



OECD's Automatic Information Exchange Standard: A watershed moment for fighting offshore tax evasion?¹

This fuller analysis complements our [brief initial summary of our concerns about the OECD's report published on February 13, presenting the new global standard for automatic tax information exchange.](#)

1. Introduction

The OECD, a club of rich countries, has published a report on a new global standard for countries and tax havens to exchange information with each other: a crucial tool for tackling offshore secrecy and tax evasion. The OECD is the dominant standard setter for information exchange, and the report represents significant progress by endorsing a principle that civil society organisations have been demanding for many years, and which has now been endorsed by the G20 finance ministers.

That principle is called *Automatic Information Exchange (AIE)*, and the G20 endorsement marks a decisive step beyond the OECD's inadequate previous system of 'on request' information exchange, where a jurisdiction could only request information from a tax haven, say, if it could demonstrate in detail that there was a specific case to answer: in effect, it had to know the information before it submitted a request for it.

The new OECD report responds to a request from G20 finance ministers and central bank governors in April 2013 to flesh out the technical details of how AIE should work in practice.

¹ To contact us about this paper, please write to andres@taxjustice.net or markus@taxjustice.net. Thanks to various members of the [Financial Transparency Coalition](#) for sharing valuable insights and to Mark Herkenrath and Mark Morris for their feedback on an earlier draft. Version dated 12.3.2014. Please visit www.taxjustice.net for more information.

Tolerance for tax evasion has shrunk dramatically in the past couple of years, but to date few serious concrete steps have been taken. The OECD's new report could be the first big step towards assembling the nuts and bolts of real change.

There are many positive details in the report: it is wide in its scope, covering not just individuals but trusts and foundations, and various investment entities. There is a special focus on due diligence checks, a crucial element in any transparency regime.

Perhaps the most promising feature is that under the new system, an enormous hurdle - likely to involve many trillion dollars' worth of assets² - could be tackled for the first time. What could be called 'ownerless' assets are often held in structures such as foundations or discretionary trusts³. These are the mechanisms through which the world's top income earners can hide tax evasion and remain unaccountable.

The new standard requires some trusts to report on the settlor, the beneficiary or any other natural person exercising ultimate effective control over the trust. While further clarifications are needed (in addition to fixing loopholes and extending this provision to foundations, too), this is a significant step towards achieving transparency by obliging those who are best fit to identify the real persons hiding behind these entities widely used for tax evasion.

Yet there are a number of shortcomings in the OECD report. Some are technical, others are political. We are concerned that powerful tax haven interests have inserted themselves into positions of influence in the OECD and forthcoming Global Forum process⁴. There is a risk that in the next months, many of the required adjustments and clarifications will be watered down. This could happen either through fierce direct financial sector lobbying efforts⁵, or in the disguise of state representatives of captured states⁶ who defend their own financial services industry.

² See Price of Offshore Revisited 2012, p102, for a distribution of total offshore wealth: 19.6 tn. US\$ of a total of 20.6 tn. US\$ of offshore financial wealth is owned by only 0.14% of the world population. So the top 1% income earners own far more than 95% of total offshore wealth; see page 102 in:

<http://www.taxjustice.net/cms/upload/pdf/Appendix%203%20-%202012%20Price%20of%20Offshore%20pt%202%20-%20pp%2060-104.pdf>; 5.3.2014.

³ See, for example, here <http://taxjustice.blogspot.ch/2013/06/jersey-90-of-our-business-is.html>; 12.3.2014.

⁴ See, for instance, the composition of the AEIOI group of the Global Forum which is going to be responsible for rolling out the new standard globally and also for devising the terms and procedures for reviewing the correct implementation of the new standard. The membership can be found here:

<http://www.oecd.org/tax/transparency/AEIOI%20Group%20Membership.pdf>; 12.3.2014.

⁵ For an open example of this regarding the European tax transparency project, see this:

<http://www.taxjustice.net/2014/03/06/european-union-savings-tax-directive-amendments-coming-soon/>; 12.3.2014.

⁶ <http://www.taxjustice.net/topics/finance-sector/finance-curse/>; 12.3.2014.

Furthermore, the way developing country interests have been heard or taken into account is far from acceptable and once more challenges OECD's and the Global Forum's role in setting legitimate international tax standards⁷.

The identified concerns need to be addressed for the new standard to contribute to stopping the growth in inequality across and within societies, now identified by the IMF as an important obstacle to economic growth.

