Automatic Exchange of Tax Information:

A Primer on Concepts, Loopholes and Developing Countries' Concerns

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Contents

Glossary

ATAF	African Tax Administration Forum
AEOI	Automatic Exchange of Information
CRS	Common Reporting Standard
DTAAs	Double Tax Avoidance Agreements
EOI	Exchange of Information
EOIR	Exchange of Information upon Request
FATCA	Foreign Account Tax Compliance Act
HIC	High Income Countries
IFFs	Illicit Financial Flows
CIAT	Inter-American Center of Tax Administrations
KYC	Know Your Customer
LMIC	Lower and Middle Income Countries
MNCs	Multi-National Corporations
MCAA	Multilateral Competent Authority Agreement
MCMAA	Multilateral Convention on Mutual Administrative Assistance in Tax Matters
NRFI	Non Reporting Financial Institution
OECD	Organisation for Economic Co-operation and Development
RFI	Reporting Financial Institution
SEOI	Spontaneous Exchange of Information
TIN	Tax Identification Numbers
TIEA	Tax Information Exchange Agreements
TJN	Tax Justice Network
UMIC	Upper and Middle Income Countries

I. Introduction

One salient feature of modern day business operations is their trans-national and cross-border nature. While, multi-national corporations (MNCs), by their very design, have subsidiaries in more than one country or jurisdiction; even domestic firms, who don't have direct overseas presence are more likely to engage in business transaction with overseas firms and entities. This phenomenon of crossing national boundaries for business purposes is not limited to corporations alone; individuals too own assets, earn income, work and engage in business transactions outside their home country or the country of their legal residence. (Hereafter, individuals and business firms combined will be referred to as taxpayers in this document.) From the perspective of national governments, this cross-border nature of business by its tax payers creates the situation where the information related to a single tax payer or business transaction is scattered across multiple jurisdictions; meaning each country involved only has limited information about the transaction or the tax payer. Due to this limited information, national governments find it difficult in many cases to determine if a particular cross-border transaction is legal or illegal. Even in cases which are suspected to be of illegal nature, incomplete availability of information proves a hurdle in further investigation. This hurdle to law enforcing agencies creates further incentive for the tax payers to engage in cross-border transactions with the primary aim of evading or avoiding paying their fair share of taxes.

To overcome some of these problems, countries seek to cooperate with each other in different ways, including simultaneous audits of financial information, sharing best practices between tax departments, training and learning from each other, tax examinations abroad, etc. One such important and continually growing mode of cooperation in the area of international taxation is known as 'Exchange of Information' (EOI), in which two or more countries exchange the pre-defined tax and financial information regarding their respective tax payers with each other.

In this context, the primer tries to provide answers to some of the basic questions related to exchange of information, such as:

1. What is Exchange of Information?
2. Why is Exchange of Information needed?
3. What are the different types of Exchange of Information?
4. What is Automatic Exchange of Information?
5. What are the legal requirements for Exchange of Information?
6. What are the current international standards for Exchange of Information?
7. Who designs the international standard for Exchange of Information?
8. What are the weaknesses in the current standard?
9. Are there any developing countries specific issues related to Exchange of Information?

It is to be noted that while the term 'exchange of information' in certain cases can also refer to information exchange between countries related to non-tax issues like security, cyber space, criminal cases, etc; this primer uses the term 'exchange of information' exclusively for exchange of tax and financial information.

