Advancing global action to support fiscal sustainability

The OECD is working with international partners to eradicate tax evasion and tax avoidance, but strong political leadership is still needed

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In the aftermath of the global financial crisis, strengthening the resilience of all economies and societies requires a multifaceted approach across a number of policy areas.

In the international tax sphere, the Organisation for Economic Co-operation and Development (OECD) is working in two key areas. First, it has a project on base erosion and profit shifting (BEPS) that is modernising the rules for the taxation of multinational corporations. Second, it is seeking to end offshore tax evasion via the automatic exchange of information (AEoI) on tax matters.

Tax evasion and tax avoidance have been depriving national governments of precious resources for decades. The problem has been getting worse over the years, as individuals and companies have become smarter at exploiting loopholes and inconsistencies in tax rules across countries. With the fiscal pressures imposed by the crisis, this problem has become even more significant.

Tax evasion and avoidance, when left unchecked, also raise the question of economic fairness and efficiency, which is particularly relevant in a context of severe fiscal consolidation and social duress. Taxation underpins the social contract, and is a powerful instrument to reduce inequality and create opportunities for all citizens and companies to prosper in an increasingly competitive environment.

Tax evasion and avoidance also distort the efficient allocation of resources in an economy, and hence have a negative impact on growth. In the light of G20 members' ambitious commitment to raise the collective gross domestic product by two per cent over the next five years, the need to fight BEPS as well as tax evasion has never been so urgent.

In recent years, international tax matters, and in particular cross-border tax planning strategies that enable corporate profits to go untaxed anywhere, have been the subject of unprecedented concern among political leaders and the public alike. At stake here is the integrity of the corporate income tax.

Tax policy is at the core of national sovereignty, with each country being free to devise its corporate tax system in the way it considers most appropriate. However, in a globalised world where economies are increasingly integrated, domestic tax systems designed in isolation are often not aligned. This may result in double taxation or in double non-taxation – one of the root causes of BEPS.

Tax transparency

In 2013, the OECD worked together with its G8 and G20 partners to achieve a quantum leap in international tax transparency and in the fight against tax avoidance and tax evasion. At the G8 Lough Erne Summit, leaders supported efforts to tackle BEPS and committed to work with the OECD to develop a multilateral model of automatic exchange of information.

This work gained further political impetus at the G20 St Petersburg Summit. In response to a call from the G20, the OECD developed, together with G20 members, a comprehensive and ambitious G20/OECD Action Plan on Base Erosion and Profit Shifting aimed at revisiting the rules, standards and transparency of international taxation. At St Petersburg, leaders welcomed the G20/OECD BEPS project and endorsed the associated action plan. In order to minimise BEPS, leaders called on member countries to examine how their domestic laws contribute to BEPS and to ensure that international and national tax rules do not allow or encourage multinational enterprises to reduce overall taxes paid by artificially shifting profits to low-tax jurisdictions.

The G20/OECD BEPS action plan will roll out over the next two years and will allow countries to draw up coordinated, comprehensive and transparent standards. It will address the gaps between different countries' tax systems, while respecting their right to design their own rules; it will revise the existing international rules on tax treaties and transfer pricing, introduce more transparency by companies, and improve cooperation between governments.

The BEPS project builds on a broad engagement, drawing on experience and perspectives beyond governments, including those of global business leaders, civil society groups and labour representatives. The OECD works closely with all the stakeholders and has put in place a number of mechanisms to ensure full transparency in the process, with a large number of public consultations.

Tax evasion and avoidance distort the allocation of resources in an economy

Although BEPS is a global concern requiring global solutions, the nature and scale of the risks faced by developing countries – and the challenges involved in addressing them – may be different. There is wide recognition that BEPS deprives developing countries of essential tax revenue: on average, 20 per cent of tax revenues in developing countries derive from corporate income tax, compared with eight to 10 per cent in OECD countries. In these countries, BEPS results in capital flight and gives multinational corporations a competitive advantage over domestic businesses that are not able to take advantage of cross-border tax planning strategies.