2. Summary of our concerns about the new OECD report

- **Developing countries.** The G20 stresses that developing countries should benefit from a more transparent international tax system. We agree, but there are no provisions in the report that cater specifically to their needs. They are expected to jump through impractical and costly hoops if they want to benefit from automatic information exchange and obtain information from tax havens. Not least, they must 'reciprocate'⁸ by setting up complex systems to collect taxpayer information for exchanging with others – even though many don't currently have the administrative capacity to do so, and almost no developing countries are tax havens: dirty money generally flows from poor countries to financial centres in rich countries.
- **Loopholes.** While the technical language seems overall to be sound and coherent, there are a few surprising flaws and in some instances, clarifications are required. Given the likelihood of lobbying attempts by the financial sector to water down the language of the commentary over the coming months, it remains fundamentally important to insist on robust language concerning, for instance, on the following points:
 - **Controlling persons.** Throughout the document, there is reference to 'controlling persons' behind structures such as trusts and secret companies. But international best practice uses the broader, more encompassing definition 'beneficial owner.'
 - **Settlor, singular.** The language about trusts only covers the 'settlor' (the creator of a trust) – when the word should be plural: 'settlors.' This creates an easy escape route.

⁷ See for instance here: <http://www.taxjustice.net/cms/upload/GlobalForum2012-TJN-Briefing.pdf>; 12.3.2014.

⁸ OECD's Pascal Saint-Amans noted that the contradictory position of Switzerland. While it is demanding full reciprocity in the new AIE standard (affecting developing countries the most), it still chose a Model 2 FATCA agreement with the U.S. which does not demand reciprocity - compared to the FATCA Model 1 agreement which was signed by the U.S. and many other countries (<http://www.tagesanzeiger.ch/wirtschaft/Der-automatische-Datenaustausch-ist-in-einigen-Monaten-Standard/story/22822086>).

- **Trusts managed by individual trustees:** While the new standard requires some trusts to report about its relevant parties, this does currently not apply to trusts which are managed by individuals.
 - **Foundations, Anstalts and other “ownerless” entities:** The rules for identifying controlling persons of trusts include most of the relevant parties. However, the relevant parties of similar legal entities such as discretionary foundations or anstalts are not covered by equivalent and specific reporting obligations.
 - **Thresholds.** There are thresholds below which reporting or due diligence checks are not required. It is easy to sidestep reporting by splitting accounts in order to fall below the thresholds, or emptying accounts just before the reporting dates, then refilling them afterwards. We do not support thresholds.
 - **Due diligence checks.** While the report has a special focus on due diligence, it fails to adequately address the crucial issue of checks on taxpayer identification numbers and birth dates.
- **No sanctions.** Without widespread participation in the process, some clandestine activity will be displaced to jurisdictions that refuse to cooperate. Proposals for sanctions will be needed to pressure recalcitrant jurisdictions - but with appropriate allowances made for developing countries.

3. Background

The OECD’s new ‘automatic’ standard will not replace the existing “[upon request](#)” standard but will complement it, while trying to address its many limitations. It will also run in tandem with other bilateral or regional practices of Automatic Information Exchange (AIE), such as the U.S. Foreign Account Tax Compliance Act (FATCA) and the EU Savings Tax Directive (EUSTD.)

The new OECD system contains two main components: a **Competent Authority Agreement** (a model agreement to be signed by jurisdictions willing to implement the new global AIE standard among each other); and the **Common Reporting Standard (CRS)** providing common rules regarding:

- **‘reporting’** (the specific financial account information that will be exchanged: name, address, Taxpayer Identification Number, date of birth, account balance, interest, dividends, etc.,) and
- **‘due diligence’** that certain financial institutions must conduct to identify the residency of reportable persons (individuals, entities and controlling persons of passive non-financial entities) whose financial account information will be

exchanged. Financial institutions will send this information to the local competent authority, which then 'automatically' exchanges the relevant information with the foreign competent authority where the reportable persons are resident.

The OECD report is to be fleshed out by a detailed commentary, providing more precise interpretations of how the standards are to be implemented. We expect this commentary will address some of our concerns below.

The commentary is officially to be presented to G20 finance ministers [in September 2014](#) – but the timeframe for remedying our concerns is more urgent: we expect a final vote on the Commentary to take place at OECD's Fiscal Affairs Committee in June 2014.

4. The problems, and the solutions, in more detail

The section below outlines our fuller range of concerns, in more detail, and proposes improvements. It comes in three parts: first, issues for developing countries; second, fixing the technical loopholes; and third, sanctions.

