The full picture of OECD's AIE Standard is unveiled: Catering to tax havens at the expense of developing countries[1]

July 21, 2014[2]

Background

The OECD has now published the Commentaries to the Common Reporting Standard (CRS) on Automatic Information Exchange (AIE). The CRS was first published on February 13, 2014, providing the legal framework for the new global standard on automatic exchange of financial account information among countries to tackle tax evasion. While AIE represents a huge advance towards transparency, which will complement the flawed upon-request standard, TJN has already identified shortcomings of the first CRS publication. This paper presents preliminary observations on the CRS's Commentaries.

Highlights

1) A significant improvement is that the term "controlling person" has been equaled to FATF's "beneficial ownership". However, the Standard should have tightened the beneficial ownership definition by lowering the threshold for company ownership (currently more than 25% according to FATF). As it stands, shell companies continue to be an easy escape route for the reporting of accounts. By splitting the shares across a small family of four or more, each owning 25% or less of the shares, reporting can be avoided. In this respect, the Standard is considerably weaker than for example FATCA, which has a reporting threshold of 10% of ownership.

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[1] TJN'S preliminary observations on the OECD Commentaries on the Common Reporting Standard (CRS) on Automatic Information Exchange (AIE), later referred as "Standard". We will publish a comprehensive technical analysis soon. Please send any feedback to andres@taxjustice.net.

[2] Updated on September 9, 2014.

2) Any reference to concerns of developing countries, including commitments to support for capacity building, have been eliminated from the Standard's "background" section. While this change appears to more honestly reflect OECDs disregard of (major) developing country interests throughout the design stage of the new standard, it evidences a sad status quo of power political dominance of the OECD. The next two points are particularly telling in this respect.

3) A Multilateral (instead of bilateral) Competent Authority Agreement (CAA) is relevant for developing countries not only to reduce costs, but also to enable them to obtain AIE with tax havens. While the Standard offers a model for a Multilateral CAA, tax havens are not prevented from arbitrarily excluding developing countries or refusing to sign a CAA with them. On the contrary, it appears that "consensus" is needed to accept new jurisdictions to the Multilateral CAA. This gives any participating "tax haven" an effective veto right over new entrants. Given the steep rise in emerging market assets under management of western private banks, this appears to be a particularly devious strategy to exclude developing countries from benefiting from the Standard. Another way to exclude them from a Multilateral CAA is presented in next point.

4) Ridiculously, the Multilateral CAA suggests non-reciprocity provisions in favor of tax havens ("a jurisdiction without income tax", not interested in receiving information), instead of facilitating developing countries' participation in AIE (by allowing them to first <u>only receive</u> information). The Model Multilateral CAA, allows for <u>non-reciprocity for tax havens</u>, by offering a special list of jurisdictions <u>only willing to send information without receiving it</u>. If the Standard had intended to favour developing countries, the Model Multilateral CAA's special list should have been for <u>developing countries only receiving information without needing to send it</u>. This reveals the extent to which the OECD is captured by tax haven interests and caters to their needs instead, wrecking havoc on the rest of the world.

5) An important improvement is that the Standard now explicitly demands that confidentiality and safeguards provisions should not be used to prevent the exchange of information. Surprisingly though, the Standard places far more emphasis on the enforcement of confidentiality than on the effective implementation of the CRS.

6) Regarding trusts and foundations, the language has been improved regarding its related persons (from singular to plural), and foundations and similar arrangements have been included as well. However, some provisions remain unclear, such as the extent of reporting requirements for trusts which are not considered to be financial institutions (e.g. managed by individual trustee).

7) Information should always be provided not just on account balances on a particular reporting date, but also the average balance for the year, and the highest value registered for that year. This would allow tax administrations and legal enforcement agencies to investigate for instance whether tax was evaded also on the principal and whether high amounts whose origin cannot be justified, lead to a corruption or money laundering investigation. However, the Standard is only offering the monthly average account as an alternative to that of a particular date and for some jurisdictions only.

