# Nueva fiscalidad

Estudios en homenaje a Jacques Malherbe

# *New Taxation*

*Studies in Honor of Jacques Malherbe*


DIRECTORES

*CATALINA HOYOS JIMÉNEZ • CÉSAR GARCÍA NOVOA • JULIO A. FERNÁNDEZ C.*



ICDT INSTITUTO COLOMBIANO DE DERECHO TRIBUTARIO

# The New Global Context Arising from the Generalization of Automatic Exchange of Information Between Tax Authorities

*Maryse Naudin & Jean-Marc Tirard*[1]



## Abstract

It is a pleasure and a great honour to be invited to contribute to this book as a tribute to our colleague and friend Jacques Malherbe.

The idea for this article came to us from a case which we had the pleasure to work on with him, involving the review of some information transmitted by the Belgian authorities to the French authorities, at the latters' request under the administrative assistance clause of the Franco-Belgian tax treaty.

This case, although relating to a period well before the signature and entry into force of the 2014 Berlin Multilateral Agreement on the automatic exchange of

---

(1) Avocats à la Cour, Cabinet TIRARD, NAUDIN, Paris.

information, was already symptomatic of the difficulties that may arise from such exchange: it revealed that the French tax authorities' understanding of a specific Belgian tax regime – for the purpose of applying the French tax rules – appeared very different from their Belgian counterparts' analysis of the same regime, thereby potentially giving rise to adverse French tax consequences in the case in point.

More generally, the purpose of this article (which does not claim to be exhaustive given the breadth and complexity of the subject matter) is to reflect on some of the potential risks which may result from the proliferation and automatic nature of the worldwide exchange of information between State tax authorities.

## Introduction

States have all progressively implemented – in more or less developed ways – internal mechanisms of information gathering in order to organise and monitor tax collection.

The principle of tax sovereignty has, however, long prevented States from organising their right to collect tax information beyond their national borders, although certain States have gradually found ways to obtain such information through alternative mechanisms – such as reporting requirements, the failure to comply with which triggers taxation and/or penalties (for example, the French 3% tax based on the market value of real estate held by foreign entities, or the FATCA regulations in the United States, etc).

In the contemporary context of globalization and the proliferation of international transactions, the question has increasingly arisen how States may access information relating to foreign situations that may involve a liability to domestic taxation.

State tax authorities have consequently sought ways to reach an overall transparency of information worldwide by legal and operational means, particularly in order to combat tax evasion.

Pursuing this ambitious goal involves cooperating to identify the nature of the necessary information to be exchanged, to develop a standardized format and medium for such information (IT tools in particular), and to develop rules that allow for easy and effective communication of such information between tax authorities.

For almost 20 years now, the work of the OECD has helped to develop ways of improving the exchange of information, initially on a bilateral basis through its Model Tax Convention. In parallel with this, the European Union also developed various legal means of which the purpose was to draw up a framework for the exchange of information between its Member States for tax purposes.

As so often, however, the implementation of an efficient global system of information exchange finally owed its birth to one or more events that acted as catalysts.

It is quite clear that the attacks of 11 September 2001, and the subsequent efforts to fight terrorism (particularly its financing) on a worldwide basis, significantly contributed to the acceleration of this process.

Within this new context, the combination in the years 2008/2009 of the global financial crisis and several financial scandals (of which the UBS case was the most prominent) led States and global institutions to respond even more effectively in this direction.

In order to do so, practical means (i.e. legal and operational instruments) had to be found in order to allow States to work together on a worldwide basis.

On the one hand, following the so-called "UBS affair" of 2009, the United States introduced a unilateral and binding mechanism of automatic exchange of information, the Foreign Account Tax Compliance Act (FATCA), by virtue of which a whole set of bilateral agreements were signed between the US and other States. Its objective was, in substance, for the US tax authorities to be able to identify where the beneficial owner of an account with a financial institution is a US taxpayer.

