchanged information is the one that is more restrictive of the laws of the information supplying and receiving states.

[632] The Multilateral Convention on Mutual Administrative Assistance in Tax Matters as amended by the 2010 Protocol, Article 22. The document is available at http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/the-multilateral-convention-on-mutual-administrative-assistance-in-tax-matters_9789264115606-en#page24

Here, the Multilateral Convention attempts to addresses a situation where the laws of the jurisdiction receiving the information do not provide adequate confidentiality protection for the received information or where the level of protection in the receiving state is below the level of protection afforded by the state, which has supplied the information. The Multilateral Convention makes clear that in such situations, to the extent needed to ensure the necessary level of protection of personal data, the safeguards that may be required to ensure data protection under the domestic law of the information supplying party may apply, if these conditions are more restrictive.

The explanatory notes to the Multilateral Convention states that such safeguards, for example, may relate to individual access, independent oversight, or redress. It also clarifies that the specifications of the safeguards may not be necessary if the supplying party is satisfied that the receiving party ensures the necessary level of data protection with respect to the data being supplied. In any case, these safeguards should not go beyond what is needed to ensure data protection.[633] This extra layer of requirements is absent in the OECD's Model Tax Convention and the Model TIEA.

Another interesting aspect of the confidentiality rules under the Multilateral Convention relates to its express provision on the possibility of transmission of the information by receiving party to third state. As its name denotes the Convention is multilateral. Therefore, it attempts to address a situation where information supplied by one member country to another would be of interest to a third member. As a default rule, the Multilateral Convention does not allow the information

[633] Explanatory note (216) to Article 22(1) of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (updated in 2011).

received by one party to be transmitted to a third state. However, as an exception, the Convention opens up the possibility of such transmissions subject to prior authorisation by the competent authority of the party supplying the information.[634] This preauthorization requirement is intended largely to avoid a situation where the third state would obtain the information, which it could not obtain it directly from the first party.

When discussing the confidentiality provisions of the OECD Model Tax Convention, the OECD Model TIEA, and the Multilateral Convention, it is also worthwhile to emphasize that in 2012 the OECD released a guide on the protection of confidentiality of information exchanged for tax purposes "Keeping it Safe", which sets out best practices related to confidentiality and provides practical guidance on how to meet an adequate level of protection for all forms of information exchanged under tax treaties, TIEAs, and the Multilateral Convention.[635] We also need to note that during the past few years the International Organization for Standardization (ISO) and the International Electro-technical Commission (IEC) also created certain technology standards for the secure storage and transmission of bulk data across borders.[636] They established international standards on information security management, risk control, data encryption, and decryption.

[634] Article 22(4) of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (updated in 2010).

[635] OECD/Global Forum, *Keep It Safe: Joint OECD/Global Forum Guide on the Protection of Confidentiality of Information Exchanged for Tax Purposes* (France: Paris: OECD/Global Forum on Transparency and Exchange of Information for Tax Purposes, 2012).

[636] Available online at http://www.iso.org/iso/home/standards/management-standards/iso27001.htm

5.3.3 Confidentiality rules applicable in automatic exchanges of information

5.3.3.1 Taxpayer confidentiality in automatic exchanges of information

When discussing the confidentiality rules applicable in automatic exchanges of information, it is appropriate to analyse the new OECD "Standard on Automatic Exchange of Financial Accounts Information in Tax Matters" introduced in 2014 and its relevant rules. The Standard contains two documents: the Common Reporting Standards (CRS) and the Model Competent Authority Agreement (OECD Model CAA). The Model CAA, particularly its Sections 5 and 7, contain some rules and principles relevant for our discussion.

Here we should note that the CAA, by its very nature, is an administrative agreement that derives its authority from the exchange of information provisions of the Multilateral Convention (i.e. Section 1) and double tax conventions (i.e. Article 26). It is designed merely to operationalize the automatic exchange of information provisions of these international frameworks. Therefore, all the confidentiality rules applicable to information exchanges under the Multilateral Convention (*i.e.* Article 22) and double tax conventions (Article 26(2)) also apply for the automatic exchanges of information under the CAA. However, the CAA adds some more requirements on confidentiality specifically applicable for automatic exchanges under these legal frameworks.[637]

A basic rule under the Standard is that, a state has no obligation to automatically extend tax information to its treaty partner unless the latter ensures that it has a comprehensive system of administrative, technical, and physical safeguards designed to adequately protect the