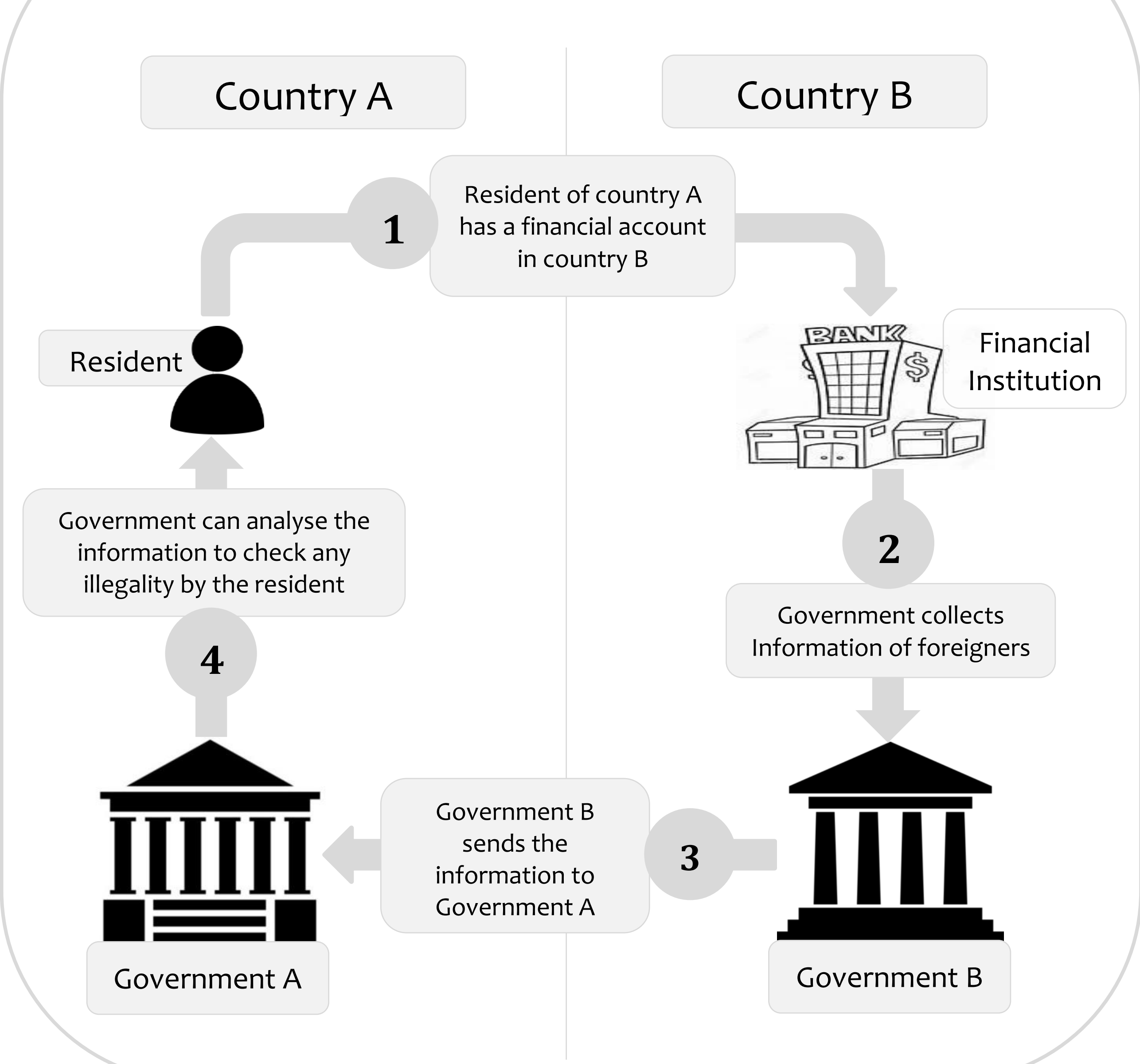
II. Exchange of Information

What is Exchange of Information?

Exchange of Information refers to a process, in which two or more jurisdictions exchange pre-agreed information with one another. More specifically, this process is referred to as 'Exchange of Tax and Financial Information' where the information is used for tax and related issues. The information shared by a sending jurisdiction with a receiving jurisdiction, in most cases, is related to the residents or tax payers (individuals as well legal entities, like companies) of the receiving jurisdiction.

The following picture illustrates the basics of exchange of information:

Chart I: How Information Flows



The process of exchange of information can be understood with the accompanied picture. A tax payer, who is a resident of country A, opens an account in a financial institution based in country B. The government of country B collects the information from the financial institution and finally shares it with country A. Based on this information, government of country A can check if its resident are breaking any law or evading any taxes.

This picture depicts only one side of flow of information, i.e. – Tax payer of country A having information in country B, and that information shared by country B with country A. However, in an exchange of information process, information can flow in both directions. For example – a resident of country B also can have financial accounts in an institution in country A, and the government of country A can collect such information and then share it with the government of country B.

Though the picture provides an overview of how information flows, there are many more aspects to the process of exchange of information, such as method of exchange, when countries exchange information, the kind of information to be exchanged, the legal agreements for exchange, etc. These aspects are discussed in the subsequent sections.

Why is Exchange of Information needed?

The last few decades have been marked by rapid globalisation. This is characterised by financialisation of capital, cross-border capital flows including foreign direct investment, increase in international trade, international business transactions, cross-border movement of individuals for business or personal reasons, overseas expansion of business establishments, and other such developments. Advancements in technology and telecommunication have also aided this process, such that a business deal can be carried out a by business person in a geographical location different from where they are present. Similarly a financial transaction can be carried out from one's home/office on a bank account situated overseas. These developments mean that it is now relatively easier for a tax payer of one country to earn income from overseas sources, own assets (tangible and intangible) overseas, carry out financial transactions overseas and so on. Since these transactions take place outside the legal jurisdiction of the domestic authorities, national governments do not have complete details about such income, wealth and financial transactions of its tax payers. By engaging in cross-border processes, one has the opportunity to hide information from their government; and this can be used for carrying out nefarious activities including:

- Tax evasion: It is the illegal action by way of which a tax payer does not pay tax or pays less taxes than what is required by the law;
- Tax avoidance: It is the abusive process by way of which tax payers use loopholes in tax laws to pay less than their fair share of taxes. Though not illegal in the strict technical sense, this is against the spirit of law;

- Money laundering: It is a process through which money earned from criminal or illegal activities are made to seem legitimate. This is done by moving the money through several layers such that illegal source become unidentifiable;
- Other illegal/criminal purposes like drug trafficking, arms trafficking, bribery, etc.

Each of the above processes has many negative consequences for the country and society at large. For example – tax evasion/avoidance means that governments in many countries are not able to raise the resource they need to provide the public basic facilities like – education, health, social security, water, electricity, etc. Because of these reasons, it is required that governments are able to access information about its residents from other countries.

A government can access information regarding its tax payers through exchange of tax and financial information with another country. However, countries seeking such information may not be given the same by nations who possess this data. For example – in any cross-border transaction by a tax payer, there are at-least two countries involved – the country A where the tax payer belongs to and the country B where the tax payer carries out the financial transaction. In the cases where the cross border aspect is being used for tax evasion/avoidance purpose, this can be stopped or curbed if the country A can access the information about the tax payers from country B. However, this may also lead to some loses in the country B, such as loss of business for the financial institutions used by the foreign tax payer, loss of business of other subsidiary services like – legal, accounting, hospitality, etc. Because of this reason, while country A wants the information, country B may not be willing to share. If both the countries involved here are similar/comparable such that tax payers from both countries use other country to engage in tax evasion/avoidance, then both countries will gain by sharing information. Though in case where both countries are dissimilar, such that tax payers from only one country A use country B to carry out financial transactions, then not only country B is very unlikely to provide information, but it has very high incentive to make efforts such that country A is not able to access information from country B. In fact, there are jurisdictions and countries which create special laws and regulations to ensure that information about foreign tax payers is not accessible to their respective governments. Broadly, such countries are known as tax havens or secrecy jurisdictions.

