tax justice network

Courses of Action to Combat Cross-Border Tax Evasion and Other Illicit Financial Flows

1. Automatic Exchange of Information
2. Restricted Lists / Lists of Restricted Jurisdictions
3. Corporate Transparency
4. AML – Anti Money Laundering
5. Disclosure of Off-Balance Sheet Entities
6. Role of Intermediaries
7. Transfer pricing and mispricing
8. Corruption
9. Country-by-country reporting and accounting standards
10. Taxation of Offshore Wealth: A Wealth Tax on Undeclared Assets
11. The ABCIIMS Countries: Greater Coordination and Cooperation Among Developing Countries
12. Tax and Crime (the "Whole of Government Approach")

(1) <u>Automatic Exchange of Information</u>

It looks as if I have intervened heavily in the text below – but in fact I have only moved the paragraphs around, and made some small changes

(a) ***Background***

When a person sends assets or invests overseas or offshore, their government needs to know about those assets so it can tax them properly. But most information-sharing happens under a dominant OECD model that is not effective.

Under the OECD's system of information "upon request" and its model Tax Information Exchange Agreement (TIEA,) the government requesting information must already know detailed information about a alleged tax evader in order to request additional information from the other government. This is ineffective.

A far better system is *automatic* exchange of information.

(b) ***Automatic exchange of information***

At present, automatic exchange of tax information among OECD member countries is quite prevalent. The European Union Savings Tax Directive, where European countries share information with each other routinely, is one example. There are various other examples. However, automatic exchange of information with developing countries, and between OECD financial centres and non-OECD financial centres, is practically non-existent.

Automatic exchange of information is important not only to limit cross-border tax evasion but other types of cross-border illicit financial flows. On February 9, 2009 Agustin Carstens, then Secretary of Finance of Mexico,[1] wrote to U.S. Treasury Secretary Tim Geithner: "The [automatic] exchange of information on interest paid by banks [in the U.S.] will certainly provide us with a powerful tool to detect, prevent and combat tax evasion, money laundering, terrorist financing, drug trafficking and organised crime." The OECD's program of exchange information upon request cannot effectively confront these cross-border problems.

[1] Formerly Deputy Managing Director of the IMF and now Governor of the Central Bank of Mexico.

Many governments face deficits and will push more aggressively for automatic information exchange. This will only be implemented in a step-by-step process, however. Although a multilateral agreement for automatic exchange of information would be ideal, implementing multilateral regulatory solutions to international financial problems is usually a step-by-step process.

Training about technical issues is also essential, especially for developing countries.

(c) ***Other forms of automatic information exchange***

Automatic information exchange is possible not only between governments, but also between foreign financial institutions and a government. This avenue for transparency should also be pursued.

Banks and other financial institutions doing business in a country, or engaging in cross border activity from outside that country into that country (such as cross-border loans to borrowers in that country) should be required to confirm:

(i) When the resident of a country has accounts in a corporate / company / trust form where they own a ten percent or more interest, the financial institution will inform that resident's government of all these accounts;

(ii) that the Financial Institution will not accept any such accounts unless the account holder provides to the financial institution a written waiver, signed by the account holder, of any applicable confidentiality and bank secrecy provisions.

The continued validity of any banking license or other license that the Financial Institution has been (or will be) issued by the Government of the country of residence is conditioned upon the financial institution complying with these requirements.

Also, foreign financial institutions should not be allowed to claim any benefit under an otherwise applicable income tax treaty with the country of residence unless that financial institution complies with these requirements.

These requirements would apply to subsidiaries and affiliates of the financial institution, including

(a) entities controlled by the Financial Institution;
(b) entities controlling the Financial Institution, and
(c) entities under common control with the Financial Institution.

(2) **<u>Restricted Lists / Lists of Restricted Jurisdictions</u>**

It is useful to prepare lists of jurisdictions ("Restricted Jurisdictions") which impose by statute, or in effect provide, low tax or zero tax treatment. Payments to entities in restricted jurisdictions would be subject to special rules and tax treatment.