On the other hand, and in parallel with this, the joint conclusions of the G20 round which took place in 2009, declaring war on tax havens, led the OECD to set up a legal framework for global financial and tax transparency, of which one of the more effective weapons would be the automatic exchange of information between the tax authorities of States.

The recent OECD / G20 work relating to the BEPS project (in particular its Action 13 introducing a country-by-country reporting obligation), as well as the work of the OECD / Global Forum aimed at implementing effective transparency of financial and tax information worldwide, represent two facets of the same objective.

On the basis of this gradual development of regulatory frameworks, State tax authorities now have the legal and operational means to access financial and tax information that is shared globally.

In addition, more recent financial scandals and data leaks, in particular the "Panama papers", have shown that public opinion (and inevitably the media) tend to pay even closer attention to these issues, thereby putting further pressure on State tax authorities not to leave fraudulent situations unpunished.

As they begin to implement these new legal means (and answer the concerns of public opinion for worldwide transparency), States have been left with an almost clear field.

The question which arises above all is how the tax authorities will manage exchanging and processing such a huge wealth of information, and how they will use it. In the face of this challenge, numerous risk areas appear: the improper use of information, breach of confidentiality, etc.

The purpose of this article is to present a brief history of the development of a common framework for automatic exchange of information, as well as a brief summary of the Common Reporting Standard that currently applies, in order to address the potential issues that arise from the practical implementation of automatic exchange of information under this new regulatory framework.

## 1. State Tax Authorities Have Gradually Benefited from Stronger Powers and Wider Access to Information

### *1.1. A Brief History*

State tax authorities were quick to identify the need to develop jointly legal instruments that would allow them to collect and exchange financial and tax information on a worldwide basis.

#### *1.1.1. The Work of the OECD*

The first sets of rules organising the exchange of information between States were negotiated in the twentieth century, particularly through the proliferation of bilateral tax treaties signed in the form of the model developed by the early work of the OECD.

The scope of these administrative assistance provisions were originally limited to the exchange of information upon request, as well as the spontaneous exchange of information.

The first comprehensive multilateral instrument addressing the issue of tax cooperation between jurisdictions in order to combat tax avoidance is the Convention on Mutual Administrative Assistance in Tax Matters, developed by the OECD and the Council of Europe in 1988. This Convention was amended in 2010 in order to comply with the joint conclusions of the G20 round of 2009, with the aim of raising standards for the exchange of information upon request, and opening it up to a greater number of jurisdictions (in particular developing countries) which, until that date, had not always entered into such types of information exchange commitment.

However, a chief obstacle to the efficiency of the exchange of information for tax purposes has always been that, as long as it was not being applied in a global and systematic way, it would remain deficient and incomplete.

This is exactly the reason why the G20 members, first, increasingly acted to put in place a global standard for the automatic exchange of financial and tax information between tax authorities, which eventually translated in 2014 – under the auspices of the OECD – into the signature of a multilateral agreement on a Common Reporting Standard (CRS).

On 29 October 2014, 51 jurisdictions signed the first Multilateral Agreement to exchange information automatically under the CRS, based on Article 6 of the Multilateral Convention of 1988.

At the date of this article, more than 100 States have already signed this Multilateral Agreement.

### *1.1.2. The European Union*

The European Union also gradually developed and implemented its own body of rules which applied in parallel, before eventually converging towards the CRS.

As early as 1977, the European Union laid down in its Council Directive n°77/799 of 19 December 1997 an acknowledgment that "collaboration between the Member States and the Commission is necessary for the permanent study of cooperation procedures and the pooling of experience […] in particular in the field of the artificial transfer of profits within groups of enterprises, with the aim of improving those procedures and of preparing appropriate Community rules". Articles 2, 3 and 4 of this Directive already provided for the possibility of Member States tax authorities to exchange information for tax purposes either upon request, automatically or spontaneously, for categories of cases to be determined through consultation.