Tax havens or secrecy jurisdictions are jurisdictions, countries or cities and regions within countries that have the following characteristics[1]:

- Low or no taxes: Tax rates (both personal and corporate) in tax havens are extremely low when compared to other countries. Tax havens also often have a territorial tax system, by way of which they tax their own citizens but not foreign nationals and foreign entities.
- Lack of transparency: Along with an escape from tax, tax havens also offer an escape from financial regulations by sidestepping due diligence processes; and transparency standards with regard to corporate ownership, financial accounts, assets and transactions.
- Lack of effective exchange of information: They systematically try not to engage in exchange of information with other country
- No requirement of substantial value creation activity: Foreign nationals and businesses can carry out financial transactions from tax havens even when no real businesses or economic activities are taking place there, and the transaction actually involves a business which is situated in a different country.

Here it is important to note that all countries that are unwilling or unable to share such information are not necessarily tax havens. Some of the least developed and developing countries don't have the infrastructure required to collect and send information to foreign authorities. However, such countries are also very unlikely to be used for tax dodging purposes by foreign nationals. In this regard, one of the essential features of tax havens is that they are used by foreign entities for tax dodging purpose. The fact that their domestic governments find it difficult to access information from tax havens provides incentives to the tax payers to indulge in tax dodging though tax havens.

By accessing relevant information, government authorities can check if a particular tax payer is evading or avoiding taxes or carrying out any other illegal activities. EOI also helps in domestic and foreign income earned by its resident being treated equally, thus discouraging artificial movement of income and wealth abroad.

What are the different types of Exchange of Information?

There are mainly three ways in which countries can exchange information, as follows:

1. **Exchange of Information upon Request (EOIR)**: Under this arrangement, if and when one of the signatory jurisdictions needs the information regarding one of its tax payers, which may be available in the legal jurisdiction of other signatory; the former makes a request for the specified information to the latter. If the asked information fits the criteria defined in the agreement, then the latter jurisdiction provides the information to the former.

2. **Spontaneous Exchange of Information (SEOI)**: Under this method, the authorities in one country may share information regarding a foreigner with its home country, if and when they find such information and deem it relevant for the latter. The exchange requires that there is an agreement between both the countries to share such information.

3. **Automatic Exchange of Information (AEOI)**: Under this method, the participating jurisdictions exchange information automatically on a regular interval. Various details, like kind of information to be exchanged, the frequency of exchange, means of exchange are all decided in the agreements.

Of the three, exchange of information upon request has been historically the preferred method in most cases of information exchange, while automatic exchange of information has become popular in recent times. Spontaneous exchange of information is used rarely and is not preferred due to its irregular nature. Between a pair of countries, depending on the agreement, one or more of the three methods could be used for EOI. It should be noted that countries do not have to choose one of the methods for exchanging information exclusively – information can be exchanged using two or even all three methods simultaneously. For example, based on information received under AEOI or SEOI, one country may start investigation and in case of need may ask the former for more information under EOIR.

What are the legal requirements for Exchange of Information?

Since tax and financial information is considered confidential and is protected by confidentiality legal provisions in most countries, the disclosure of such information to a foreign jurisdiction may be legally challenged. Also, in absence of a legally binding agreement, there is a possibility that countries may not exchange information on a continuous and reliable manner. To address these concerns, countries enter into agreements which make it legally binding on countries and providing the legal basis for exchanging information. There are four types of major international agreements, as follows:

1. **Double Tax Avoidance Agreements (DTAA)[2]:** When an individual or a legal entity engages in an economic activity in another jurisdiction, it creates the situation where countries acting unilaterally can lead to either double taxation or double non-taxation of certain income. To decide each country's jurisdiction over such income, countries enter into Double Taxation Avoidance Agreements. In most cases, the agreements also have provisions which allow countries to access the information regarding its residents from the partner signatory country. Mostly, DTAAs are based on the two model DTAAs published by Organisation for Economic Co-operation and Development (OECD) and United Nations.

2. **Tax Information Exchange Agreements (TIEA)[3]:** While DTAAs are primarily aimed at sharing taxation rights, TIEAs refer to the agreements which are aimed exclusively for allowing countries to exchange information regarding one another's residents. TIEAs are generally based on the model TIEA published by OECD in 2002.

3. **Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MCMAA)[4]:** In 1988, the Council of Europe and OECD jointly developed MCMAA for allowing countries to co-operate in the area of international taxation. Originally, MCMAA was only for the members of either organisation. Following the work undertaken by the G20 and OECD on information of exchange issues, MCMAA was amended in 2010 and was made available for other countries in 2011. This convention has provisions for facilitating the exchange of information between the signatory jurisdictions.

4. **Foreign Account Tax Compliance Act (FATCA)[5]:** FATCA is a domestic law of the United States of America (USA), which requires specified foreign entities to report the assets held with them by USA residents. Since this requires disclosure by foreign entities, an Inter-Governmental Agreement (IGA) is signed between USA and other countries. FATCA has limited reciprocity, implying that while USA receives much of the information it requires regarding its residents from all over the world, it provides very little information about foreigners to their respective home countries.