(a) Lists of restricted jurisdictions should be more complete than most current lists are. A list should cover (i) jurisdictions which by statute impose a low tax or zero tax, and (ii) jurisdictions which, whatever the general statutory income tax rates, provide preferential tax regimes which *in effect* constitute a low tax or zero tax, such as limited liability companies organised in a state in the United States which (A) are not engaged in trade or business in the United States and (B) which are not owned by any U.S. person. For example, the List of Restricted Jurisdictions[2] issued recently by the Brazilian government is extensive.

(b) The treatment of transactions with entities organised in such restricted jurisdictions should cover all types of payments to and from entities organised in these jurisdictions, whether or not the payor and the payee are related parties. These would include, for example, interest, royalties and other payments for intangibles, profit remittances (dividends, and branch profit remittances), management fees, other fees for payment of services, and payment for goods.

(c) The consequences of such payments should be (a) higher withholding taxes or other restrictions on such payments (such as restrictions on deductibility), and (b) special transfer pricing rules. It is essential that such rules apply whether or not the payor and the payee are related parties, because (among other reasons) proving a relationship between payor and payee may be difficult.

(3) **<u>Corporate Transparency</u>**

All jurisdictions should comply with corporate and company transparency requirements: disclosure of beneficial owners, directors and officers. With regard to trusts, this should include disclosure of settlors and beneficiaries. The method / degree of required disclosure has to be determined: whether such information should be (i) provided automatically to the respected government; (ii) provided to the respected government upon request; or (iii) available to the public,

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[2] See Instrução Normativa RFB nº 1.037, de 4 de junho de 2010, and associated links and updates http://www.receita.fazenda.gov.br/Legislacao/Ins/2010/in10372010.htm

such as in a public registry. The corporate transparency issue is related to the role of intermediaries, discussed below, in paragraph (6).

(4) **<u>Anti – Money Laundering</u>**

(a) The definition of predicate offences for money laundering purposes should be harmonised.

(b) Tax evasion should be considered a money laundering offence (but perhaps with different procedural rules and penalties for tax evasion than for other offences within the definition of money laundering). This is important for purposes of enforcing the United Nations Convention Against Corruption which at present applies to money laundering offences but not to fiscal offences which are not also considered money laundering offences).

(c) The work of the Financial Action Task Force (FATF) and FATF Regional Bodies should be strengthened.

(5) **<u>Disclosure of Off-Balance Sheet Entities</u>**

Publicly listed companies, and systematically important financial institutions and certain other financial institutions (including hedge funds and, private equity funds) should be required to disclose all corporations, limited liability companies, partnerships and other entities that they directly or indirectly organise. Such disclosure would increase transparency and prevent the inappropriate use of off balance sheet entities, and in general to make available to governments and the public information about the use of entities organised in a jurisdiction on a list of restricted jurisdictions.

(6) **<u>Role of Intermediaries</u>**

All jurisdictions, especially financial centres, should regulate intermediaries more intensively. These include
(a) attorneys
(b) Tax Advisers: (accountants and other tax advisers);
(c) Corporate Service Providers: corporate formation agents, trust companies and other corporate service providers; and
(d) Financial Institutions: commercial banks, investment banks, brokerage firms and other financial institutions.

Such Intermediaries should be required:
(i) to get confirmation in writing from each client that the client is complying with local law (that is, the law of the jurisdiction where the Intermediary is operating),
(ii) to exercise appropriate due diligence, such as obtaining legal opinions from foreign jurisdictions, to ensure that each client is

complying with all applicable foreign laws (that is, the law of each applicable foreign jurisdiction).

Intermediaries should be required to obtain from each client written waivers of confidentiality / secrecy laws of each applicable jurisdiction.

Intermediaries who help clients evade taxes should be subject to civil and criminal penalties in the client's country of residence for aiding and abetting tax evasion.

Financial Institutions and other intermediaries engaged in international private banking should be required to make payments to governments to settle cross-border tax evasion cases, such as the April 2011 payment by Swiss Bank Julius Baer of 75 million euros to the German Government to settle tax evasion claims.