The EU "Savings Directive" n° 2003/48 of 3 June 2003 introduced a multilateral mechanism of which a particular consequence was that, where the beneficiary of interest resides in a Member State other than that in which the paying agent is established, the latter is automatically required to report a minimum amount of information to the tax authorities of the Member State of the beneficiary.

A further step was taken when the EU adopted Directive n° 2011/16 on 15 February 2011, the purpose of which was to introduce mandatory automatic exchange of information for income from employment, director's fees, life insurance products (other than those covered by the 2003 "Savings Directive"), pensions and the ownership of and income from immovable property.

Eventually, with a view to aligning its pre-existing system of information exchange with the new OECD standard as enshrined in the Berlin Multilateral Agreement of October 2014, on 9 December 2014 the EU adopted Council Directive n° 2014/107 (amending its Directive n° 2011/16) in order to incorporate the CRS. Since the adoption of Directive n° 2015/2376 of 8 December 2015, automatic exchange of information within the EU also covers advance cross-border rulings and advance pricing arrangements.

In addition to the above, the EU entered into bilateral agreements extending the CRS standard to the exchange of information with non-EU member States, namely Switzerland (Agreement of 27 May 2015) and Liechtenstein (Agreement of 8 December 2015).

Lastly, with the adoption of the Fourth Anti-Money Laundering Directive (n° 2015/849) of 20 May 2015, the EU extended the scope of its regulatory framework on the automatic exchange of information by providing for the obligation to identify the beneficial owners of legal persons and trusts (requiring that such information be made available to the financial authorities of Member States and be made accessible in central registers) and by organizing enhanced cooperation between the competent financial authorities of Member States.

### *1.1.3. US Status vis-à-vis the Common Reporting Standard*

Although in 2010 the US introduced FATCA, which is at the origin of the CRS, it is nevertheless not a party to the Berlin Multilateral Agreement of 2014.

The US current status *vis-à-vis* the Common Reporting Standard is therefore somewhat difficult to analyse, bearing in mind that although the "Model 1A" intergovernmental agreements which it has entered into with other jurisdictions enshrine the need to implement automatic exchange of information and include commitments to keep adopting further regulations and legislation pursuing this goal, the respective scope of FATCA and the CRS still present substantial differences.

For instance, FATCA requires non-US financial institutions to report exclusively US "reportable" accounts on the basis of the account holder's citizenship, whereas the CRS reporting requirements are based on the notion of tax residence.

In addition, the CRS does not provide for threshold provisions regarding pre-existing accounts, contrary to FATCA. The terminologies also differ, giving rise to differences in scope (e.g. in relation to trusts or investment funds).

### *1.2. Brief Description of the Common Reporting Standard*

Following the above historical summary, this article cannot dispense with a brief reminder of the practical content of the Common Reporting Standard in order to contextualize the risks which may result from the development of the automatic exchange of information.

In substance, the CRS requires the competent authorities of each State to gather information from their financial institutions and to exchange it automatically with their foreign counterparts on an annual basis.

It sets out details of the financial information to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions.

As a starting point, CRS is based on the concept of tax residence, and therefore requires financial institutions to identify the tax residence of their "reportable" clients (thereby placing financial institutions in the delicate position at least of being a "checker" – or, in cases of doubt about residence, of being a "prosecutor").

The objective of the CRS is therefore to connect any bank account to a recipient whose State of residence must be determined, and to enable automatic exchange of information to take place between the State where the account depositary (e.g. the Bank) is located and the State where the beneficial owner/ tax payer is resident for tax purposes.

In practice, reportable accounts include all financial accounts opened with a financial institution identified (under due diligence procedures provided by the CRS) as being held by one or more persons subject to a reporting requirement in another jurisdiction.

The notion of participating financial institutions is construed widely (namely banks, brokers, collective investment vehicles, certain insurance companies, etc.), and the persons covered include physical persons, legal persons and natural persons holding a financial account through "passive" entities (trusts, foundations, etc.).