Along with providing the legal basis for exchange of information, these agreements also give the specific details of information, processes, scope, and other related details, for example the channel or mode to make requests for information, the mandatory timeline to respond to requests, dispute resolution mechanism , etc.

Global Forum on Transparency and Exchange of Information for Tax Purposes

The Global Forum on Transparency and Exchange of Information for Tax Purposes (hereafter Global Forum) is an international organisation which oversees exchange of information between countries[6]. With 147 member countries as of December 2017, it is the largest international organisation working in the area of exchange of information.

The Organisation for Economic Co-operation and Development (OECD) established 'Global Forum on Taxation' (the Forum) in 2000 to work on exchange of information. Its membership, however, was limited primarily to OECD countries and a few others, which were identified as the jurisdictions with harmful tax regime in the 1998 report titled "Harmful Tax Competition: An Emerging Global Issue[7]". After the global financial crisis of 2007-08, the issues of tax evasion and tax avoidance, both of which are combined known as tax dodging started receiving increased attention globally, and international organisations like the G20, shifted their focus to this subject. At the behest of G20, the OECD restructured the Forum and established it as the 'Global Forum on Transparency and Exchange of Information for Tax Purposes' in 2009. After its restructuring, its membership was opened up to all countries. Its initial members consisted of OECD countries, G20 countries, and some other countries which were the members of the Global Forum on Taxation. Since then many countries – both developed as well as developing – have joined the Global Forum taking its membership count to 147.

The Global Forum's primary focus is on two aspects:

1) Monitoring the process and standard of exchange of information, and
2) Helping developing countries adopt and benefit from the EOI standard.

The Global Forum has endorsed two methods of exchanging information as the standards – Exchange of Information upon Request in 2009, and Automatic Exchange of Information in 2014.

To oversee the implementation of exchange of information upon request, the Global Forum has created a Peer Review process, by way of which representatives from select countries evaluate a particular country based on several indicators. The Peer Review process evaluates the domestic legal framework, including the EOI agreements, of a particular country to assess if it matches the recommended standard or if it needs improvement. They also check if the country in question has been engaging in exchange of information with other countries according to the recommended standard. Based on these assessments, recommendations are provided if the country needs certain improvements to meet the standard.

For Automatic Exchange of Information, the Global Forum has adopted the Common Reporting Standard[8] (CRS) - a set of guidelines for AEOI developed by the OECD. The CRS lists out different aspects of carrying out automatic exchange of information, such as the financial account information to be exchanged, the financial institutions required to report, different types of accounts and taxpayers covered. It also provides due diligence procedures that should be followed by financial institutions. To oversee the implementation of AEOI, the Global Forum is working to develop a peer review process similar to the one used for exchange of information upon request. In this new peer review process, countries that have started the AEOI process will be evaluated to see if they are carrying out AEOI as per the standard recommended by the Global Forum.

Furthermore, to assist developing countries, the Global Forum is focusing on bringing out training manuals and guidelines, pilot projects, skill training seminars, and is working with other international organisations like African Tax Administration Forum (ATAF), Inter-American Center of Tax Administrations (CIAT) and World Bank.

III. Automatic Exchange of Information

Automatic Exchange of Information can be defined as:

"The systematic and periodic transmission of "bulk" taxpayer information by the source country to the residence country concerning various categories of income (*e.g.* dividends, interest, royalties, salaries, pensions, etc.)"

– OECD (2012): *Automatic Exchange of Information*[9]

A source country is one which sends the information, while a residence country is the one where the tax payer, whose information is being shared, belongs to.

Countries have been carrying out exchange of information on a bilateral basis for several decades now. However, most of the exchanges were done through the method of exchange of information upon request. In 2013, G20 countries endorsed AEOI as the new global standard for exchange of information and asked the OECD and the Global Forum to develop a standard, as well as the required implementation and monitoring processes. In response to the G20's request, a new group named the AEOI group was formed within the Global Forum in 2013 to work specifically in the area of automatic exchange of information. In 2014, the Global Forum adopted the CRS, as the standard for automatic exchange of information. After the adoption of the CRS, 89 members of the Global Forum committed to start AEOI through CRS from either 2017 or 2018. As of December 2017, 49 countries have committed to implement AEOI from 2017, another 53 from 2018, and 3 more from 2019 or 2020. 41 countries have committed to AEOI but have not provided a timeline yet[10].

What is Common Reporting Standard (CRS)?

Common Reporting Standard (CRS) is a set of guidelines developed by the OECD which provides the standard for countries to engage in automatic exchange of information. In particular, the CRS focuses on the following three areas -

1. Reportable Accounts: The accounts belonging to the foreign tax payers whose information needs to be reported;
2. Reportable Information: The information that need to be reported; and
3. Reporting Institution: The institutions that need to report the information.

Details of all above three are given below[11] –

Reportable Accounts: – Reportable accounts refer to the accounts of foreign entities whose information needs to be reported. Since a financial institute has number of accounts, majority of which are likely to be of domestic entities, the CRS provides guidelines of how to identify the accounts of foreign tax payers whose details need to be reported. The CRS has different procedures for identification of reportable accounts in case of pre-existing or old accounts and the accounts which will be newly opened. The process to identify reportable accounts is as follows:

1. For pre-existing accounts, if based on following details, it is identified that account holder is a residence of a reportable countries, then such accounts are termed as reportable account:
    a. Residential address of the account holder
    b. Identification of account holder through mailing address
    c. Identification of account holder through telephone number
    d. Identification of account holder through other methods, such as standing instructions, hold mail instructions, or 'in care of address'.