[637] *OECD Standard for Automatic Exchange of Financial Account Information in Tax Matters (with commentaries)* (France: Paris OECD, 2014). See the Commentary to Section 5 of the Model Competent Authority Agreement (MCAA).

confidentiality of the exchanged information.[638] Section 5 of the OECD Model CAA reads as following:

> *All information exchanged is subject to the confidentiality rules and other safeguards provided for in the* [Convention]/[Instrument]*, including the provisions limiting the use of the information exchanged and, to the extent needed to ensure the necessary level of protection of personal data, in accordance with the safeguards which may be specified by the supplying Competent Authority as required under its domestic law.*
>
> *Each Competent Authority will notify the other Competent Authority immediately regarding any breach of confidentiality or failure of safeguards and any sanctions and remedial actions consequently imposed.*

The OECD Commentaries on the Model CAA defines such safeguards as measures necessary to meet the security requirements for information exchange. They stipulate 3 building blocks (a) the legal framework; (b) information security management: practices and procedures; and (c) monitoring compliance and sanctions to address a breach of confidentiality.[639]

Legal Framework. The Commentary stipulates that the treaty partner must have a legal framework to protect the confidentiality of taxpayer information and provide for purposes for

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[638] Section 7(2) of the OECD Model Competent Authority Agreement (2014). Available at http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm

[639] Ibid. Commentary to Section 5(2), Paragraph 7, at 83.

and specific and limited circumstances under which such information can be disclosed. The domestic law must also impose significant penalties for the breach of the confidentiality.[640]

Information Security Management: Practices and Procedures. The Commentary to Article 5 of the OECD Model CAA also states that the treaty partner must have practices and procedures in place to ensure that the exchanged information is not disclosed to persons and government authorities that are not engaged in the assessment, collection, administration, or the enforcement of covered taxes, or in related prosecutions, appeals or oversight.[641] Furthermore, the domestic law must ensure that individuals in positions of authority and access the relevant information are trustworthy and meet security criteria, and their access privileges must be appropriately managed and monitored. They must be screened for potential security risk to help ensure that they responsibly handle the information and do not present a security risk. It also requires that as long as employees continue to have access to data, annual or more frequent training must continue. Procedures must exist for quickly terminating access to confidential information for employees who leave or who no longer need access to the information to ensure confidentiality of information. The obligation to maintain tax secrecy should continue after the end of the employment relationship. Tax authorities are also required to have security measures in place to restrict entry to the premises where they store and maintain the relevant information. Such measures may include the presence of security guards, security passes, or coded entry systems for the employees.[642]

[640] Ibid. The Commentary on section 5(2), Paragraphs 8-10, at 82.

[641] Ibid. The Commentary on section 5(2), Paragraphs 11, at 83.

[642] Ibid. The Commentary on Section 5(2), Paragraphs 13-17, at 83-84.

Monitoring Compliance and Sanctions. The Commentary recognizes that having the domestic laws on confidentiality in place itself is not adequate, unless the competent authorities in fact enforce these laws, impose applicable civil penalties and criminal sanctions against those who violate them.[643]

Finally, under the OECD Model CAA, each competent authority has the obligation to notify the other competent authority immediately any breach of confidentiality or failure of safeguards including any sanctions and remedial actions consequently imposed. Non-compliance with confidentiality and data safeguard provisions would be considered significant non-compliance and may result in immediate suspension of the CAA.[644]

5.3.3.2 Safeguards against government misuse of the exchanged information.

One of the biggest confidentiality concerns in automatic information exchanges is the possibility that government itself may use the supplied information for improper purposes. For example, a government may use the supplied information to harass political opposition. In such cases, the automatic exchange of information may in fact contribute to the violation of human rights in the information-receiving jurisdiction. Therefore, states may want assurance that the information supplied to foreign governments would not be used for such purposes.

The Commentary to the Model CAA provides that information does not have to be supplied to another jurisdiction if the disclosure of the information would be contrary to the *ordre public* (public policy). The Model CAA borrows this interpretation from the language in Article 26(3)(c)

[643] Ibid. The Commentary on Section 5(2), Paragraph 34-35, at 87.

[644] Ibid. The Commentary on Section 5(2), Paragraph 6, at 81.

of the OECD Model Tax Convention and Article 21(2(d) of the Multilateral Convention.[645] The commentary notes that while it is rare to apply in the context of information exchange between competent authorities, certain jurisdictions may require their competent authorities to specify that information it supplies may not be used or disclosed in proceedings that could result in the imposition and execution of the death penalty or torture or other severe violations of human rights (such as for example when tax investigations are motivated by political, racial, or religious persecution) as that would contravene the public policy of the supplying jurisdiction.[646] Thus, there is no assurance against such misuse by the receiving country, unless the language of a competent authority agreement contains such restriction.

