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OECD'S REPORTING STANDARD: COLLATERAL DAMAGE

by Ashley Fife

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The elimination of tax evasion is a laudable objective. Governments miss out on revenue if assets are moved to other jurisdictions to evade taxes, and the impact is greater in poorer countries.

However, it is reasonable to ask whether international efforts for the automatic exchange of information (AEOI) strike an appropriate balance between the objective of eliminating tax evasion and the legitimate concerns of individuals concerning their privacy and safety.

The use of planning techniques to lawfully minimise taxation combined with honest tax reporting is very different from illegally hiding assets and income to avoid accurately reporting to tax authorities. However, those who pay higher tax rates may be forgiven for begrudging those with the resources to structure their affairs utilising lower tax jurisdictions, potentially only further increasing the substantial proportion of global wealth held by a tiny proportion of the population. The Tax Justice Network, a tax research and advocacy group, estimates that offshore financial centres (OFCs), many of which are United Kingdom (UK) dependencies or territories, hold US$21 to US$32 trillion of individuals' financial assets.

Governments and media have described tax avoidance as a moral evil, often distinguishing between aggressive and ordinary tax planning. However, taxpayers cannot be expected to comply with subjective notions of morality.

Rather, the imposition of tax through application of clear laws should be the objective. In order to implement appropriate tax laws, governments may require information regarding the transactions and entities that their residents benefit from locally and abroad. The Organisation for Economic Cooperation and Development (OECD) and many governments are concerned that OFCs attract foreign investment by:

imposing low, or no income or corporate taxes on foreign investors; and facilitating foreign investors to keep their identities and financial affairs private.

Since the financial crisis began, the OECD has escalated global initiatives against harmful tax competition, focusing on OFCs. However, OFCs may facilitate investment into poorer jurisdictions and help avoid the imposition of double or triple taxation on workplace pensions and other investments.

Many OFCs impose customs and probate duties, annual fees on entities and other taxes to generate revenue. Should OFCs be criticised for not introducing taxes that are not appropriate for their economic circumstances?

OFCs are not the only jurisdictions whose tax systems and laws attract foreign investment. Many US jurisdictions, including Delaware, Nevada, Wyoming and South Dakota impose little or no income or corporations tax and restrict disclosure of the identities of beneficial owners of entities established there. Foreign investment into the UK is facilitated by the UK's relatively low corporation tax rate and a preferential tax regime for individuals who are resident but not domiciled there.

The OECD has used blacklists and other measures to compel OFCs to enter into tax information exchange agreements (TIEAs) with higher tax jurisdictions. The Model TIEA requires an applicant to demonstrate that the information requested from the partner jurisdiction is "foreseeably relevant" to a tax investigation. Critics consider the TIEA process too difficult and cumbersome to significantly reduce tax evasion.

Following the US Foreign Account Tax Compliance Act (FATCA) 2010, the OECD developed the Common Reporting Standard (CRS). There are more than 100 CRS participating jurisdictions. Unlike TIEAs, CRS essentially operates on a multilateral basis requiring participating jurisdictions to disclose information received from resident reporting financial institutions (RFIs) in bulk to other participating jurisdictions, where RFI "account holders" are resident. The information need not be relevant for a tax investigation.

In some instances, CRS requires exchanging information about persons who cannot even benefit from "accounts". FATCA is generally limited to non-US financial institutions disclosing financial information on accounts held by "US persons". FATCA does not require any meaningful reciprocal disclosure by US financial institutions about non-US residents to non-US governments. The US does not presently participate in CRS. Consequently, in some cases, non-US persons may hold accounts in financial institutions in the US without being subject to FATCA or CRS reporting obligations.

The compliance costs on financial institutions and the costs on governments to collect, disclose and review disclosed information are huge. Poorer governments may not have the resources to effectively create such infrastructure. It is also questionable whether any additional taxes collected from CRS will justify these costs.

Aside from philosophical or constitutionally enshrined entitlements to privacy, many individuals legitimately fear that disclosure of financial information may increase their exposure to kidnapping, extortion or blackmailing by criminals or confiscation of assets by corrupt governments.

Given the recent data breaches associated with the US election, Panama papers and The Bahamas, can we conclude that existing global technology and systems are sufficient to prevent unauthorised access and disclosure of the information reported under CRS? Should international efforts focus instead on preventing corruption and tax evasion through ongoing anti-money laundering measures, general anti-avoidance legislation, continued development of robust and efficient TIEAs, voluntary disclosure programmes and initiatives to improve national governance in poorer countries?

Despite the OECD's safeguards, CRS may presently be unable to adequately address legitimate privacy and safety concerns of tax compliant individuals.

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