    Here reportable countries are those who have entered into an agreement with the country the financial institution is based in. For example, for a financial institution based in India, the reportable countries are those who have signed an agreement with India to exchange information automatically.
2. In case the above mentioned details are not available, then it will not be a reportable account until the financial institution gets the abovementioned information.
3. In case the details are not obtained in previous steps, these accounts are to be reported as 'Undocumented Accounts'.
4. Any Pre-existing Individual Account that has been identified as a Reportable Account once, will be reportable account for all subsequent years, unless the Account Holder ceases to be a Reportable Person.
5. A Preexisting Account with an account balance or value that does not exceed $250,000 as of December 31 of the reporting period, is not required to be reviewed, identified, or reported as a Reportable Account until the account balance or value exceeds $250,000 as of the last day of any subsequent calendar year.
6. With respect to New Individual Accounts, upon account opening, the Reporting Financial Institution must obtain a self-certification that allows the Reporting Financial Institution to determine the account holder's residence.

The process of identifying 'reportable accounts' is laid out in detail in the due diligence procedure. It should be noted that there are some difference between the identifying process of individuals and legal entities as well as between new and pre-existing accounts.

Reportable Information: Reportable Information refers to the information that needs to be reported. The CRS provides for the following information to be exchanged:

1. The name, address, jurisdiction(s) of residence, Tax Identification Number (TIN) and date and place of birth of each reportable person (individual and legal person)
2. The account number (or any other equivalent in the absence of an account number)
3. The name and identifying number (if any) of the Reporting Financial Institution
4. The account balance or value as of the end of reporting period; or if the account was closed during the reporting period, then the closure of the account
5. In case of Custodial Accounts (the accounts which are managed by someone else on behalf of its beneficiary)
    a. the total amount of interest, the total amount of dividends, and the total amount of any other income generated
    b. the total proceeds from the sale of property paid or credited to the account during the reporting period

6. In the case of any Depository Account, the total gross amount of interest paid or credited to the account during the reporting period.

The above mentioned details are only the broad overview of reportable information, the CRS provides much more detail regarding what information needs to be reported and the information that can be exempted. For example, the CRS allows that in case of a pre-existing account, the TIN or date of birth is not required to be reported if the financial institution does not have those details or if they are not required by domestic law, though the financial institution is expected to collect such information.

Reporting Institutions: Reporting Institutions refer to the financial institutions that need to report the information under CRS. CRS divides financial institutions into two categories – Reporting Financial Institution (RFI) and Non-Reporting Financial Institution (NRFI).

1. Any financial institution which is not categorised as 'Non-Reporting Financial Institution' (NRFI) is a 'Reporting Financial Institution' (RFI).
2. There are four type of institutions, that are categorised as 'Financial Institution' as follows:
    a. Custodial Institution - any entity that holds financial assets for the account of others
    b. Depository Institution - any entity that accepts deposits in banking or similar business
    c. Investment Entity – an entity that invests and manages portfolios and assets like money market instruments (cheques, bills, certificates of deposit, derivatives, etc.), foreign exchange, interest rate and index instruments, transferable securities, or commodity futures trading
    d. Specified Insurance Company - any entity that is an insurance company that issues or makes payments with respect to a Cash Value Insurance Contract or an Annuity Contract.
3. The following institutions are categorised as 'Non-Reporting Financial Institutions':
    a. A Governmental Entity, International Organization or Central Bank
    b. A Broad Participation Retirement Fund, a Narrow Participation Retirement Fund, a Pension Fund of a Governmental Entity, a Qualified Credit Card Issuer
    c. Any other entity that presents a low risk of being used to evade tax
    d. An Exempt Collective Investment Vehicle
    e. A trust established under the laws of a Reportable Jurisdiction to the extent that the trustee of the trust is a Reporting Financial Institution.

These descriptions are expanded and many of the terms are defined more precisely to remove any ambiguity. The full version of the standard also includes many commentaries as well as the guidelines for implementation of this standard for financial institution and national governments.

For exchange of information to take place between two countries, both countries need to sign the CRS Multilateral Competent Authority Agreement (MCAA). The MCAA provides specific details such as what information will be exchanged, the frequency of exchange, and the channel for exchange. It also has rules on confidentiality, safeguard measures, format of information, dispute resolution mechanism, terms of amendment, terms of termination, and other practical issues. The MCAA provides the legal basis for the authorities to exchange information.

How is Automatic Exchange of Information an improvement upon Exchange of Information upon Request?

Historically, exchange of information upon request has been the most prevalent method for information exchange, however in recent times automatic exchange of information has gained increased popularity. Global Forum, which endorsed exchange of information upon request as the standard for information exchange in 2009, moved to include automatic exchange of information as another standard in 2014. This move towards automatic exchange of information can be explained on the basis of its inherent advantages over exchange of information upon request.

Chart II: Automatic Exchange of Information vs. Exchange of Information upon Request

Upon Request	Steps	Automatic
Authorities in country A find something suspicious about a tax payer X and start investigation	1	Governments of countries A and B sign an agreement to exchange information automatically
Authorities find evidence that X has financial accounts in a foreign country B	2	Financial institutions in both countries collect the information and send to their respective governments periodically
Government A sends a request to Government B for information about X	3	Both governments send appropriate information of foreign tax payers to each other at regular intervals
Government B sends request to its financial institution mentioned in the request	4	
The financial institution sends the information to Government B	5	
Government B sends the information about tax payer X to Government A	6	

Chart II indicates the number of steps involved in both the methods of information exchange. However, depending on particular cases, there can be more number of steps involved in exchange of information upon request. For example, before step 5, the financial institution can send the request back to government B, if the details mentioned in request are not sufficient to identify the appropriate financial account(s). In such cases, after receiving the answer from the financial institution, Government B will have to send the request back to Government A with reason(s) provided by the financial institution. Then, Government A has to carry out further investigation to get the necessary details, in absence of which the investigation may stall.