4.1 Participation of developing countries

The G20 has stressed that developing countries should be able to benefit from a more transparent international tax system. Civil society and opposition parties in developing countries as well as influential bodies such as the African Progress Panel and the African Development Bank have long been calling for automatic information exchange. Yet the proposed OECD standards regarding developing countries' specific needs lack provisions such as the possibility of staged reciprocity.

This adds to the already massive problems of legitimacy the OECD as a club of rich countries faces when taking on the role of drafting international tax rules. It is not the appropriate forum to create international tax rules that apply beyond its membership. It is hardly surprising, then, that developing countries have not been involved in designing the new standard – yet they are expected to meet all the conditions if they are to be allowed to participate.

An example of a lack of responsiveness to their needs is the Global Forum survey on AIE circulated among member states and other countries. While developing countries are correctly asked about their specific capacity building needs, their views on the legal framework or scope of the new standard have not been sought. Furthermore, the timing of the survey indicates that they were never supposed to have a material stake in creating the standard. Nevertheless, low income countries and others are required to pay €15,000

annually to the Global Forum for rendered services. So developing countries have to pay for the creation and delivery of standards in which they do not have a full say⁹.

The choice of the OECD as the standard setter, and the lack of responsiveness to their needs, adds to the obstacles for overcoming domestic political resistance when demanding a crackdown on offshore tax evasion through any new transparency regime. Tax authorities in developing countries are often confronted with political problems when trying to tackle tax evasion by local élites. This often arises because their bosses and their powerful associates are themselves engaged in tax evasion, for which reason they do not want to obtain this information. Therefore, the choice of the OECD and Global Forum for devising the new international AIE-system provides an easy pretext for local elites in non-OECD countries to reject transparency and AIE as a form of imperialism.

While civil society should robustly challenge and unmask this bogus argument, it is also becoming clearer that the only existing forum that has potential legitimacy would be the United Nations Committee of Experts on International Cooperation in Tax Matters. For many years, this Committee has been severely under-resourced. It is urgent that this is upgraded to a more influential, intergovernmental committee – something that has regularly been blocked by most OECD members.

We outline five specific concerns regarding developing countries.

⁹ For more on this asymmetry between developing countries and the OECD, see page 6-11, here: <http://www.taxjustice.net/wp-content/uploads/2014/03/Global-Forum-2012-Creeping-Futility-TJN-Briefing-1.pdf>. The Global Forum, which currently pays the OECD for services rendered, should also be made fully independent from the OECD, as a transitional move towards a greater role of the United Nations in setting and implementing international tax rules.

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| <p>1. Reciprocity</p> <p>The OECD report assumes ‘reciprocity’, meaning that developing countries can be excluded from the process if they do not provide to tax havens (and others) the same kind of information that they are provided with. This is unfair: <u>first</u>, many developing countries do not have the resources or capacity to collect the information; <u>second</u>, very few tax havens are located in developing countries, so there is little point in requiring immediate reciprocity.</p> | <p>Fix</p> <p>There should be model provisions for staged reciprocity, for which developing countries would be eligible.</p> <p>For those developing countries with small cross-border financial services markets, reciprocity requirements should be waived. Once their market grows above a certain threshold (such as the size or per-capita size of financial services exports to non-residents, or the number of incorporations per head) then a second stage of reciprocity would be triggered¹⁰.</p> |
| <p>2. Local confidentiality</p> <p>Even if developing countries are not excluded by reciprocity demands, the Model CAA allow tax havens and other countries to impose their own domestic confidentiality requirements before exchanging information with developing countries¹¹.</p> | <p>Fix</p> <p>The agreement should at the very least place constraints on countries from imposing additional conditions before signing a CAA with any country that requests it.</p> <p>The OECD could include additional provisions stating that “In no case shall</p> |

¹⁰ This data is readily available for 217 jurisdictions worldwide, based on methodology and data published by the IMF (e.g. Zorome 2007.) Zoromé, Ahmed 2007: Concept of Offshore Financial Centers: In Search of an Operational Definition (IMF Working Paper), Washington D.C., in: <http://www.imf.org/external/pubs/ft/wp/2007/wp0787.pdf>; 26.9.2011. This methodology is used with updated data for the construction of the Financial Secrecy Index every two years.

¹¹ The text reads: “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” [emphasis added]. Even if applicable bilateral treaties imply that a developing country already complies with confidentiality provisions, the data protection requirements could now be increased by the developed country, because of the higher amount of information that would be exchanged under AIE. Most double tax agreements use the “upon request” standard described above, which contemplates exchanging information regarding a specific person whose information was sought. By contrast, the new standard of automatic exchange of information covers information of all reportable persons who are resident in one jurisdiction.