5.3.3.3 Evolving principles of taxpayer confidentiality

Based on our analyses of the relevant international legal frameworks in the preceding sections, we can develop some fundamental principles that govern taxpayer confidentiality in automatic exchanges of information:

Principle of Access Restriction – As a general rule, the access to taxpayer information supplied by one treaty partner to another is restricted only to persons who are involved in the assessment, collection, and enforcement of taxes or in related prosecutions, appeals and oversights in the latter country. In other words, once transferred, the information is generally not accessible by any other government authorities except tax administration and justice system (when there is a

[645] Ibid. The Commentary on Section 5(2), Paragraph 5, at 80.

[646] ibid.

prosecution or court proceedings).[647] However, even within that tax administration, the data is not freely accessible for all agents. The law generally restricts the access only to agents whose duties require access to such data, who undergo appropriate security checks, and who have necessary training to handle such confidential data. As an exception, the exchange of information mechanisms may allow the information receiving country to share the supplied information with its other law enforcement agencies but only when the domestic laws authorize such access and when the information supplying treaty partner consents to such dissemination. Under these circumstances, the receiving law enforcement agencies must treat that information received under the same terms applicable to the initial recipient agency (i.e. tax administration).

Principle of Purpose Restriction – As the name denotes, the first and foremost purposes of government collection of tax information is to administer its tax laws or to assist other countries in administering their tax laws. Therefore, as a default rule, the collected and exchanged information should be used only for assessment, collection, and enforcement of taxes. In international tax law, this principle is often referred to as the "principle of speciality".[648] It means that the information exchanged should be used solely for the purposes for which the information has been supplied. For example, in Canada, Section 13 of the Access to Information Act (1985) and Section 19 of the Privacy Act (1983) specifically provide that information received in

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[647] Robert Wood, "In 'Lost' Trove Of IRS Emails, 2,500 May Link White House To Confidential Taxpayer Data" Forbes (27 November 2014). Available at http://www.forbes.com/sites/robertwood/2014/11/22/lost-lois-lerner-emails-found-despite-no-backup-claims-irs-has-no-comment/ (The author talks about a recent controversy over an IRS official's alleged dissemination of taxpayer data to the White House officials).

[648] Ulrika Lomas, "Switzerland Commits To Automatic Tax Information Exchange " Tax News (10 October 2014). Available at http://www.tax-news.com/news/Switzerland_Commits_To_Automatic_Tax_Information_Exchange____66070.html.

confidence from a foreign government cannot be disclosed and used for non-tax purposes unless the foreign government consents to the disclosure.

However, in practice there are exceptions. Agencies within a government mechanism often collaborate and assist each other. Exchange of information between these agencies is an important part of such collaboration. For example, tax authorities may possess information that may be useful for another law enforcement purposes, e.g. public security, criminal investigation of anti-money laundering and terrorism cases. However, if government intends to use the collected information for other than tax purposes, it must statutorily determine the scope and limits of such additional uses and make the information supplying party aware of its intents at the time of entering into the information exchange agreement.

Principle of Accountability. The taxpayer confidentiality rules require accountability from those who work with the exchanged information. They confront disciplinary, administrative, or criminal penalties if they breach the confidentiality rules. The purpose of these penalties is to discourage breaches. As a result, the applicable sanctions are often severe. For example, in France, the penalty of the disclosure of secret information is punishable by one year's imprisonment and a fine up to EUR 15,000 under the Criminal Code. In Germany, public officials who breach tax secrecy can be punished by imprisonment of up to two years or by a fine. In New Zealand, legislation allows for up to six months of imprisonment, a fine of NZD 15,000 or both.[649]

[649] OECD/Global Forum. *Supra* note 653, at 17.

Principle of Proportionality. Proportionality is a general principle applicable in many areas of law (e.g. criminal law, administrative law, and constitutional law) as a criterion of fairness and justice. For example, in criminal law, the proportionality principle requires that a criminal punishment or a corrective measure imposed by law must be proportionate to the severity and the nature of a wrongdoing.[650]

In tax law, especially in tax information exchange relations, this principle can be used as a measure to establish the correct balance between the government's requirement for the taxpayer disclosure and the latters' right for privacy. In other words, government must demand, collect, and use only that information which is necessary to accomplish particular tax administrative purpose; the government must not demand information that is more than what it needs for such stated purpose.