To address this issue, the OECD is working with developing countries on its own account and through the G20 Development Working Group. The OECD put in place a series of regional BEPS consultations – in Africa, Asia and Latin America, as well as a specific consultation for francophone countries – which bring together senior policymakers to discuss challenges specific to developing countries. The first series of regional

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Automatic exchange of information will help authorities in the fight against individuals who evade tax by exploiting inconsistencies in different tax systems

consultations was attended by more than 80 countries and over 300 delegates.

The OECD is also working with the United Nations and the International Monetary Fund to avoid duplication of efforts and ensure the institutions' work streams complement each other.

Work on the BEPS project is only part of the plan to modernise the approach to countering international tax evasion. The OECD also promotes the automatic exchange of information on tax matters as the single global standard. This year, it has taken a major leap forward in improving international tax cooperation that will enable governments to better fight offshore tax evasion.

International standard

Following a call from the G20 leaders at the St Petersburg Summit, the OECD delivered to the G20 a proposal for a new international standard for AEoI – the common reporting standard – which was endorsed at the February 2014 meeting of G20 finance ministers and central bank governors. This builds on previous work to ensure effective exchange of information 'on request' between tax administrations, which is now led through the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes. The forum counts more than 120 jurisdictions as members, including more than 60 developing countries.

By the G20 Brisbane Summit in November 2014, the OECD will deliver the technical details of the AEoI standard that will allow the G20 to take the next step and move towards its effective implementation. As announced in St Petersburg, the G20 leaders expect to begin to exchange information automatically by the end of 2015. One of the main legal instruments that provides for AEoI, the multilateral Convention on Mutual Administrative Assistance in Tax Matters, has now been signed by 64 countries, with another 14 jurisdictions covered by way of territorial extension.

The OECD again recognises that developing countries may face specific challenges in implementing AEoI, inasmuch as there is varying capacity to implement it in an effective and timely way. The Global Forum on Transparency and Effective Exchange of Information is developing a road map to show developing countries how they can overcome obstacles to participation in AEoI, which will assist them in meeting the standard and thereby allow them to share the benefits of improved global transparency.

Political leadership

Today, together with its G20 partners, the OECD is changing the rules governing international tax practices that lead to lost tax revenues. As it uses its expertise and experience to find the most appropriate solutions, strong political leadership is still needed. At an international level, leaders should continue to draw attention to the need for collective action to deliver on these two important initiatives. These efforts should be augmented by swift action at the domestic level to undertake the requisite national reforms. Coordinated political support and international cooperation are crucial as we define the policy approaches and tools required to create the international tax systems of the 21st century. ■

Clamping down on tax evasion: why taxpayer information is the new industrial revolution

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For many years, governments have been working actively to combat offshore tax evasion. Adopting various legal actions to enforce the disclosure of cross-border financial account information, governments have added a significant and powerful tool to improve cross-border tax compliance: automatic exchange of financial account information.

The OECD's standard for automatic exchange of information

In 2012, the G8 and G20 leaders asked the Organisation for Economic Co-operation and Development (OECD) to develop a standard to facilitate automatic exchange of tax information between non-US countries.

Published on 13 February 2014, and formally endorsed by the G20 leaders on 23 February, the OECD's model Competent Authority Agreement (CAA) and Common Reporting Standard (CRS) are designed to be a standardised and cost-effective model for the multilateral exchange of taxpayer information.

Presenting this new standard, the OECD Secretary-General Angel Gurría said: "This is a real game changer. Globalisation of the world's financial system has made it increasingly simple for people to make, hold and manage investments outside their country of residence. This new standard on automatic exchange of information will ramp up international tax cooperation, putting governments back on a more even footing as they seek to protect the integrity of their tax systems and fight tax evasion."

The OECD developments on the automatic exchange of information complement existing measures recently implemented by governments, such as:

- **Foreign Account Tax Compliance Act FATCA** Effective on 1 July 2014;
- **Intergovernmental Agreements (IGAs)** Designed to enable non-US financial institutions to comply with FATCA;
- **G5 Multilateral Pilot European Union Initiatives** To expand Automatic Exchange of Information (AEOI) between EU member states; and
- **UK FATCA** With British Overseas Territories and Crown Dependencies.

What are the OECD's CAA and CRS?