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| <p>While this provision could help overcome constitutional problems for exchanging data in some cases, it opens the way for potential abuse by tax havens to use these concerns as pretext for generally not sending data to lower income countries.</p> | <p>domestic law provisions of confidentiality be construed to permit a jurisdiction to decline to sign a CAA or engage in bilateral AIE with another jurisdiction that so requests it”.</p> |
| <p>3. Bilaterals, not multilateral</p> <p>The above problem is exacerbated by the fact that – as discussed in the section on loopholes below - the CRS emphasise bilateral agreements, and make it only optional to sign a multilateral agreement. Bilateral agreements are costly to implement and open possibilities for tax havens to demand additional concessions from developing countries (see e.g. pp1-3 here for an example of how that might be done).</p> <p>They also raise the risk of inconsistency between different bilateral agreements.</p> | <p>Fix</p> <p>The standards should make it the norm, rather than just an option, for the CAA to be signed on a multilateral basis.</p> <p>Having a multilateral CAA as the norm would help reinforce the above point on local confidentiality requirements. A multilateral CAA that allows reservations could replace bilateral CAAs altogether: by default, parties to the Multilateral CAA will agree to AIE with all jurisdictions; reservations could be allowed to exclude AIE with specific countries, for specified reasons.</p> |
| <p>4. Capacity Building</p> <p>Revenue authorities in developing countries in many cases will need to develop capacity to handle automatic information.</p> | <p>Fix</p> <p>The OECD (and G20 and Global Forum) should, when requested, provide material and technical support to help developing countries benefit from AIE, such as training, IT infrastructure and helping with legal and regulatory changes. We recommend that this become a priority task for Tax Inspectors Without Borders.</p> <p>A new international development fund should fund this, in addition to existing capacity building programmes. It could be administered by the UN Tax Committee.</p> |

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| | <p>There is a risk that ‘capacity building’ could become a rhetorical concession to justify demands for ‘reciprocity’ as outlined above.</p> <p>So developing countries without large cross-border financial services sectors should be allowed to judge for themselves whether and how best to use capacity building and to address domestic tax challenges, and should be given full policy space to pursue them without interference from OECD.</p> |

4.2 The technical loopholes

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| <p>5. A trust managed by individual trustees is not a “financial institution”</p> <p>The common reporting standard does not only rely on banks for reporting of relevant accounts. Trusts can in some circumstances be defined as financial institutions (or “investment entity”). In those cases, they would need to report about the settlor and potential beneficiaries (CRS page 34).</p> <p>However, the language defining the trusts which are financial institutions (CRS page 29) leaves out trusts that are managed by individuals¹².</p> | <p>Fix</p> <p>Clarify that trusts are considered to be financial institutions with reporting obligations in a specific country if any part of the trust management (any trustee) is a resident of that country, irrespective of the trustees being legal entities or individuals, and independent of whether the trust is managed professionally or not.</p> |

¹² The guidance notes for implementing the UK FATCA-agreement points to an additional potential problem since it also excludes those trusts which are “not professionally managed” (pages 58-59, here: <http://www.hmrc.gov.uk/drafts/uk-us-fatca-guidance-notes.pdf>; 11.3.2014). It remains unclear what exactly means “professionally managed” in this context and if this problem may be taken over in the commentary to the CRS.

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| <p>6. Controlling persons</p> <p>The common reporting standards refer to ‘controlling persons’ instead of ‘beneficial owners,’ which is the normal international standard set by the FATF.</p> <p>All entities ultimately have (or can be deemed to have) beneficial owners: that is a natural person who owns and/or controls them¹³. Not all have ‘controlling persons’ – such as when a shareholding is atomised or is a minority stake.</p> <p>Furthermore, even the FATF rules, to which the CRS is making reference, are weak in some important aspects. For instance, in case of an account held by a company, a (nominee) director could be registered as a beneficial owner if other mechanisms fail¹⁴. These problems are clearly replicated with OECDs CRS.</p> | <p>Fix</p> <p>The notion of “Controlling persons” should be replaced by the broader definition of “Beneficial Owner” based on an improved version of the definition by the Financial Action Task Force¹⁵.</p> <p>This definition should cover the ultimate natural persons, disregarding any intermediate chain of control or ownership made up of legal persons, whether incorporated in different jurisdictions or not. Nominee directors or any other sham nominee service provider should not be considered a controlling person or a beneficial owner. If any account holder fails to provide all the necessary information to determine the ultimate beneficial owner or owners, the account should be closed and the Financial Institution should file a report to the Financial Intelligence Unit (FIU).</p> <p>The AIE standard should require participating jurisdictions to establish public registries of beneficial ownership information for all legal persons and</p> |

