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Effective international information exchange as a key element of modern tax systems: promises and pitfalls of the OECD's common reporting standard

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Abstract

Today's global economic environment is characterized by the high mobility of capital and labour across national borders. Against the backdrop of a legal framework governing taxation of cross-border income, this may lead to double taxation on the one hand, as well as provide opportunities for tax evasion and tax avoidance on the other. It is well-established that a prerequisite for effective taxation of foreign-sourced income earned by "domestic taxpayers" (i.e. tax residents) is the system of administrative co-operation across national boundaries, mainly in the form of exchange of tax-relevant information between tax authorities. Since the lack of information-exchange mechanisms is linked with tax havens and the proliferation of "harmful tax practices", the OECD put the issue high on the global political agenda as early as 1998. Further developments strengthened the importance of the exchange of information, leading to the so-called "big bang" of 2009, i.e. to a significant increase in the number of concluded tax information exchange agreements, caused by the growing concern about international tax evasion and avoidance in the post-crisis period.

Nowadays the so-called automatic exchange of information (AEOI) between tax authorities has emerged as a new global standard. This is mostly due to the development of specific national and international models, aimed at enhancing inter-governmental cooperation in fighting offshore tax evasion. In this regard special attention should be drawn to the 2014 release of the OECD's Common Reporting Standard (CRS), which is based on the idea that banks and other financial institutions should play a crucial role in providing information on taxpayer's income and assets to tax authorities around the globe.

The aim of this paper is to explore some of the most important implications of the adoption of the CRS as a global AEOI model. While there are marked advantages of the new standard – mainly related to its potential in curbing large-scale offshore tax evasion – some important concerns arise as to its implementation on a global level. Particular attention will be paid to the issue of coordination of the CRS with the other information exchange models (e.g. FATCA) and to the problem of protecting taxpayers' rights and information.

Keywords: exchange of information, tax transparency, Common Reporting Standard, FATCA, international tax law

1 INTRODUCTION

It is quite commonplace for any new scholarly contribution on the subject of international taxation to open by remarking on the way in which the legal framework for taxing cross-border economic activities has evolved in the aftermath of the latest global economic crisis (the "Great Recession"). In essence, this ongoing evolution is founded on the idea that wealthy individuals and large multinational companies (MNCs) were somehow allowed legally to avoid payment of their "fair share" in the financing of public services. Against the backdrop of this normative

judgement – notwithstanding its vague content (Stevens, 2014:702) – a coordinated approach for the reform of a pertinent legal framework has emerged, primarily under the auspices of the G20 and the OECD, the epitome of which is the initiative against base erosion and profit shifting (BEPS) (OECD, 2013).

The new era of “tax transparency”, characterized by the unprecedented levels of taxpayer information shared between governments around the globe (Owens, 2014; Turina, 2016), cannot be viewed separately from this broad context. However, one crucial point should be added: while the BEPS project and similar initiatives are aimed at curbing tax planning schemes which are by definition legal (i.e. tax avoidance), the emergence of new forms of inter-governmental cooperation in the area of information exchange is mainly aimed at preventing the phenomenon of international tax evasion, i.e. taxpayer behaviour that breaks the law, mainly in the form of income underreporting. It is therefore unsurprising that the strengthening of the framework for information exchange was recognized as a political priority as early as 1998, within the debate on the negative effects of “harmful tax practices” and tax havens (OECD, 1998). The issue gained new prominence in 2008, when several tax evasion scandals broke out; the largest Swiss banks had connived in wealthy clients escaping taxation via offshore accounts. Amid much fanfare, G20 leaders jointly declared in 2009 that, with regard to taxation, the era of bank secrecy was over (G20, 2009). The panacea was found in the so-called automatic exchange of information (AEOI), which essentially entails “systematic and periodic transmission of ‘bulk’ taxpayer information by the source country to the residence country regarding various categories of income (e.g. dividends, interest, royalties, salaries, pensions, etc.)” (OECD, 2012:7).

The catalyst for worldwide expansion of AEOI was a piece of legislation adopted in the United States (US) in 2010, commonly called the Foreign Account Tax Compliance Act (FATCA) (Grinberg, 2012:352; Zucman, 2015). The subsequent quest for “multilateralization” of the mechanics of FATCA – with the key role played by banks and other financial institutions – reached a pinnacle in 2014, when the OECD published the so-called Global Standard for AEOI, the key component of which is the Common Reporting Standard (CRS) (OECD, 2014b). Put simply, the CRS shadows the structure of FATCA, with the aim of giving governments a proper instrument for retrieving information on the assets their tax residents hold with foreign financial institutions, thus putting an end to evasive tax practices.