8) While the Standard does not suggest nor promote a sanction or incentive scheme to promote global participation in AIE, at least Annex 5 provides an option to collect information on residents from non-participating jurisdictions, foreseeing their future participation.

Notes and References

1) **A significant improvement is that the term "controlling person" has been equaled to FATF's[3] "beneficial ownership". However, the Standard could have referred directly to "beneficial owner" for consistency reasons and improved the high threshold to be considered a controlling person (25%), based for example on FATCA's[4] 10%, since for a small 4-people family it would be easy to avoid this threshold**.

The Standard now reads: "Subparagraph D(6) sets forth the definition of the term 'Controlling Persons'. This term corresponds to the term 'beneficial owner' as described in Recommendation 10 and the Interpretative Note on Recommendation 10 of the Financial Action Task Force Recommendations (as adopted in February 2012), and must be interpreted in a manner consistent with such Recommendations, with the aim of protecting the international financial system from misuse including with respect to tax crimes. For an Entity that is a legal person, the term "Controlling Persons" means the natural person(s) who exercises control over the Entity. 'Control' over an Entity is generally exercised by the natural person(s) who ultimately has a controlling ownership interest in the Entity. A 'control ownership interest' depends on the ownership structure of the legal person and is usually identified on the basis of a threshold applying a risk-based approach (e.g., any person(s) owning more than a certain percentage of the legal person, such as 25%). Where no natural person(s) exercises control through ownership interests, the Controlling Person(s) of the Entity

[3] Financial Action Task Force (FATF)
[4] US's Foreign Account Tax Compliance Act (FATCA)

will be the natural person(s) who exercises control of the Entity through other means. Where no natural person(s) is identified as exercising control of the Entity, the Controlling Person(s) of the Entity will be the natural person(s) who holds the position of senior managing official"[5] (emphasis added).

The "owning more than a certain percentage such as 25%" is a threshold that could be easily avoidable by a small family (mother, father and two children) where no one would be considered beneficial owner. The threshold could have been based on FATCA's 10%: "AML requirements generally limit identification requirements at the 25% threshold of controlling shareholdings/interest, whereas FATCA goes deeper in the definition of 'substantial US owners'. The FATCA definition refers to the controlling threshold of 10% for shares/capital in an entity."[6]

2) Elimination of references to developing countries from the Commentaries' "background" section. Setting the tone for the Standard' regressions, references to AIE being "attainable by all countries, including low-income developing countries", "provide capacity building support for them" and "importance of developing countries being able to benefit from a more transparent international tax system" were eliminated from the Standard' "background" section.

CRS published on February 13, 2014	**Commentaries published on July 21, 2014**
6. On 20 July the G20 Finance Ministers and Central Bank Governors endorsed the OECD proposals for a global model of automatic exchange in the multilateral context.[3] [Footnote 3: "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. We are committed to automatic exchange of information as the new, global standard and we fully support the OECD work with G20 countries aimed at setting such a new single global standard for automatic exchange of information. We ask the OECD to prepare a progress report by our next meeting, including a timeline for completing this work in 2014. We call on all jurisdictions to commit to implement this standard. <u>We are committed to making automatic exchange of information attainable by all countries, including low-income countries, and will seek to provide capacity building support for them</u>. 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".] <u>On 6 September</u> the G20 leaders reinforced this message, and said: 'Calling on all other jurisdictions to join us by the earliest possible	3. "Starting in 2012 […]. On 19 June 2013 the G8 leaders welcomed the OECD Secretary General report 'A step change in tax transparency' which set out the concrete steps that need to be undertaken to put a global model of automatic exchange into practice. G8 leaders agreed to work together with the OECD and in the G20 to implement its recommendations urgently. <u>On 6 September</u> 2013 the G20 Leaders committed to automatic exchange of information as the new global standard and fully supported the OECD work, with G20

[5] Standard, page 137, para. 132-133.