¹³ Even Pascal Saint-Amans, head of OECD’s tax department, said that an efficient exchange of information has to include “beneficial owners” (“Ein effizienter Datenaustausch muss die wirtschaftlich Berechtigten mit einbeziehen” <http://www.tagesanzeiger.ch/wirtschaft/Der-automatische-Datenaustausch-ist-in-einigen-Monaten-Standard/story/22822086>).

¹⁴ Pages 60-61, in: Financial Action Task Force 2012: The FATF Recommendations. International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation (February 2012), Paris, in: http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf; 6.6.2013.

¹⁵ The FATF definition is as follows: (FATF 2012, Page 10915:) “Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.” (“Reference to “ultimately owns or controls” and “ultimate effective control” refer to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control.”) While this definition is useful as a conceptual basis, the way the FATF breaks it down to trusts and foundations is insufficient. Sections 5-8 referring to ‘ownerless assets’ describes tools to tackle these problems.

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| | arrangements: companies, partnerships, trusts, foundations, etc. |
| <p>7. Trusts general: settlor, singular</p> <p>When defining the Controlling Persons of a trust, the standards cover <i>“the settlor, the trustees, the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust”</i>.</p> <p>Our emphasis added.</p> | <p>Fix</p> <p>The word “settlor” should be plural - just like the other persons identified in the standard - and should explicitly include the “contributors of the funds”, to avoid identifying instead the nominee lawyer who formally settles the trust.</p> <p>If not all related parties of a trust can be identified, including its beneficial ownership, the associated bank accounts of the trust should be frozen and later closed, and a suspicious activity report be filed.</p> |
| <p>8. Lack of provisions on foundations and other ownerless assets</p> <p>While the CRS introductory comments refer to foundations, the only reference to them in the CRS legal text is to include foundations or anstalts as an “entity”.</p> <p>An enormous problem – likely to include several trillion dollars’ worth of assets¹⁶ – involves what might be called ‘ownerless’ assets held in structures such as discretionary foundations.</p> <p>With a discretionary foundation, for example, assets are given away into the foundation, but until a distribution is made, possibly decades in the future, there is no immediately identifiable beneficiary. Legally speaking, nobody is (yet) even entitled to those assets, until the foundation council (and protector) use their ‘discretion’ to make a distribution. Since the</p> | <p>Fix</p> <p>The new OECD standards rely too heavily on financial institutions for reporting. The best solution for ensuring the proper reporting of assets without any immediate beneficial owners (trusts, foundations, anstalts, etc.) is to explicitly oblige the managers of trusts, foundations and anstalts (and the directors of companies) to report about the entities and related persons. It is the managers of these entities and arrangements, rather than the banks that arrange the payments on their behalf, who possess all the necessary information.</p> <p>This reporting obligation is present for some trusts (though with loopholes and other problems mentioned above which need to be fixed). The CRS should thus clearly extend these same provisions and include structure-specific terms</p> |

¹⁶ See, for example, here <http://taxijustice.blogspot.ch/2013/06/jersey-90-of-our-business-is.html>

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| <p>assets at this point in time have been given away but nobody has yet received (or become entitled to) them, they are, legally speaking, in an ‘ownerless’ limbo - so in theory, no jurisdiction can claim taxing rights over them.</p> <p>With respect to discretionary trusts, which are similar to discretionary foundations, this problem has been addressed at least partially in the CRS (see points 5-7 above). However, there are no provisions in the CRS regarding a foundation’s related persons (founder, contributor of the assets, foundation council, protector or beneficiaries) nor any express stipulation of foundations being equal to a financial institution with the consequent reporting obligations on its beneficial owners (or at least controlling persons).</p> | <p>(“foundation council”, etc.) to foundations, anstalts and other similar structures.</p> |
| <p>9. Active and Passive NFEs</p> <p>The CRS only requires financial institutions to look into the controlling persons of passive non-financial entities (NFEs). Determining whether an entity is a “passive” or “active” NFE depends on the percentage of income (more than 50%) being “passive income”. In practice, this determination may be very hard to make for a financial institution on the ground. Still, it has a major consequence because if deemed an “active” NFE, then CRS would not require to look into the controlling persons.</p> | <p>Fix</p> <p>Alongside the Beneficial Ownership rules described above, all beneficial owners¹⁷ of all entities that are reportable persons (regardless of whether it is a passive or active non-financial entity) should be identified and considered reportable persons - in addition to the entity itself.</p> <p>Information should be sent to <u>both</u> the entity’s country of residence, <u>and</u> to every beneficial owners’ country of residence.</p> <p>This would promote transparency and be useful as a source of beneficial ownership information for tax administrations, since</p> |