The aim of this paper is to explore some of the most important implications of the adoption of CRS as a universal model for AEOI. While there are marked advantages of the new standard – mainly related to its potential in curbing large-scale offshore tax evasion – some important concerns arise as to its implementation on a worldwide level. Accordingly, this paper comprises five main sections. Following the introductory part, section two traces the development of a legal framework for AEOI on an international level, thus depicting the historical context of the

OECD's adoption of the CRS. Particular attention is drawn to FATCA, since it acted as the catalyst for future developments under the auspices of the OECD. Section three analyses the most important features of the CRS and puts special emphasis on its legal and operational basis. Section four examines some of the possible pitfalls of the CRS, which need to be taken into account in the evaluation of its appropriateness as a global anti-tax evasion instrument. Concluding remarks are provided in section five.

2 A SHORT HISTORY OF CROSS-BORDER EXCHANGE OF INFORMATION IN TAX MATTERS: THE ROAD TO THE CRS

The slogan “no taxation without representation” not only played a central role in the American Revolution, but is also one of the cornerstones of other modern Western democracies, in the light of historical movements against arbitrary taxation (Vanistendael, 1996:15-19). Similarly, from the viewpoint of tax authorities and their objective of efficiently enforcing tax laws and collecting taxes due, recent times confirm the validity of the saying “no taxation without information” (Pomeranz, 2015). This especially applies to taxation of income, since a self-assessment system prevails in most jurisdictions (Gordon, 1996:103). In other words, tax authorities ordinarily collect income tax on the basis of information received from the taxpayers themselves, backed up by the authority to request relevant information from third parties (e.g. banks) and conduct more detailed inquiries into taxpayers' activities and assets.

While this system works reasonably well in relation to taxpayers involved in purely “domestic” economic activities, the problem arises with regard to resident taxpayers who earn at least one part of their income abroad. Since the state wishing to tax foreign-sourced income of its tax residents lacks, under current norms of public international law, the same enforcement powers in relation to foreign financial institutions and other foreign persons holding relevant information (Picciotto, 1992:257-262), it will most likely need to rely on some form of assistance provided by foreign tax authorities in order to enforce tax collection effectively. Unsurprisingly, the data on the extent of international tax evasion and on the ensuing loss of tax revenue is staggering. As per official estimates, every year USD 100 billion in tax revenues is lost due to offshore tax abuse (Blank and Mason, 2014:2). Tax evasion schemes are quite straightforward and will not be examined in detail here. Put simply, financial institutions located in tax havens facilitate evasion by assisting clients to open accounts in the name of offshore entities, by advising clients on offshore structures to hide ownership or assets and covering up asset transfers between accounts. The importance of a formidable framework for inter-governmental exchange of tax-relevant information was recognized very early, long before the high mobility of capital and labour across national borders became a quintessential feature of the global economic environment. Accordingly, this section will proceed with a short insight into the history of information exchange models.

2.1 A HISTORICAL OVERVIEW OF INFORMATION EXCHANGE

The present-day network of bilateral tax treaties, which have a key role in allocating taxing rights over cross-border income, is largely based on the intellectual work carried out under the auspices of the League of Nations in 1920s, resulting in the creation of the first “model tax treaties”. Even at that time, when the economy was largely based on “bricks and mortar” and opportunities for cross-border trade and investments were severely limited, governments around the globe paid serious attention to the issue of international tax evasion (Picciotto, 1992:250-251). More remarkably, the history of the exchange of information for tax purposes goes back to the double taxation treaties signed between Belgium and France in 1843 and between Belgium and the Netherlands in 1845 (Oberson, 2015:4).

In 1963, the Draft Double Taxation Convention on Income and Capital (hereinafter: the OECD Model Convention) was adopted, containing provisions on the exchange of information (Ring, 2016:9). Namely, Art. 26 of the OECD Model Convention 1963 provided a legal basis for three forms of information exchange: 1) exchange upon request; 2) spontaneous information exchange; and 3) automatic exchange of information (AEOI). The three forms may be combined and some other techniques are also possible, such as simultaneous examinations or tax examinations abroad. Tax treaty practice has shown that the most frequently used method is information exchange upon request where one state requests information foreseeably relevant for a specific case from another state. On the other hand, spontaneous exchange of information entails provision of foreseeably relevant information from one state to another without prior request, when it is supposed that the information provided will be of interest to the other state. Finally, AEOI entails routine transmission of information on a regular basis without specific request from another state.