[6] "FATCA + AML = an equation with too many variables?", Weis, Thinnes, PWC Luxembourg, May 2012, in: http://www.pwc.lu/en/press-articles/2012/fatca-aml-an-equation-with-too-many-variables.jhtml; 20.7.2014.

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 single global standard for automatic exchange by February 2014 and to finalizing technical modalities of effective automatic exchange by mid-2014.'[4] They also asked the Global Forum to establish a mechanism to monitor and review the implementation of the new global standard on automatic exchange of information and stressed the importance of developing countries being able to benefit from a more transparent international tax system." (page 6; emphasis added).	countries, aimed at presenting such a single global standard in 2014. In February 2014, the G20 Finance Ministers and Central Bank Governors endorsed […]." (page 8; emphasis added).

3) Multilateral CAA is not welcoming to developing countries

A Model Multilateral CAA is offered in Annex 1 of the Standard. However, nothing prevents tax havens from arbitrarily excluding or refusing to sign a CAA with developing countries. In other words, a tax haven such as Switzerland may sign a Multilateral CAA with OECD countries but reject to sign one with developing countries and there is no provision suggesting that jurisdictions cannot refuse to engage in AIE with each other if all conditions are met (e.g. confidentiality).

Moreover, the Model Multilateral CAA suggests that "consensus" is needed to accept a new jurisdiction willing to join the agreement[7]. Given that the agreement itself would be multilateral, but the actual exchange of information would still be on a bilateral basis[8], an alternative solution would be to have properly-justified "reservations" against engaging in AIE with a specific jurisdiction. This way, the new joining jurisdiction, could still engage in AIE with all the other jurisdictions that have not opposed its inclusion.

[7] "1. This Agreement will come into effect on the date two or more Competent Authorities have provided notice to, and it has been received by, the CB Secretariat that its Jurisdiction has the necessary laws in place to implement the Agreement. After the effective date a Competent Authority may make a request to sign the Agreement. Notwithstanding the foregoing sentence, a Competent Authority that wants to sign the Agreement before it has come into effect, but after it has been signed by a group of Competent Authorities that are the first signatories to the Agreement, the first-mentioned Competent Authority must make a request to sign the Agreement.
2.The decision to invite a Competent Authority, and whether the Competent Authority will be listed in Annex A, will be taken by consensus of the Competent Authorities that have signed the Agreement. Following signature the Competent Authority must notify the CB Secretariat that its Jurisdiction has the necessary laws in place to implement the Agreement. The Agreement will become effective with respect to the notifying Competent Authority on the date its notification is received by the CB Secretariat" (Standard, Annex 1, Section 7 -Terms of Agreement, page 154; emphasis added.).

[8] "Although the agreement would be multilateral the exchange of information itself would be on a bilateral basis." (Standard, Introduction to the Commentaries, page 43).

4) Non-reciprocity provisions are suggested in favor of tax havens, instead of to facilitate developing countries' participation in AIE

Non-reciprocity provisions (the option to first only receive information) would facilitate developing countries' participation in AIE, by allowing them to invest their limited resources to analyze the received information: "first, many developing countries do not have the resources or capacity to collect the information; second, very few tax havens are located in developing countries, so there is little point in requiring immediate reciprocity" [9]. Moreover, as TJN published here[10], some developing countries have already expressed interest in non-reciprocity provisions (Knobel/Meinzer 2014).

However, the Standard suggest non-reciprocity provisions not in favor of developing countries, but for those tax havens which are not interested in receiving information: "There may be situations where the automatic exchange of financial account information does not need to be reciprocal (e.g., because one of the jurisdictions does not have an income tax)."[11]. For these cases, the Model Multilateral CAA of Annex 1, allows for non-reciprocity for tax havens, by offering a special list of jurisdictions only willing to send information without receiving it[12]. Instead, if the Standard had intended to favor developing countries, the Multilateral Model CAA's special list should have been for developing countries unable to send information.