¹⁷ If our suggestion of “beneficial ownership” (instead of “controlling person”) is not addressed, then reporting should refer to the “controlling person”.

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| | <p>most countries do not yet have effective beneficial ownership registries¹⁸.</p> <p>Another option – not as effective as the one mentioned above, but still better than the current standard – would be to require financial institutions to deem all NFEs to be “passive NFEs” by default, unless proven differently. This would imply reversing the burden of proof for non-reporting and may be far more practical for financial institutions in any case.</p> |
| <p>10. Account balances, reporting thresholds</p> <p>The size of the balance of an account affects how far due diligence checks should go and, if the balance is small enough, whether there is any reporting at all. Under the current proposed standard, existing entity accounts with a balance below US\$250,000 need not be reviewed, identified or reported, creating a loophole.¹⁹</p> <p>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.</p> <p>Beyond the question of whether or not reporting happens, it is also important to consider the quality of account balance data that is reported.</p> | <p>Fix</p> <p>First, the threshold for reporting should be eliminated or dramatically reduced, to no more than US\$ \$10,000. Otherwise, one would expect a systematic restructuring of existing entity accounts just before the new system comes into effect.</p> <p>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.</p> <p>Financial institutions should also be obliged to adapt their computer systems to</p> |

¹⁸ For those jurisdictions which already have a beneficial ownership register, this reporting of beneficial ownership information would serve for cross-checking purposes.

¹⁹ Particularly with the widespread deposit insurance schemes across the world which usually protect up to €100,000 per bank customer in case of bank failures, the usual portfolio management strategy of wealthy individuals may anyway tend towards smaller balances in many different bank accounts.

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| | add up the total account balances for each client with multiple accounts. Accounts held in name of a legal entity or arrangement should be “looked through” to identify the beneficial owners of the accounts. |
| <p>11. Mobile residency</p> <p>The due diligence checks to identify all reportable persons rely on determining the residency of the reportable persons. Under the standards, financial institutions are expected to take reasonable efforts to identify genuine residency. While the CRS refer to “changes of circumstances” that could determine that a self-certification or other account documentation is incorrect or unreliable, these “changes of circumstances” are not yet defined.</p> <p>However, it is increasingly easy for individuals to move residency elsewhere, as more jurisdictions offer easy residency packages. This could be another way to escape reporting.</p> | <p>Fix</p> <p>Anti-avoidance provisions should be applied: such as to check for recent and unjustified changes of residency, and for warning signs such as tax havens giving away real residency documents in exchange for investment. “Changes of circumstances” need to be defined, and – among other - should trigger requests for new and valid recent certificates of residency.</p> <p>An OECD-coordinated process for certificates of tax residency in combination with international tax identification numbers could help remedy this problem in the medium term.</p> |
| <p>12. Taxpayer Identification Numbers (TINs) and date of birth</p> <p>TINs are crucial tools to enable jurisdictions to match information they receive with their own taxpayers²⁰. But the standards seem to fall short here.</p> <p>For example, relevant financial institutions are supposed to use ‘reasonable effort’ to determine a TIN and date of birth within two years of identifying a Reportable Account – but there is no indication what happens if they fail to find this information.</p> | <p>Fix</p> <p>Due diligence provisions should also focus on reasonable means (e.g. provide algorithm or evidentiary documentation) to ascertain the validity of TINs. If a TIN and date of birth are not provided by the second year, the account should be closed. Jurisdictions should also be encouraged, within a suitable timeframe, to issue and require the collection of TINs.</p> <p>The OECD should also coordinate an effort to create consistent TINs across the globe,</p> |

²⁰ See for instance here: <http://www.taxjustice.net/cms/upload/pdf/AIE2012-TJN-Briefing.pdf>; 12.3.2014.