Some of the advantages of AEOI over EOIR are discussed below:

- Tax officials of requesting jurisdiction are no longer burdened with the responsibility of providing initial details – The standard of EOIR requires a country making a request for information to another country to provide specific information about the tax payer whose information is being sought, like account number, name of financial institution, etc. However, tax authorities in the requesting country may not have access to such specific information. In fact the very need for information from overseas arises precisely when the domestic authorities do not have complete information. Due to this, EOIR has long been termed as a mechanism to confirm a suspicion that the requesting countries already know instead of them getting new information.
- AEOI can detect previously unsuspected cases – In case of EOIR, a request is made only in case of suspected cases or the cases in which an investigation is ongoing. AEOI, by providing information about all taxpayers, including those who are previously not under investigation, can provide the authorities with details of cases which were previously unsuspected. This way many cases which were previously not under investigation can be detected now by the government authorities.
- Deterrent effects and voluntary compliance – Because of the possibility that AEOI would help government authorities detect unsuspected cases which went undetected previously, AEOI is likely to have a deterrent effect on the potential evaders.
- Potential increase in the Know Your Customer (KYC) norms implementation by financial institutions – Due to guidelines and instructions about to determine if an account is a reportable or not, it is likely that FIs will strengthen the KYC norms, or in case where some details were not asked previously would be asked now.

IV. Automatic Exchange of Information – Taking a Critical Look at the Standard

Automatic Exchange of Information, though certainly an improvement over Exchange of Information upon Request and Spontaneous Exchange of Information, is not without flaws. There are various strands of criticism levelled against the standard of AEOI and the loopholes in the CRS. The standard is also criticised for not including developing countries in the process of designing and not recognising the differentiated realities of developing countries.

What are the weaknesses in the current standard of AEOI?

There are three parts of the AEOI standard – reportable accounts, reporting institutes and reportable information. For an effective AEOI arrangement, it is required that selection of above three should be such that it eliminates or reduces significantly any possibility for tax payers to circumvent/escape the standard. Meaning, through AEOI, A country should be able to receive all relevant financial information regarding its tax payers from foreign countries. The process of tax dodging will remain unaddressed if relevant information is not included due to gaps in the standard. On a close evaluation of the standard, these are the primary loopholes in the CRS (Knobel and Meinzer 2016[12]):

- It is up to a particular sending country to decide whether to report accounts with balance below $250,000 or not. If decided not to, this will create the loophole for abuse where instead of one account, a few accounts can be operated by a single individual such that the balance in each of them remains below the threshold level of $250,000, hence escaping the reporting requirement completely.
- The balance of a reportable account is to be determined on a particular date, either at the end of calendar year or the end of reporting period defined in the agreement. In such cases, the account holder can easily reduce the balance on that particular date, and avoid having the account reported.
- It is required that for exchange of information to take place, both participating countries have proper data security and confidentiality arrangements in place. However, it is up to the sending countries to assess if the confidentiality provisions in the receiving countries are sufficient. This provides tax havens a potential excuse to refuse information especially to developing countries, claiming insufficient data protection in the receiving country.
- Some financial instruments and non-financial assets are not included in the reportable accounts list, such as trusts managed by an individual trustee, trusts managing real estate, registries and entities owning assets like real estate, art, pension accounts, life insurance contracts, corporations listed on a stock exchange, etc.
- Unique tax identification numbers (TIN) and date of birth of the tax payers are the two most important pieces of information for government authorities to be able to identify the tax payer and match their details against domestic information. However, financial institutions are not required to collect these details if they are not in the records of the concerned financial institution already. Without TIN and date of birth details, the identification of the tax payer for any further action is likely to be difficult.

- The CRS requires that in case of closure of account, the financial institution reports the account closure, without the need to provide information regarding the account balance. This provides an opportunity to escape reporting, as accounts can be opened for a short period and carry out their operations without the need to be reported.
- There are a few countries that provide certificate of residency in exchange of a nominal investment in the country. These certificates can then be used to open financial accounts in another country, such that the account holder is registered as the residence of this intermediary country instead of their original country. Such certificates are known as fake resident certificates. In case of accounts opened through fake resident certificates, the information will be sent to that intermediary country rather than the real home country of the tax payer.
- The standard allows information to be used only for tax purposes. Therefore, the information received cannot be used for other purposes of the receiving country's government, such as anti-corruption, anti-money laundering etc.
- United States of America has not signed the standard of AEOI despite being one of the most influential countries in the world, having the largest financial sector, and being home to states like Nevada, Wyoming and Delaware which are recognised as tax havens. Although the USA has not agreed to exchange information under the CRS, it engages in automatic exchange of information under FATCA. There are two concerns in this regard – first, as FATCA only has limited reciprocity, more information will flow from other countries to the USA, while the USA will provide only limited information from its own financial institutions to other countries; second, as FATCA is essentially a bilateral agreement, negotiations and bargaining based on geo-political strength of various countries play an important role in determining whether the USA will be reciprocal in its exchange.