The new OECD Standard on automatic exchange of financial account information anticipates the participating countries to exchange fairly large scope of potentially sensitive data about large number of taxpayers. However, the tax administration of receiving country may not yet need or be able to utilize all these supplied information. This may result in so-called "information inflation"[651] in the hands of the tax administration of the receiving country. This may potentially lead to the breach of taxpayer confidentiality.

Therefore, it is appropriate for the treaty partners not to demand more information than it can reasonably utilize or to establish some sort of central filter and data management center within

[650] Andrew Von Hirsch, "Proportionality in the Philosophy of Punishment" (1992) 16 Journal of Crime and Justice, at 55.

[651] George L Paul & Jason R Baron, "Information Inflation: Can the Legal System Adapt?" (2007) 13 Rich. JL & Tech.

their tax administration where all the supplied information from their treaty partner is collected, stored, sorted, and then passed to relevant tax agents and departments. Such internal filter mechanism may allow only the necessary categories of information to be transferred and used and keep the remaining information until the administration subsequently builds up its capacity to utilize such additional information. This mechanism can eventually allow the tax administration to adjust its information emission as its information processing capacities grow. Overall, this mechanism may serve as one additional safeguard to ensure taxpayer confidentiality.

5.3.3.4 Taxpayer notification

Discussions on international exchange of information often touch one more important question: whether a taxpayer has a right to be notified about the transfer of his or her tax-relevant information to a foreign government.[652] This right is often accommodated, with some restrictions, under the information exchanges upon request.

There are certain challenges to accommodate this right under the automatic exchange of information system. Under the automatic exchange of information system, the information exchanges occur on a routine basis. As a result, when the system is put in place and is publicly announced, taxpayers would generally know the type, scope, and frequency of information exchange between their country of residence and other countries. Moreover, the automatic exchange of information system functions more like domestic third-party reporting system under which employers, financial institutions, and other third parties have the obligation to regularly

[652] Christopher C Branson, "The International Exchange of Information on Tax matters and the Rights of Taxpayers" (2004) 33 Australian Tax Review. at 66-67; A. Quintas Seara & J.M. Calderón Carrero, "The Taxpayer's Right of Defence in Cross-Border Exchange-of-Information Procedures" (2014) 68:9 Bulletin for International Taxation.

report the government on their payments to the taxpayers. These parties generally have no *ex-ante* obligation to notify the relevant taxpayers about their information reporting to tax authorities except providing the relevant taxpayers *ex-post* notification thorough year-end tax information slips.

Therefore, due to the routine nature of the exchanges and systematic nature of the tax enforcement, which such information is used for, *ex-ante* taxpayer notification mechanism appears difficult, or even unnecessary in the automatic exchange of information system. However, it appears appropriate to consider *ex-post* notification mechanism as it exists in the purely domestic third-party reporting system. Under this proposed system, a financial institutions or local tax authority notifies non-resident accountholders on what data about them has been transferred to their countries of residence and for what period that data relates. However, there are some potential administrative challenges of this system due to the requirements of the Standard.

First, under the OECD Standard on Automatic Exchange of Financial Account Information in Tax Matters, as a general rule, the information exchanges occur nine months after the end of the calendar year to which the information relates.[653] Hence, by the time when the information has been transferred and the relevant notifications follow, the taxpayers might have already filed their residence country tax returns for the period. This questions usefulness of such *ex-post* notifications to the taxpayer. Therefore, the treaty partners need to consider the costs and benefits of such notification mechanism.

[653] The OECD Model CAA (2014), Section 3(3).

Second, under the OECD Standard, automatic exchange of information occurs between the competent authorities of contracting parties based on the information that the supplying country generally obtain from its financial institutions. Hence, there is a question of which body would be appropriate to perform the ex-post notification: would it be the financial institution or the tax authority of the supplying country, or the tax authority of the residence country?

At first glance, financial institutions appear to be an appropriate body to perform the taxpayer notification but they generally have no knowledge or control over when and which of their reported information will be actually transferred to foreign countries by their domestic tax authorities; neither they have accurate knowledge about to which foreign country that their tax authorities reports the particular information. Therefore, the tax authority of the supplying country appears to be in a better position to carry out the taxpayer notification, if any.