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| <p>There are also few measures for addressing the issue of fake TINs.</p> <p>Because the efficiency of any automatic information exchange system hinges upon the smooth automatic matching of data records, a lack of rigor in this area risks to lead to great frustration among tax administrations and may reduce political support for the new standard.</p> | <p>similar to the work around legal entity identifiers for financial market participants developed by the Bank for International Settlements (BIS.)</p> |
| <p>13. Undocumented accounts</p> <p>Pre-existing individual accounts may have only a ‘hold mail’ instruction or an ‘in-care-of’ address, with no other address available. In this case, the CRS require the financial institution to report the account as “undocumented” to its tax authorities, but not to all reportable jurisdictions. There is no indication, as yet, that these accounts should be closed.</p> | <p>Fix</p> <p>Undocumented accounts and any account whose beneficial owner cannot be determined must be closed and the account balance transferred to the tax authority within the country that is most closely associated with the account.</p> <p>Banks should also be obliged annually to file and send to their domestic competent authority a statistical control file summarising the number of and amounts in different account categories created by the new AIE standard.</p> <p>This report should reconcile these reported figures with the entire figure for assets under management by country in order to detect and prevent avoidance schemes. The competent authority should forward this report to all AIE-partners.</p> |

| TECHNICAL LOOPHOLES AND EXCLUSIONS | |
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| The problem | The fix |
| <p>14. No reporting if law prevents sale</p> <p>The CRS say that a Preexisting Individual Account that is a Cash Value Insurance Contract or an Annuity Contract is not required to be reviewed, identified or reported, provided the Reporting Financial Institution is effectively prevented by law from selling the Contract to residents of a Reportable Jurisdiction. This would be understandable in a world of effective law enforcement – but intermediaries routinely circumvent these controls. This could be a big loophole.</p> | <p>Fix</p> <p>Remove this exemption.</p> |
| <p>15. Non-reporting financial institutions</p> <p>The CRS say that certain supposedly low-risk financial institutions can be exempted from reporting requirements. Tax havens have shown themselves to be fundamentally untrustworthy when sticking to the spirit of the rules; it is risky to let them decide which institutions do not need to apply the reporting requirements.</p> | <p>Fix</p> <p>Remove this exemption.</p> |
| <p>16. Freeports and hard assets</p> <p>While the CRS cover financial institutions, it is not applicable to the burgeoning rash of avoidance schemes that involve warehouses, freeports, safe deposit boxes and other storage mechanisms, which have a business model of applying few controls or reporting obligations (see here, for example). Furthermore, non-financial wealth such as real estate, yachts or gold is not covered by reporting.</p> | <p>Fix</p> <p>The CRS scope of financial institutions (reporting agents) should include an additional category of entities (“alternative investment entities”) that should include warehouses, freeports, immovable property registries etc. Furthermore, in addition to the category “financial assets” an additional wealth category should be added (“alternative assets”) that encompasses real estate, safe deposit boxes, gold and diamonds, yachts, ships, private jets, and other forms of extreme wealth.</p> |

| TECHNICAL LOOPHOLES AND EXCLUSIONS | |
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| <p>17. Accounts under court orders</p> <p>An account subject to a court order is not required to be reported. So there might not be any registration of the beneficiary of the account.</p> <p>Fake lawsuits are common as a way to move money offshore or justify illicit origin of funds²¹. If accounts under court orders are excluded from reporting, then a person who won a lawsuit could withdraw all the cash (instead of transferring the money to his bank account) and this way he could avoid reporting on this amount, and the money trace would be lost. While it is true that the court or judge would know who the beneficiary is, unless there is any kind of reporting from the court or the financial institution, there will be no reporting to the corresponding jurisdiction.</p> | <p>Fix</p> <p>Eliminate that exclusion, with appropriate safeguards.</p> |
| <p>18. Specialty Principle: “for Tax Purposes”</p> <p>The Model CAA limits the exchange of information to those which are “for tax purposes” and allows jurisdictions to determine the scope and modalities of such exchanges²². This seemingly innocent provision may actually enable the supplying jurisdiction (e.g. tax haven) to prevent the recipient jurisdiction’s tax</p> | <p>Fix</p> <p>The agreement should at the very least place constraints on countries from preventing competent authorities to share information with other law enforcement agencies within the same country which could be used to tackle corruption and other matters related to illicit financial flows.</p> |

²¹ See for instance here: <http://www.cbc.ca/news2/interactives/offshore-tax-havens/>; 11.3.2014.