While the Model Bilateral Non-Reciprocal CAA of Annex 2 is also suggested for tax havens[13], it could eventually be used for developing countries too, although it lacks provisions referring to the time when full reciprocity would have to be in place.

5) Confidentiality provisions should not prevent actual exchange of information. However, these provisions are far more extended and demanding than those preventing financial institutions' non-compliance with the CRS

[9] "OECD's Automatic Information Exchange Standard: A watershed moment for fighting offshore tax evasion?", TJN, March 2014, in: http://www.internationaltaxreview.com/pdfs/TJN2014_OECD-AIE-Report.pdf; 20.7.2014.

[10] "Automatic Exchange of Information: An Opportunity for Developing Countries to Tackle Tax Evasion and Corruption", Knobel, Meinzer, TJN, June 2014, page 33, in: http://www.taxjustice.net/wp-content/uploads/2013/04/AIE-An-opportunity-for-developing-countries.pdf; 20.7.2014.

[11] Standard, Annex 2, page 155, para. 1.

[12] "Whereas the Competent Authorities of Jurisdictions or territories listed in Annex A to this Agreement will send information under Section 2, the Competent Authorities will not receive such information" (Commentaries, Annex 1, page 150). Likewise the introduction to the Model Multilateral CAA reads, "in addition the multilateral model contemplates jurisdictions participating on both a reciprocal and nonreciprocal basis (see paragraph 1 of Section 2). Jurisdictions sending information but not receiving information would be listed in Annex A" (page 149; emphasis added).

[13] See note 10.

Importantly, the Standard adds a provision against arbitrary confidentiality requirements: while "the Competent Authority receiving the information shall treat the information in compliance not only with its own domestic law, but also with additional safeguards that may be required to ensure data protection under the domestic law of the supplying Competent Authority"[14], "in any case, these safeguards should be limited to what is needed to ensure the protection of personal data without unduly preventing or delaying the effective exchange of information"[15] (emphasis added).

However, it is surprising that confidentiality provisions, especially in cases of non-compliance, are far more extended and demanding than provisions regarding non-compliance by reporting financial institutions in frame of the effective implementation of the CRS. For instance, "domestic law must impose penalties or sanctions for improper disclosure or use of taxpayer information, and tax administrations must in fact impose these penalties and sanctions against personnel who violate security policies and procedures to deter others from engaging in similar violations. To ensure implementation, such laws must be reinforced by adequate administrative resources and procedures"[16] (emphasis added). In contrast, regarding effective implementation of the CRS "for example, a jurisdiction may have rules that provide for the imposition of fines or other penalties where a person does not provide information requested by the tax authority"[17] (emphasis added).

6) Trusts and Foundations: extension of provisions, but reporting obligations of some trusts remain unclear.

Controlling Persons of a trust now include related persons in plural, referring also to the natural person exercising ultimate control in case of a chain of control or ownership. The language is also extended to similar arrangements and foundations: "in the case of a trust, the term 'Controlling Persons' means the settlor(s), the trustee(s), the protector(s) (if any), the beneficiary(ies) or class(es) of beneficiaries, and any other natural person(s) exercising ultimate effective control over the trust. The settlor(s), the trustee(s), the protector(s) (if any), and the beneficiary(ies) or class(es) of beneficiaries, must always be treated as Controlling Persons of a trust, regardless of whether or not any of them exercises control over the trust. […] In addition, any other natural person(s) exercising ultimate effective control over the trust (including through a chain of control or ownership) must also be treated as a Controlling Person of the trust […] In the case of a legal arrangement other than a

[14] Standard, Commentary on section 5 concerning confidentiality and data safeguards, page 52, para. 4.
[15] Idem.
[16] Standard, Commentary on section 5 concerning confidentiality and data safeguards, page 57, para. 35.
[17] Standard, Commentary on section 9, page 147, para. 18.

trust, the term 'Controlling Persons' means persons in equivalent or similar positions as those that are Controlling Persons of a trust. Thus, taking into account the different forms and structures of legal arrangements, Reporting Financial Institutions should identify and report persons in equivalent or similar positions, as those required to be identified and reported for trusts. […] In relation to legal persons that are functionally similar to trusts (e.g., foundations), Reporting Financial Institutions should identify Controlling Persons through similar customer due diligence procedures as those required for trusts, with a view to achieving appropriate levels of reporting"[18] (emphasis added).