5.3.3.5 Potential issues

As it has been discussed in the preceding sections, under the automatic exchange of information system, it is critical that the jurisdiction, which is supplying information, receives assurance from the receiving jurisdiction that confidentiality of the supplied information will be upheld. This condition attempts to address a situation where the laws of the jurisdiction receiving the information do not provide adequate confidentiality protection for the received information. However, even when such protection is provided, the level of protection may be below the level of protection afforded for the information by the supplying country.

Therefore, the OECD Model CAA provides greater power to the contracting party supplying the information. It allows the supplying country to impose the receiving country the confidentiality requirements and safeguards established by its own laws if they are more restrictive. This rule essentially allocates the right to determine the scope and level of confidentiality rules applicable to the exchanged information to the authority of the country supplying the information. It is assumed that this mechanism will resolve the problem of confidentiality. However, in reality, this power reallocation mechanism may jeopardize the proper functioning of the automatic exchange of information system for the following reasons:

First, automatic exchange of information under the standard is intended to apply eventually on a global scale. That is, countries are ultimately expected to exchange financial account information with a large number of countries, if not with all other countries. When the current confidentiality rules are viewed with such a global system in mind, its implications appear somehow worrying. It means that the information receiving country might be required to meet often-divergent confidentiality requirements of multiple jurisdictions if it seeks to receive information from these jurisdictions.

Second, there is a long-running fundamental challenge in establishing effective international tax information exchange mechanism. In substance, states generally have interest in receiving tax information from other states but they generally have no interest in providing similar information in return. In fact, some countries' (i.e. secrecy jurisdictions) financial industry and economy depend so much on secrecy and confidentiality factors, more precisely, the confidentiality and secrecy protection that they provide for non-resident investors in the country. These countries have built their reputation on bank secrecy and confidentiality for decades[654] and their system

[654] Rose-Marie Belle Antoine, *Confidentiality in Offshore Financial Law*, 2 ed. (Oxford; New York: Oxford University Press, 2014), at 5-8.

would be clearly threatened if they commit to automatic exchange of information. Therefore, it is fair to say that their immediate self-interest dictates against information exchange. As a result, these jurisdictions and territories historically have taken every possible opportunity to oppose such initiatives.[655]

However, this time around most secrecy jurisdictions have joined or are compelled to join the automatic exchange system due to the international community's strong and unyielding demand for global transparency. In this context, the current confidentiality rules under the Standard may provide such jurisdictions with a new opportunity to avoid information sharing or to share information only with certain countries to which they are compelled to share information. Because the Standard has simply left the design and level of confidentiality rules applicable to the exchanged information to the authority of information supplying jurisdiction by allowing that treaty partner to specify the expected level of confidentiality for the supplied information as required under its domestic law.

This creates opportunity for the information supplying party to use the confidentiality provisions merely as an excuse to refuse or suspend information exchange with less influential but highly beneficiary countries by claiming that the treaty partner's legal frameworks cannot provide the same level of confidentiality available under its domestic laws. Some secrecy jurisdictions have already begun to emphasize this "myth of confidentiality".[656] For an average country, it is often

[655] OECD, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998), at 77.

[656] Nadia Fountain, "Riding the Waves of Change: Balancing Compliance with Confidentiality " IFC Review (1 January 2015). Available at http://www.ifcreview.com/restricted.aspx?articleId=8831&areaId=17

difficult or even unnecessary to compete with secrecy jurisdictions on the legal guarantees of confidentiality.

Overall, the current OECD mechanism attempts to address some potential problems surrounding taxpayer confidentiality by simply reallocating the authority to determine applicable rules from the information receiving party to the information supplying party without enough consideration that the latter may also abuse this authority.

The Standard must attempt to ensure consistency not only in the design and operation of automatic exchange of information system, but also in providing confidentiality protection for the exchanged information across all participating jurisdictions. To this end, the Standard must eliminate the existing imbalance of authority in determining confidentiality rules applicable to the exchanged information and provide an objective minimum standard for taxpayer confidentiality applicable for all participating countries. Such minimum standard must be designed to ensure necessary level of confidentiality protection for the exchanged information while eliminating possible opportunities for its abuse by self-interested parties.

5.3.4 Concluding remarks

The international exchange of tax information and the taxpayer confidentiality are inseparable matters. An enhancement in international information exchange must be followed by a corresponding enhancement in the protection and confidentiality of the exchanged information.