(7) **<u>Transfer Pricing (Mispricing)</u>**

(a) Multinational enterprises derive tax benefits by shifting income to low or no tax jurisdictions. Current transfer pricing rules, under the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, which are based on the 'arm's length' concept for pricing internal transfer prices, are not effective in preventing multinational entrerprises from shifting profits to low tax or no tax jurisdictions. This is especially important with respect to intangibles (such as intellectual property). The OECD's seminal 1998 report, "Harmful Tax Competition: An Emerging Global Issue" (chapter III, section V (d) highlighted topics for further study, including two paragraphs (reproduced below) on the application of the OECD Transfer Pricing Guidelines to tax haven jurisdictions. The OECD has yet taken any action on such recommendations.

1998 OECD Report: "Harmful Tax Competition: An Emerging Global Issue" and Recommendation on Application of OECD Transfer Pricing Guidelines to Tax Havens

(d) Application of Transfer Pricing and Guidelines

166. Measures that constitute harmful tax competition often result in significant income being attributed to a foreign entity which performs few if any real activities. The application of transfer pricing rules which typically start from an analysis of the true functions performed by each

> part of a group of associated enterprises, does in that respect, constitute a useful counteracting measure.
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> 167. It may be appropriate, however, that the [OECD's Fiscal Affairs] Committee develop procedural rules that would address the specific circumstances of tax havens and regimes that constitute harmful tax practices. Rules effecting a reversal of onus of proof in certain cases….. would fail in that category. One action that could be taken in that respect would be for the [OECD's Fiscal Affairs] Committee to supplement its Transfer Pricing Guidelines with more guidance on the application of the [OECD Fiscal Affairs] Guidelines in relation to tax havens and regimes constituting harmful tax competition.

Therefore, the OECD's transfer pricing guidelines should be revised to confront this issue.

(b) As the OECD's Transfer Pricing Guidelines based on the arm's-length concept, are widely viewed as ineffective in preventing transfer mispricing, alternative transfer pricing rules such as safe harbors (with or without rebuttable presumptions), and formulary apportionment, and hybrid methods combining the arm's-length method and the formulary apportionment method, have to be considered.

(8) **Corruption**

(a) The United Nations Convention Against Corruption (UNCAC) has to be signed and ratified by those countries which have not yet done so, and energetically enforced.

(b) Know your Customer rules have to be strictly complied with by Intermediaries.

(c) As indicated above, tax offences should be included in the definition of money laundering offences under FATF rules, and also under domestic laws because UNCAC covers fiscal offences only if included in other offences such as money laundering offences, described in UNCAC.

(9) **Country-by-Country Reporting and Accounting Standards**

Country-by-country reporting has to be adopted as a required accounting standard. The country of residence should require all foreign companies doing business in or with the country, and each multinational company based in the country, to adopt country-by-country reporting. Domestic and international accounting groups --

notably the Financing Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) - should be pressed to require country-by-country reporting.

(10) **Taxation of Offshore Wealth: A Wealth Tax on Undeclared Assets**

An annual tax should be imposed on "Offshore Wealth" (anonymous wealth), that is, assets held in a jurisdiction other than the country of residence and not declared for tax purposes in the country of residence.[3]

(11) **The ABCIIMS Countries: Greater Coordination and Cooperation Among Developing Countries**

The seven major developing countries in the G-20: Argentina, Brazil, China, India, Indonesia, Mexico and South Africa (the ABCIIMS countries) should intensify their contacts for coordinating and cooperating on international tax matters. Other developing countries should intensify their relations with the ABCIIMS and with other developing countries, to coordinate and cooperate on international tax matters. Developing countries have to be more aggressive in asserting their interests in international tax matters.

(12) **Tax and Crime (the "Whole of Government Approach")**

The March 2011 Conference on Tax and Crime hosted by the Norwegian Government emphasised the relationship between cross-border tax evasion and other criminal activity. The Conference emphasised that governments should take a "whole of government" approach (coordinating the work of all government departments and agencies) to this problem[4].

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[3] See, for example, *Tax Offshore Wealth Sitting In First World Banks*, James S. Henry, Forbes Magazine 07.01.10. Note Henry's emphasis on major financial institutions as intermediaries.
[4] The Wickenby Project in Australia is an example of this.