Article 2, §2 of the Berlin Multilateral Agreement sets out the information to be exchanged with the competent authorities of other States under the CRS.

Financial institutions transmit the information collected in relation to "reportable" accounts to the competent authorities of the taxpayers' / beneficial owners' State of residence, which in turn transmits the information collected to the competent authority of the recipient State.

The risks and limits of this process of collecting and exchanging information lie in the fact that, despite safeguards (notably relating to privacy and data protection), its implementation does not enable any initial checking to take place, which gives rise to inevitable risks of *de facto* abuse.

## 2. The CRS Involves an Increased Risk of Improper Use as Well as Erroneous and/or Extensive Interpretation of the Information Automatically Received by the Tax Authorities

### *2.1. Moving from Exchange of Information Upon request to automatic Exchange of Information*

One should not be under any illusion: conceptually and practically, the automatic exchange of information is very different from the traditional exchange of information upon request.

#### *2.1.1. Exchange of Information Upon Request*

The exchange of information upon request aims at a specific purpose; it is, by definition, the voluntary initiative of a State, and refers to a particular taxpayer over a given period (this also applies to the spontaneous exchange of information, provided of course it is not performed "blindly", which is rarely the case).

Under Article 26 of the OECD Model convention, the requesting State must ensure (and evidence, if need be) that the information requested is "foreseeably relevant for carrying out the provisions of [the] Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind […] imposed on behalf of the Contracting States".

The requested information may therefore only respond to a specific purpose, which in itself offers a first layer of protection for taxpayers. The scope and relevance of the targeted request can therefore be more easily checked by the State receiving the request.

In addition, under Article 26, §2 of the OECD Model Convention, the information received by the requesting State may only 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 authorizes such use".

The standard provisions of Article 26 of the OECD Model Convention relating to the exchange of information (whether spontaneous or upon request) thus include limitations to ensure that States can only access foreseeably relevant and clear information, reasonably usable by the requesting State.

But what matters above all is that the exchange of information upon request allows for an initial (*ex ante*) check of the relevance of the request and of the nature of the information requested.

Despite the above, cases of erroneous interpretation or improper use of information do occur (the case which gave rise to this article being a typical example).

Nevertheless, given the strict scope and framework of information exchange in such cases, any potential mistake leading to erroneous reporting (error in the taxpayers' identity, bank account, etc) or inappropriate reporting (e.g. beyond the scope of what it is permitted to request and obtain) is in any case more easily identifiable.

### *2.1.2. Automatic Exchange of Information*

On the other hand, implementing automatic exchange of information on a worldwide basis pursues a very different objective conceptually, which is to ensure that no cross-border situation remains unknown or unrevealed to the States potentially concerned, when such situation may give rise to taxation in such States.

This aim is entirely legitimate, and the authors of this article naturally acknowledge that the Multilateral Convention of 1988 and the Berlin Agreement of 2014 both provide for safeguards that are designed to ensure that dealing with massive amounts of data should in most cases not lead to abuse.

However, taking the overview, one of the greatest risks arising from the worldwide exchange of information on an automatic basis is that the consequences of any erroneous or inappropriate reporting will inevitably have to be dealt with after the event (*ex post*).

In other words, the concern is that in many cases the harm will already have been done.

Moreover, the concerns in this respect may not exclusively be limited to financial and/or tax issues. What if, for example, data evidencing the existence of a same-sex union were transmitted to the authorities of a State where such unions are forbidden, because for some reason a safeguard had not been respected? What if the disclosure of some piece of information relating to a taxpayer's personal wealth (perhaps when transmitted to another State and made accessible in a public register) gave rise to a risk of threat to personal safety – for example, a ransom demand?

These specific examples, among many others, should serve to draw our attention more generally to the fact that in return for wider powers, States bear heavier responsibilities when disseminating information.

If the effectiveness of automatic exchange will inevitably depend on the ability of States to process a very large amount of data, the legitimacy of this system in the long term will depend on its ability to prevent abuse and harmful consequences.