The main question is whether the international community can build an appropriate mechanism that promotes effective exchanges of tax information between states thereby enhancing global tax enforcement, while providing necessary level of confidentiality and protection for the exchanged information. The new standard attempts to shape such mechanism. It sets out some strict confidentiality requirements and safeguards. It provides that the taxpayer information received by a competent authority must be treated as secret in the same manner as taxpayer information obtained under the jurisdiction's domestic laws, and to the extent needed to ensure the necessary level of protection of personal data, in accordance with the safeguards which may be specified by the supplying party as required under its domestic law. By so doing, the standard essentially allocates the right to determine the scope and level of confidentiality rules applicable to the exchanged information largely to the authority of the information supplying country.

Although it is yet to be seen how these rules work out in practice, it is not difficult to anticipate that this mechanism poses some challenges. The fundamental problem is that countries generally have interest in receiving the relevant tax information from other countries but they have no immediate interest in providing it. Therefore, taking away the authority to determine the scope of confidentiality rule applicable to the exchanged information from the party that has a strong interest in receiving information and reallocating it to the party, which generally has no interest in providing it, has the potential to undermine the proper functioning of the information exchange system. It may allow the confidentiality to become a next most popular argument to decline information exchange. Such tendency is already existent.

Therefore, it is appropriate for the OECD to rectify this unbalanced approach and set a minimum standard on taxpayer confidentiality rather than leaving this matter to the discretion of biased parties. This would ensure consistency in confidentiality protection for the exchanged information across all participating jurisdictions, while removing the unwanted opportunities for its abuse.

Chapter 6: Summary and Overall Conclusions

Income tax and its administration

The 21st century is characterized by an unprecedented economic and technological globalization. An increasingly free cross border flow of ideas, information, goods, services, and capital has lead to the greater integration of economies across the world. These developments have also posed some challenges to national tax systems. A seemingly simple rule, **"residents ought to pay taxes on their worldwide income"** or the residence-based tax system that most countries have adopted and maintained for decades, now has to prove its feasibility in the face of new realities. There has been a question as to how administer this tax regime in a world where states' tax administrative capacities are highly restricted to their territorial borders, while their residents increasingly trade, invest, and provide services across borders. The few years of practice have already shown that the residence-based tax system is prone to abuse without robust cooperation between states. After all, resolving the question of enforcing tax laws on the foreign source income of resident taxpayers has become one of the main priorities of national and international income tax systems.

The result of this research suggests that if the states still want to maintain the residence-based income tax system – more precisely, if they still want to see the foreign-source income of their residents in their future tax base – a substantial reform is necessary. Ensuring transparency in cross-border economic activities, establishing an effective international information exchange system, and finally, taking a coordinated and balanced approach in taxing cross-border income between source and residence countries, appear to be necessary steps to begin such a reform.

Evolution of automatic exchange of tax information system

The analyses of this research also suggest that one crucial component of this reform began almost a half a century ago, through the introduction of the concept of automatic exchange of tax information in international tax policy instruments. Automatic exchange of tax information involves systematic and periodic transmission of “bulk” taxpayer information by the source country where the taxpayer earned income to his or her country of residence concerning various categories of income. Based on the information received, it would be then possible for the residence country to assess taxes on the foreign income of the taxpayer. Overall, the system allows the states to better enforce their tax laws on the foreign-source income of their residents.

The concept was first officially mentioned in the Commentary of the OECD Model Tax Convention of 1963. However, at that time the states did not seem very receptive to this idea. There was no desire, neither was there an urgent need to implement this politically difficult, somehow costly, and inherently domestic tax enforcement mechanism (i.e. third party tax information reporting) in cross-border context. Thus, the concept of automatic exchange of tax information remained as a mere idea.

Instead, the states directed their efforts on implementing another international mechanism – exchange of tax information ‘upon request’. Under this system, a state can request particular tax information, e.g. concerning foreign assets of its resident taxpayers, from another state. However, in order to make such a request, a state has to possess detailed information about its residents’ foreign assets and their location. In fact, states need other states’ assistance for the exact same reason. The states often did not possess such detailed information. If they already possessed such information, there would not be much need for the information request. Hence, this mechanism did not yield any plausible outcome.

In the meantime, some countries have realized the problem and put the concept of automatic exchange of information in practice. It was first implemented in 1972 between the Scandinavian countries (i.e. Denmark, Finland, Iceland, Norway and Sweden) under the Nordic Mutual Assistance Convention. The Nordic Convention applied the automatic exchange of information system for cross-border payments of dividends, interest, royalties, wages, salaries, fees, pensions and life annuities, compensation for damage, insurance payments, and similar compensation received in connection business activities, or any other income or property.