As for individual trustees which are not financial institutions, the Standard provides the following example: "(Trust managed by an individual): X, an individual, establishes Trust A, an irrevocable trust for the benefit of X's children, Y and Z. X appoints Trustee A, an individual, to act as the trustee of Trust A. Trust A's assets consist solely of Financial Assets, and its income consists solely of income from those Financial Assets. Pursuant to the terms of the trust instrument, Trustee A manages and administers the assets of the trust. Trustee A does not hire any Entity as a service provider to perform any of the activities described in subparagraph A(6)(a). Trust A is not an Investment Entity under subparagraph A(6)(b) because it is managed solely by Trustee A, an individual"[19] (emphasis added).

7) 7) Information should always be provided not just on account balances on a particular reporting date, but also the average balance for the year, and the highest value registered for that year. This would allow tax administrations and legal enforcement agencies to investigate for instance whether tax was evaded also on the principal and whether high amounts whose origin cannot be justified, lead to a corruption or money laundering investigation. However, the Standard is only offering the monthly average account as an alternative to that of a particular date and for some jurisdictions only.

The Account balance could be relevant not only for tax avoidance on the principal but also for corruption cases (where someone, for example a government official could not justify the origin of his funds). However, if only the account balance of a specific date is informed, this could be avoided by transferring or withdrawing the funds before that date. For this reason, additional information such as average account balance and highest account balance would also be relevant.

[18] Standard, page 137, paras. 134-136.
[19] Standard, page 112, Example 5.

While the Standard includes provisions regarding average account balance, this is presented as an alternative to the account balance as of a specific date, and only for some jurisdictions already requesting it: "Subparagraph 2(d) of Section 2 provides that a jurisdiction is required to exchange the account balance or value as of the end of the calendar year or other appropriate reporting period. However, paragraph 11 of the Commentary on Section I of the CRS provides that <u>jurisdictions may, as an alternative, require financial institutions to report the average account balance or value during the relevant calendar year or other reporting period</u>. Where a jurisdiction requires reporting of the average account balance or value <u>rather than</u> year-end balance, this should be set out in the Agreement, including the applicable rules to determine the average account balance or value, so that it is clear what is being exchanged"[20] (emphasis added). Likewise, "<u>some jurisdictions, however, already require financial institutions to report the average balance</u> or value of the account during the calendar year or other appropriate reporting period. These jurisdictions are free to maintain reporting of that information <u>instead of requiring reporting of the balance or value of the account as of the end of the calendar</u> year or other appropriate reporting period"[21] (emphasis added).

8) While the Standard does not suggest nor promote a sanction or incentive scheme to promote global participation, at least Annex 5 provides an option to collect information on residents from non-participating jurisdictions, foreseeing their future participation.

The Standard's Annex 5 provides: "The due diligence procedures in the CRS (in particular the indicia search procedures) are designed to identify Reportable Accounts understood as those of residents in a jurisdiction that is a Reportable Jurisdiction at the moment the due diligence procedures are performed. <u>However, there are good reasons why jurisdictions may wish to go wider and, for instance, extend due diligence procedures to cover all non-residents or residents of jurisdictions with which they have an exchange of information instrument in place</u>. Such an approach could significantly reduce costs for financial institutions because they would not need to perform additional due diligence each time a new jurisdiction joins" (emphasis added).

[20] Standard, page 47, para. 4.
[21] Standard, page 65-66, para. 11.