Those who drafted the Berlin Multilateral Agreement were obviously aware of this when stating in Section 4 that « a Competent Authority will notify the other Competent Authority when the first-mentioned Competent Authority has reason to believe that an error may have led to incorrect or incomplete information reporting or there is non-compliance by a Reporting Financial Institution with the applicable reporting requirements and due diligence procedures […]".

Similarly, Section 5 of the Berlin Agreement (which guarantees data confidentiality) addresses the question of breach of confidentiality: "a Competent Authority will notify the Co-ordinating Body Secretariat immediately regarding any breach of confidentiality or failure of safeguards and any sanctions and remedial actions consequently imposed".

One may take the view that such provisions would not have been so necessary in the context of the exchange of information upon request. This therefore raises the question of the typology of risks which in practice are likely to occur regularly or frequently.

## *2.2. Risks in Implementing Automatic Exchange of Information*

Once again, what follows is far from claiming to be exhaustive and will more likely be viewed as raising certain key issues which result from the automatic nature of data exchange on a worldwide basis.

### 2.2.1. The Content of the Information Exchanged

Risks may first result from an erroneous analysis or understanding of a piece of information, leading for example to inappropriate tax assessments.

As already mentioned, Article 2 §2 of the Berlin Agreement sets out the information to be supplied to the other State's competent authorities under the CRS, namely the taxpayer's details (name, address, tax identification number, date and place of birth of an individual or creation of an entity), and details of financial assets (bank account references, name and identification number of the reporting financial institution, balance or value of the account at year end, annual income generated).

An example often discussed regarding the identification of taxpayers, is the risk of errors relating to homonymy, which is supposedly eliminated by the use of the Tax Identification Number. Indeed, for new accounts opened from 1st January 2016, the collection and verification of the TIN is mandatory.

For existing accounts, however, financial institutions are only required to communicate the TIN if they have it in their files (or if local laws require them to collect from their customers the TIN of their country of tax residence). Although financial institutions must make every effort to get this information, the risk of errors is far from theoretical given the considerable amount of data concerned.

### 2.2.2. The Use by the Receiving State of Information Automatically Transmitted

The question what information may (or may not) be used by a Party is addressed in Article 22 of the Multilateral Convention of 1988 relating to secrecy.

On the one hand, Article 22 § 3 of the Convention provides that "if a Party has made a reservation […], any other Party obtaining information from that Party shall not use it for the purpose of a tax in a category subject to the reservation. Similarly, the Party making such a reservation shall not use information obtained under this Convention for the purpose of a tax in a category subject to the reservation".

This once again raises the question how in practice a State will comply with a requirement not to use information of which in any case it may already have been aware owing to the automatic nature of data exchange.

As already mentioned, these provisions once again offer a striking example of the risk for taxpayers inherent in the fact that the automatic exchange of information does not allow for an initial check of the information supplied to another State.

The question is even more crucial when reading the provisions of Article 22, §4 of the same Convention, which state that "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 authorizes such use. Information provided by a Party to another Party may be transmitted by the latter to a third Party, subject to prior authorization by the competent authority of the first-mentioned Party".

It follows from these provisions that not only the information received by a State may be used for purposes other than taxation (which was already possible under exchange of information upon request), but also that such information may be transferred to third States.

However, the fact that transmission to a third party is subject to the initial supplying State's authorization does not provide a complete safeguard, as it ought not to obscure the fact that widespread information is in itself a threat to secrecy and confidentiality.

In particular, this is because global access to financial and tax information by States now goes hand in hand with the fact that tax authorities are increasingly putting in place public registers of data.

The French Public Register of Trusts (offering free access, on the French tax authorities' website, to certain information – including the identity of the settlors and the beneficiaries – relating to all French-connected trusts which have been declared to the tax authorities) is a good example of this.