This Convention later formed the basis for the Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters (1988), which is another international framework that has contributed to the evolution and implementation of the concept. The Convention included the provisions that allow automatic exchange of tax information between the signatory parties. However, the instrument required the existence of an additional agreement between the signatory parties interested in the exchange. Such agreement would establish the procedure to be adopted and the type of information to be exchanged automatically. In practice, such additional agreements were hardly concluded.

The concept of automatic exchange of tax information has been further explored in the European Union under the Savings Directive (2003/48/EC). The Savings Directive requires each Member State to automatically report the income payments that its residents make to the residents of other member states. However, the Directive applied the mechanism only for savings income in the form of interest.

In 2010, the United States gave the world a big push to think about the automatic exchange of information mechanism more seriously when it passed the Foreign Account Tax Compliance Act (FATCA). FATCA attempted to apply the concept unilaterally in "the U.S. and the rest-of-the-world" context by requiring financial institutions around the world to regularly report information on their US account-holders to the U.S. tax authorities. The law imposed a 30% withholding tax on the US source income of relevant foreign financial institution that do not comply with these requirements. This was a controversial and hard-to-enforce domestic law with significant extraterritorial scope. As a result, the U.S. introduced a new generation of bilateral agreements called "intergovernmental agreements" or IGAs in 2012 to facilitate the implementation of FATCA regime by making it intergovernmental and somehow reciprocal. One of the key advantages of these agreements was that, by following the agreed procedures set by their governments after concluding an IGA with the U.S., non-US financial institutions will be regarded as compliant with FATCA, which in turn means that US paying agents will refrain from imposing the 30% withholding tax on US source income of these financial institutions.

Limitations of the existing frameworks

All these frameworks have had one simple purpose: to keep the countries informed of the foreign income, assets, and holdings of their resident taxpayers and thereby allowing them to enforce taxes on these incomes.

Financial institutions are required to play an important role to achieve this tax policy objective. However, the unilateral, bilateral, or regional nature these multiple legal frameworks and the lack of uniformity within these frameworks have created huge challenges.

First, these legal frameworks often overlap. They often touch on same tax authorities and even same taxpayers but from different angles and with different levels of requirements. For example, a country may be party to the EU Savings Directive, the Multilateral Convention, the Nordic Convention, and FATCA Intergovernmental Agreement, each having different material, geographical scope, but similar purpose.

Second, there are substantial inconsistencies and discrepancies between these legal frameworks. For example, the EU Savings Directive applies only for savings income payments in the form of interest, while the other international frameworks apply for a broader range of items. Moreover, FATCA intergovernmental agreements have *de minimus* thresholds for reportable accounts, while the other frameworks do not have such thresholds. They also have differences in their requirements to establish the beneficial owner of reportable accounts. These discrepancies create difficulties for financial institutions, which are primary administrators and cost bearers of these frameworks.

Third, the few years of practice has already revealed that the automatic exchange of tax information arrangements under these frameworks are less effective in triangular situations. In other words, if tax information arrangements are confined only to bilateral or narrow geographical context, the taxpayers could then simply channel their investment and income through a non-participant third jurisdiction. In this situation, these international frameworks merely scare away or relocate the problem of offshore tax evasion rather than resolving it. Then not only would the original offshore tax evasion problem remain unsolved but also the countries, which have initiated the regime, might themselves become the victims of the initiative.

Steps to a better system

The OECD's Standard on Automatic Exchange of Financial Account Information in Tax Matters, introduced in 2014, was the first crucial step to address some of these problems. The Standard attempts to instil some uniformity and standardization to these fragmented international frameworks by introducing Common Reporting Standards (CRS). The CRS contains general due diligence rules to be followed by financial institutions in establishing reportable accounts. The Standard also attempts to apply the concept of automatic exchange of information on a global scale by introducing a multilateral Model of Competent Authority Agreement (MCAA).

In October 2014, over 51 jurisdictions came together in Berlin to sign the first-ever Multilateral Competent Authority Agreement implementing the automatic exchange of tax information mechanism on a global scale. There are about 40 more countries, which had indicated their intention to join the initiative soon. These countries committed to a specific and ambitious timetable to implement the CRS and the MCAA, thereby leading to the first automatic information exchanges as early as 2017 or the end of 2018. These were significant developments in the global trend towards a new tax enforcement ststem.

Challenges ahead

All these developments support one simple conclusion: states have finally recognized that the current income tax system requires a greater international cooperation. These developments also indicate that the countries have realized the potential role played by automatic exchange of information as one of the promising mechanism of such cooperation. They have begun to embrace it. However, there are some challenges looming ahead in transitioning to the new regime.