AEOI and Developing Countries' Concerns

The standard of Automatic Exchange of Information was designed by the OECD – an organisation of 35 rich, developed countries– at the behest of the G20, another group of the world's twenty most powerful countries. The majority of the world's countries, mainly developing countries had no part in designing this standard of exchange of information that affects them directly. Developing countries' differentiated realities and concerns therefore do not reflect in the standard of AEOI, even though these countries are expected to adopt the standard.

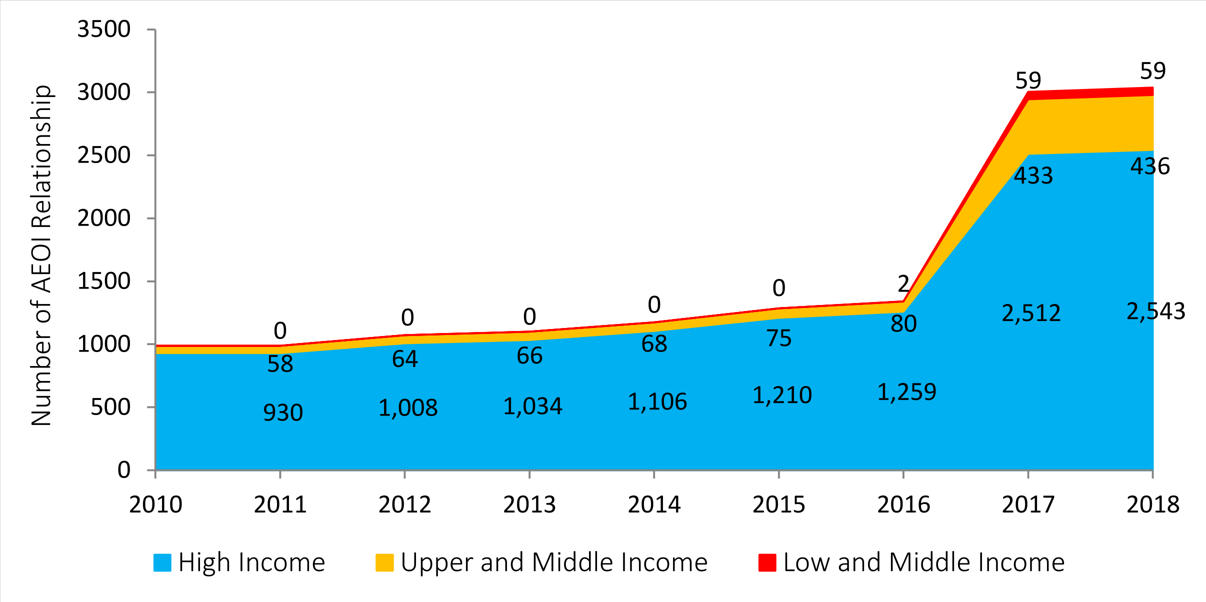
More specifically, the concerns faced by developing countries vis-à-vis the AEOI standard, which are proving to be obstacles for developing countries joining the standard, are as follows:

- No unique multilateral agreement for all countries: There is a two-step requirement for countries to sign up to an Automatic Exchange of Information agreement under the CRS – first, countries need to become a member of the Multilateral Convention on Mutual Administrative Assistance (MCMAA); and second, countries are required to sign bilateral agreements known as the Multilateral Competent Authority Agreement (MCAA) with other countries who are members of the MCMAA. This dual requirement contravenes the idea and essence of a common multilateral agreement, and becomes an unnecessarily arduous process of negotiating bilateral agreements with each country separately. This is an especially crucial concern for developing countries, which face severe capacity gaps and may not consider AEOI a priority. Countries which are destinations of offshore wealth have vested interests in avoiding AEOI agreements. This has been observes several times, when tax havens and secrecy jurisdictions have refused to sign agreements[13], especially with developing countries that do not have the same geopolitical weight compared to their developed counterparts. Hence, it is likely that tax havens and secrecy jurisdictions will try to enter into as few as possible agreements, thus defeating the purpose of the multilateral AEoI standard. It should be noted that even when tax havens and financial centres agree for an agreement, it requires serious negotiation, time, and human resources, creating a constraint for developing countries towards EOI agreements.

- Lack of non-reciprocity for developing countries: The AEOI standard holds that information must flow in both directions, implying that both partner countries will send and receive information, a condition known as reciprocity. However, many developing countries may not have the required infrastructure and human resources to collect and send information of foreigners to their respective countries. It should also be noted that in case of a developed country and a developing country, the money with the aim to evade/avoid tax is more likely to flow from a developing to a developed country, and rather unlikely to flow in the opposite direction. Because of this unidirectional flow of money, more information is to flow from developed to developing countries and few in opposite direction. Hence, in an agreement between a developing country and a developed nation, the developing country will benefit far more from the information it receives compared to a developed nation, which is unlikely to be greatly impacted from non-reciprocity. It is therefore worthwhile for the AEOI standard to include a clause for non-reciprocity for a limited span of time for developing countries to become true and effective partners in the quest to address offshore wealth. The condition of reciprocity for AEOI could potentially end up in the exclusion of developing countries from effectively participating in the exchange of information and receiving information regarding their citizens that they crucially require
- The issue of unequal exchange: In 2017, OECD published a list of all the countries which would be sharing information under the AEOI standard. Each pair of countries exchanging information with one another is called an 'AEOI relationship'. An analysis of all the AEOI relationships by countries group reveals that while in last couple of years there has been a significant increase in the number of AEOI relationships, most of these have taken place among developed countries (See Chart III).