The CAA is a bilateral agreement, but governments can conclude bilateral or multilateral AEOI agreements. It draws heavily on the principles outlined in the Model 1 FATCA IGA and establishes a legal basis for AEOI between tax authorities. The CRS contains the reporting and due diligence rules and imposes obligations on financial institutions to collect and report financial account holder information to their home government. However, it has no direct legal force and will, therefore, need to be translated into local law before it can be implemented.

Financial institutions required to report include banks and custodians, depository institutions, brokers, certain collective investment vehicles and certain insurance companies. The scope of information to be reported includes interest, dividends, income from certain insurance contracts and other similar types of income, account balances and gross sales proceeds from financial assets. While the CAA and CRS set a minimum standard for information to be exchanged, governments may choose to exchange information beyond this minimum.

With 44 countries already signed up for early adoption, it is possible we will see agreements concluded soon.

Does the CRS close the gap on tax evasion completely?

As recognised by the OECD, we are living in a highly integrated world where cross-border portfolio investment is commonplace and an important feature in a global economy.

Investors making cross-border investments will typically aim to receive income from their investments. Such investments may be subject to source-country taxation and, absent a simplified mechanism to collect any tax relief that the investor may be entitled to, source-country taxation is applied anonymously to the income paid. If that end investor is not reportable under the CRS and CAA initiatives, and despite the fact that CRS due diligence and reporting requirements will go a long way towards addressing residency-country tax concerns, it may not capture everything.

The OECD's other work in the area of tax compliance could be the final piece in the jigsaw to achieving full disclosure.

That work is the Treaty Relief and Compliance Enhancement (TRACE) project, which was endorsed in January 2013 by the OECD's Committee on Fiscal Affairs. It is designed to reduce compliance costs and facilitate cross-border investment by enabling financial institutions to act as financial intermediaries, by providing tax relief at source on cross-border portfolio investment and simultaneously reporting account holder information to the source country. The implementation of the OECD's CAA and CRS implies a significant investment in technology and resources for local governments and their financial institutions. Substantial efficiencies can be achieved for both businesses and governments by aligning implementation covering both AEOI and TRACE initiatives simultaneously.

The benefits derived from TRACE implementation would not only offset many of the additional compliance

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costs associated with new information reporting requirements in AEOI, but would also reduce many of the administrative burdens governments currently face in running tax relief systems.

Furthermore, the momentum of the proposed CRS effort may be enhanced if governments agree that a financial intermediary cannot operate the TRACE system unless it is resident in a country that participates in the CRS, or otherwise agrees to AEOI with the source country.

By tying TRACE to the proposed CRS, financial institutions will have a strong incentive to urge their respective governments to adopt the CRS. In addition, participation in TRACE by financial institutions will provide an incentive for account holders to identify their residence for tax purposes and provide an additional cross-check for governments.

The start of industrialising client data?

There will now be vast amounts of data to collect, manage and mine in order to meet the reporting requirements under these various tax evasion initiatives. The method in which data is collected and recorded will be vital to its effectiveness. The way in which financial institutions interact with customers and conduct know your customer (KYC) and anti-money laundering (AML) procedures for capturing the relevant tax information will need to be enhanced. New local AML rules will include tax avoidance as a money laundering offence. Therefore, customer relationship teams will need to be trained to identify and determine sources of wealth in addition to wrestling with the jigsaw of tax residency definitions of each customer.

Coupled with the reporting of the information, this puts significant strain on IT systems that collect data from customers and share customer information from or with other sources.

This industrialisation of client data, creating centralised information hubs and designing solutions to integrate KYC without violating customer privacy, presents opportunities.

To that end, for well-prepared financial institutions it can lead to an improved and more comprehensive identification of customers and a reduction in time to onboard customers to new products or services.

With full transparency over investment activity and products becoming the norm across the globe, financial institutions that have solutions in place to meet these various tax-reporting initiatives will have a distinct competitive advantage. Customers will be looking for certainty that their financial institutions are compliant and able to assist them in meeting their reporting obligations.

BNY Mellon supports these core tax-compliance objectives and believes the cross-border gathering and exchange of information is an essential aspect of global financial markets, with financial institutions playing a key role as tax intermediaries globally.

We strongly encourage the development of a standardised and truly global framework for customer due diligence, reporting and simplification of cross-border tax relief.

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