First, the transition to the new regime would not be easy. There are some countries, commonly referred to as “secrecy jurisdictions” and “tax havens”, which have benefited from the non-transparent and non-cooperative world for a long time. They put every possible effort into preventing the automatic exchange of tax information from becoming a global practice. They may, at least, distract such initiatives. The Rubik model or the anonymous tax withholding and transfer arrangement has been one of such attempts. Under the Rubik model, a country where non-resident taxpayers hold their foreign assets: (1) withholds taxes at source on the income accrued on the assets; (2) aggregates all the collected tax; and (3) transfers the tax collected to the tax authorities of the residence country of the taxpayers without disclosing the taxpayers’ identities, income, or assets. Thus, the resident country receives tax money instead of information, while the source country keeps the integrity of its banking secrecy laws. However, in its substance, the Rubik model institutionalizes a privilege for the wealthy and affluent over the rest of society by providing secrecy protection for taxpayers with foreign assets and foreign-source income, while the taxpayers with income from domestic sources are generally subject to full disclosure for tax purposes. The model also allows them to pay taxes at a flat rate, while the resident taxpayers who earn similar income from domestic-sources generally pay taxes at progressive rates.

Hence, the world still needs to convince secrecy jurisdictions and tax havens that the automatic exchange of information system, more precisely, global tax transparency is a single dominant strategy that results in a more efficient outcome for all states in the long run than the existing regimes or the Rubik model.

Second, the transition to the new regime must be smooth, avoiding unnecessary victimization for the involved taxpayers and disruptions in society. One specific concern is that the new system essentially unveils the cases of foreign assets and incomes of residents that have been stashed abroad for many years and that have never been declared and known to their countries of residence before. As a result, the question of regularization of the past tax liabilities will become a critical consideration once countries launch the exchanges. The governments have to find ways to deal with this problem in a smooth, efficient, and a reasonable manner. Tax amnesty and voluntary disclosure programs offer a great solution to this problem and can serve as a "transitional bridge" to the new regime. However, tax amnesty and voluntary disclosure programs must be specifically tailored for such transition.

Third, it must be recognized that the automatic exchange of information system proves effective only when all or most jurisdictions participate. As long as there are non-participating jurisdictions, there is a gap in the system. The recent OECD initiative and Standard on automatic exchange of information are intended to establish a platform for regular flow of information mainly between tax havens and developed countries. It, by and large, ignores developing countries' participation. In fact, some strict requirements of the Standard (e.g. immediate reciprocity, multi-bilateralism, and strict confidentiality rules) would prevent most developing countries from joining the regime anytime soon. Encouraging developing countries to join, considering and accommodating their needs in this process, must be an integral part of the transition. Without developing countries participation, what is intended to become global standard cannot become really so. Instead, the marginalization may encourage some of them to become new tax havens.

Finally, when the new OECD Standard on automatic exchange of financial account information takes effect, there will be massive potentially sensitive taxpayer personal and financial information constantly flowing between national tax authorities around the world. Therefore, the enhancement in international information exchange relations must be followed by a corresponding enhancement in the protection of the exchanged information. The new Standard attempts to shape such enhancement. It sets out some strict confidentiality rules for international tax information exchanges. It essentially allocates the authority to determine the scope and level of confidentiality rules applicable to the exchanged information to the discretion of the information supplying party, which generally has no interest in providing information but has every interest in not providing it. This may also allow confidentiality to become the next most popular argument against international information exchanges.

Therefore, it is appropriate for an international body to set a minimum standard on confidentiality of the exchanged information rather than leaving this matter to the discretion of either biased parties. This would ensure consistency in confidentiality protection for the exchanged information across all participating jurisdictions and prevents its improper application.

What the future may hold

The automatic exchange of information regime is still in its infancy. Many aspects of the phenomenon are still open for debate on which scholars will have to pursue further studies. Some of these urgent problems relate to the determination of reportable persons or more precisely, the beneficial owners of reportable accounts, the quality of information that is exchanged, and the states' ability to utilize the supplied information. Moreover, taxpayers have a strong self-preservation instinct and are quick to adapt to new rules and regimes. Therefore, we are yet to see further issues emerging in this area as we go along.

What is most important is that a new era of transparency is dawning in the international tax system, and countries are eager to embrace it. Increasing economic globalization requires a greater tax administrative cooperation between countries and the emerging automatic exchange of information system is taking the world precisely in this direction.

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