  This analysis categorises all countries into three income groups – High Income Countries (HIC), Upper and Middle Income Countries (UMIC) and Lower and Middle Income Countries (LMIC). Although all three income groups have seen an increase in the absolute number of AEOI agreements, developed countries have seen a considerably disproportionate rise compared to developing countries. Developing countries have 59 AEOI relationships compared to 436 for UMIC and 2543 for HIC. It is noteworthy that 57 out of these 59 agreements are pertaining to only one country - India. Due to its geopolitical strength, its membership of the G20 and its weight as a large emerging economy, India's case as a developing country is an exception rather than a norm.

Chart III: Number of AEOI Relationships by Income Group of Data Receiving Country



Reproduced from: Christian Aid; and Financial Transparency Coalition (2017): *Unequal Exchange*[14]

Apart from India, there are only two other countries in the LMIC category which have an AEOI agreement, namely, Honduras and Philippines - each of which have only one agreement. Both of these agreements are under FATCA, which is more likely to have been signed by Philippines and Honduras on the insistence of the USA. The limited reciprocity of FATCA would also result in the Philippines and Honduras receiving less information about their own residents from the US tax authorities. The fact that no other country in the lower and middle income group except India has any AEOI agreements under the framework of CRS clearly indicates the need for making the standard more inclusive of developing countries and their concerns.

While the AEOI standard has several improvements over previous exchange of information arrangements, there are a number of loopholes that undermine the effectiveness of the CRS and threaten its acceptance as a global standard.

V. Summary

Tax dodging is one of the major problems faced by countries globally. For the evasion/avoidance which takes place within the country, the government authorities can frame new laws and enforce them. However, when the evasion/avoidance involves cross border aspects, such that tax payer of one country earn income or own assets in another country, or the cases where financial transactions are carried out across countries, government of one country can't enforce the law on its own. Dealing with such cases require co-operation among countries involved. Exchange of tax and financial information, whereby countries share information of foreign tax payers with their respective governments, is one such measure. Since the AEOI standard was adopted by the global forum, 146 countries have signed up to the standard and have committed to automatic exchange of information.

However, the design of the AEOI standard leaves a lot to be desired. The need to sign the MCMAA and the subsequent requirement to negotiate bilateral agreements with every country to establish a successful AEOI relationship unnecessarily convolutes the process of exchange of information, hinders the full participation of developing countries and threatens the effectiveness of the standard. Further, the AEOI standard, which was designed by 35 rich and powerful OECD member countries, does not reflect the differentiated realities and concerns of developing countries. This has resulted in only one developing country signing agreements under the AEOI standard, thus defeating the intent of a multilateral framework for exchange of information.

The AEOI standard must therefore take these loopholes into consideration, and strive to develop a more robust standard for exchange of information, one that would not only comprehensively address tax dodging and offshore wealth, but one that would also allow all countries' full participation in the process.

Among the countries that have entered into AEOI agreements, 2017/2018 marks the beginning of the period when they will be able to access the information on automatic basis. It is expected that this flow of information should be able to curb the cross-border tax evasion/avoidance, however it can only be ascertain after some quantitative evidences. Disclosure of some statistics/data in this regard will be helpful to support that claim. It will also provide the researchers to examine how the process can be improved further.

VI. Endnotes/References

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[10] See Annex

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Annex : Countries' Commitments to start AEOI

2017

Anguilla	Faroe Islands	Jersey	Romania
Argentina	Finland	Korea	San Marino
Belgium	France	Latvia	Seychelles
Bermuda	Germany	Liechtenstein	Slovak Republic
British Virgin Islands	Gibraltar	Lithuania	Slovenia
Bulgaria	Greece	Luxembourg	South Africa
Cayman Islands	Guernsey	Malta	Spain
Colombia	Hungary	Mexico	Sweden
Croatia	Iceland	Montserrat	Turks and Caicos Islands
Cyprus	India	Netherlands	United Kingdom
Czech Republic	Ireland	Norway	
Denmark	Isle of Man	Poland	
Estonia	Italy	Portugal	

2018

Andorra	China	Macau (China)	St. Vincent and the Grenadines
Antigua and Barbuda	Cook Islands	Malaysia	Samoa
Aruba	Costa Rica	Marshall Islands	Saudi Arabia
Australia	Curacao	Mauritius	Singapore
Austria	Dominica	Monaco	Sint Maarten
Azerbaijan	Ghana	Nauru	Switzerland
The Bahamas	Greenland	New Zealand	Trinidad and Tobago
Bahrain	Grenada	Niue	Turkey
Barbados	Hong Kong (China)	Pakistan	United Arab Emirates
Belize	Indonesia	Panama	Uruguay
Brazil	Israel	Qatar	Vanuatu
Brunei Darussalam	Japan	Russia	
Canada	Kuwait	St. Kitts and Nevis	
Chile	Lebanon	St. Lucia	

2019/20

Albania	Maldives	Nigeria	

No Date Yet

Armenia	Egypt	Lesotho	Rwanda
Benin	El Salvador	Liberia	Senegal
Botswana	Republic of Macedonia	Madagascar	Tanzania
Burkina Faso	Gabon	Mauritania	Thailand
Cambodia	Georgia	Moldova	Togo
Cameroon	Guatemala	Morocco	Tunisia
Chad	Guyana	Niger	Uganda
Côte d'Ivoire	Haiti	Papua New Guinea	Ukraine
Djibouti	Jamaica	Paraguay	
Dominican Republic	Kazakhstan	Peru	
Ecuador	Kenya	Philippines	

Source: OECD (2017): AEOI Commitments (as of November 2017)