The register was put online for a few days until a taxpayer requested its immediate removal from the French tax authorities' website on the (obvious) constitutional ground that it infringed the right to privacy.

Nevertheless, confidential information relating to French resident tax payers remained accessible to everyone for a certain period of time, without of course the French tax authorities worrying about the fact that revealing the identity of trusts beneficiaries, for example, may expose very personal details of many people's lives.

## 3. How Will Tax Payers' Protection be Guaranteed

Again, it is not disputed that the CRS provides for rules intended to protect the confidentiality of information exchanged on an automatic basis.

Neither it is disputed that the new standard also contains safeguards designed to ensure that in most cases the exchanged information may not be used for purposes, other than taxation, which would not be authorized by the laws of the supplying State.

We live, however, in a world that is rapidly evolving, and it is utopian to believe that States will be in position to control other States' legislation and practices in order to prevent potential harm resulting from an erroneous or improper use of information supplied, or from the use of such information in a way which would have been forbidden in the supplying State.

Bearing in mind that the CRS has already been implemented by more than 100 States and that it aims to cover even more jurisdictions, including those of emerging and developing countries, this issue is not merely theoretical.

Given the limited (in practice) preventive measures made available to States by the Multilateral Agreements of 1988 and 2014, taxpayers will always need to act in response after the event. In other words, the automatic nature of data exchange on a worldwide basis will inevitably require citizens/taxpayers to develop new strategies of defence against a State's public powers when the standards are not met, whether in law or in practice.

## 4. Conclusion

Lawyers of all jurisdictions will, in particular, be called upon to play an essential role in denouncing any excesses which arise and in organizing legal checks of data exchange, particularly on the grounds of fundamental principles of law.

In this context, the challenge is twofold.

First, from a purely legal and procedural standpoint, the lawyers' role will be to exercise, so far as possible, some control over the nature of the information used by a State as well as the relevance and the validity of the actual exchange of that information.

This may prove difficult, because it implies first that citizens/taxpayers have been informed in a fully transparent way of the information about them which has been exchanged. It is doubtful whether full access to this information will be made possible by all the legislation of all the States involved.

The legal tools available to lawyers in this respect include of course all instruments of international law guaranteeing the protection and confidentiality of data subject to the automatic exchange of information, namely multilateral instruments (such as the Charter of Fundamental Rights of the European Union - cf. its Article 8 relating to the Protection of personal data - and the European Convention on

Human Rights) and bilateral instruments (cf. the possible recourse to the Mutual Agreement procedures generally provided by tax treaties entered into between States under the OECD Model Convention, Article 25), as well as the domestic law and case law of all States involved, specifically in the context of litigation.

However, one limitation to all the steps which can be taken at a cross-border level will always remain: although there are texts safeguarding the protection of privacy and framing the processes of data exchange, the sanctions for any breach of those safeguards are very limited in practice.

In the absence of international courts or supervisory authorities having powers to compel States, and in the absence therefore of any sanctions, the question of the effectiveness of any controls on automatic exchange will inevitably fall to the States' domestic Courts, making it dependent on each jurisdiction, for good or ill.

This is precisely where the second – and most important – challenge lies.

As a counterweight to the cooperation of States in the exchange of information, efficient worldwide cooperation between lawyers is the first building block that will guarantee equality of firepower between States and their citizens/taxpayers.

Indeed, as multilateral instruments cannot prevent every harm or protect every situation, and in the absence of any competent supranational supervisory body, it is up to lawyers of all jurisdictions to work together: federated control for States implies a federated defence for taxpayers.

As in the case described at the beginning of this article, on which we had the pleasure of working with our friend and colleague Jacques Malherbe, where it was only the intervention of lawyers on both sides that enabled the relevant States' tax authorities to communicate on the proper analysis to be given to the domestic legislation of one of the States, it is only by working together – not in a spirit of systematic challenge but in the proper defence of the taxpayer – that one will be able to prevent the abuse and harmful consequences which may otherwise result from the automatic exchange of information.