²² The Model CAA reads: “Whereas, [Article [...]] of the Income Tax Convention between [Jurisdiction A] and [Jurisdiction B]/[Article 6 of the Convention on Mutual Administrative Assistance in Tax Matters] (the “Convention”)/[other applicable legal instrument (the “Instrument”)], authorises the exchange of information for tax purposes, including the exchange of information on an automatic basis, and allows the competent authorities of [Jurisdiction A] and [Jurisdiction B] (the “Competent Authorities”) to agree the scope and modalities of such automatic exchanges;” [emphasis added].

| TECHNICAL LOOPHOLES AND EXCLUSIONS | |
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| <p>authorities from sharing the received information with law enforcement agencies, even if the information could be relevant for corruption or money laundering cases²³. It is not surprising that this was one of Switzerland’s concerns which was included in the CRS²⁴.</p> | |
| <p>19. Reporting information <u>only</u> of those persons who are resident in a participating jurisdiction.</p> <p>This allows residents of non-participating jurisdictions to benefit from having no reporting of their financial account information</p> | <p>Fix</p> <p>Countries should extend due diligence procedures for pre-existing and new accounts to cover all non-residents or, at the very least, residents of countries where they have an exchange of information instrument in place because some of this information could at least be exchanged spontaneously.</p> <p>In addition, this could also provoke a deterrent effect on tax evaders who are residents in jurisdictions which are not yet engaging in AIE.</p> |

²³ The OECD Convention on Mutual Assistance in Tax Matters addresses this issue in Article 22.4 regarding Secrecy: “Notwithstanding the provisions of paragraphs 1, 2 and 3, 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 [...]” [emphasis added]. The OECD Model Convention Article 26 however, did not even allow for this other (non-tax) uses: “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” [emphasis added]. It was only with the 2012 update of Article 26 that information could be shared for other (non-tax) uses, though again, as long as the supplying jurisdiction allows it. The update added “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 of both States and the competent authority of the supplying State authorises such use”.

²⁴ <http://www.nzz.ch/wirtschaft/wirtschafts-und-finanzportal/baldige-verabschiedung-neuer-standards-zum-informationsaustausch-1.18230257>; 11.3.2014.

4.3 SANCTIONS

| The problem | The fix |
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| <p>20. Lack of sanctions</p> <p>The OECD standards do not outline sanctions for recalcitrant jurisdictions.</p> <p>Yet the fewer that participate, the easier it will be to migrate assets or structures to non-participating jurisdictions, which will become <i>de facto</i> secrecy jurisdictions. So it is essential to encourage and, if necessary, coerce recalcitrant jurisdictions to join in. The more jurisdictions that participate, the more effective the system will be.</p> <p>Switzerland, for instance, implicitly rejected the OECD standards within 24 hours of their being published, using the devious but common ‘level playing field’ argument: ‘we won’t participate until everyone else does.’ It has subsequently made more nuanced noises but the point is clear: sanctions are an essential part of this process.</p> <p>The legitimate needs of developing countries should not interfere with this sanction regime: for them, sanctions should take careful account of appropriate staged reciprocity arrangements.</p> | <p>Fix</p> <p>There should be sanctions for any jurisdiction with a substantial level of per-capita cross-border financial services that reject AIE in order to attract illicit financial flows.</p> <p>Sanctions could, for instance, be based on U.S. FATCA’s 30 percent withholding tax: a threat that ensured quite wide adherence to the scheme.</p> <p>Any Reportable Person whose country of residence does not participate should be liable to a 30 percent withholding tax on the account’s income.</p> <p>Again, developing countries engaging in staged reciprocity should not be affected by the withholding tax. Part of the revenues from this withholding tax could be used to fund capacity building in low income countries.</p> |

Conclusion: every law has a loophole

We have identified various loopholes, and there is always the risk that lawyers and bankers will identify other loopholes which they can sell to their clients. For this reason the language, particularly when referring to the people involved with trusts and foundations will need to be as clearly defined as practicable.

To put pressure on lawyers and bankers to cooperate, we suggest that regulators should require financial institutions to seek advanced approval for new avoidance schemes. They should be required to identify any relevant change that took place between the G20

decision to adopt the new AIE standard (2013) and the effective date in which reporting becomes applicable. This should include changes in residency, closing or transfers of accounts, discontinuance of trust distributions, and large withdrawals of cash over the period.

For decades tax authorities have been too permissive of the culture of tax avoidance that pervades the legal and banking professions. It is overdue that this culture be aggressively countered in order to restore to sovereign governments their ability to tax in a just and progressive fashion. The OECD proposals for a new international AIE standard have the potential for taking the world in precisely that direction.



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