Tax treaty provisions replicating Art. 26 of the OECD Model are essential for correct allocation of taxing rights between treaty partners, primarily from the perspective of the state of taxpayer’s residence (Dourado, 2015:1858-1859). Amendments to Art. 26 in subsequent versions of the OECD Model, most recently in 2014, contributed to the strengthening of information exchange effectiveness in a bilateral context (Ring, 2016:13). Most importantly, in line with the global developments (see below, section 3), since 2009 the focus has shifted on linking Art. 26 to AEOI, rather than to the previously-favoured exchange upon request (Dourado, 2015:1853-1854).

The first efforts for AEOI outside the framework of double tax treaties can be traced to the very beginning of the 20th century. Zucman (2015) discusses the first national anti-fraud mechanism of 1901 based on AEOI between banks and the tax authorities, intended to fight fraud regarding inheritance. In 1908 the first international treaty on AEOI was signed between France and the UK. For the purpose of this paper special attention needs to be drawn to the 1988 Multilateral Convention on Administrative Assistance in Tax Matters (hereinafter: the Multilateral

Convention), drafted jointly by the Council of Europe and the OECD, providing the possibility for AEOI on a multilateral basis. As stated by Ring (2016:14), its status “(...) has allowed it to serve as a vital platform for important international developments in exchange of information, as demonstrated by its role in promoting expansion of automatic exchange of information.”

One should also take note of the role played by the EU in developing anti-tax evasion instruments. The so-called Savings Directive, adopted by the Council of the EU in 2003, set out AEOI provisions in respect of specific items of income (i.e. interest on savings accounts). Even more importantly, the scope of AEOI between tax authorities of EU member states has been significantly expanded by the 2014 amendments to the Directive on Administrative Cooperation (DAC), mainly under the influence of OECD's work on the CRS (Somare and Wöhrer, 2015:814).

2.2 FATCA CHANGES THE GAME: FROM UNILATERAL ACTION TO MULTILATERAL SOLUTION

The US imposes income tax on the basis of both citizenship and residence. The citizenship-based tax regime allows US tax authorities to tax worldwide income of every US citizen, irrespective of his residence. Certain concessions embodied in the US federal tax law are given to US citizens in order to avoid the negative effects of double taxation. One is the foreign tax credit which allows US citizens to take a tax credit for tax liabilities paid to foreign tax authorities, and the other is the foreign earned income exclusion, granting preferential tax treatment for foreign-source income (Holm, 2014:459). While it is beyond the scope of this paper to analyse the rationale of such a tax regime, it is important to note the problems with its enforcement, mainly related to the above mentioned issue of information deficit on the side of tax authorities. When it comes to taxation of income earned abroad not only by US citizens and corporations, but also by individuals who are deemed tax residents in the US, income tax essentially turns into a “tax on honesty”, particularly in cases where no foreign withholding tax applies.

2.2.1 The mechanics of FATCA and its criticism

Against this backdrop, US legislators amended the federal tax code in March 2010 by imposing obligation on foreign banks and other financial institutions (FFIs) to directly and periodically report to the US Internal Revenue Service (IRS) information on the financial accounts of US citizens and corporations. These obligations imposed mainly upon FFIs and US paying agents were embodied in Sections 1471 through 1474 of the Internal Revenue Code (IRC) and the new regime became widely known as Foreign Account Tax Compliance Act (FATCA). If a FFI does not comply with this basic requirement, a 30% withholding tax is imposed on a variety of payments it derives from US sources (Gupta, 2013:226). The purpose of withholding is twofold, as explained by Dourado (2015:1869): “(...) to induce foreign financial institutions that were investing in or through participating financial institutions but not in the US to participate in FATCA and to make the participating foreign financial institutions consider stop doing business with non-participating institutions (since such business would imply withholding tax).”

The UBS banking scandal of 2008, where a banker employed with the Swiss bank helped wealthy US citizens to evade US taxes by covertly keeping the money in Swiss bank accounts, accelerated the adoption of FATCA (Oberson, 2015:151) and the legislation went into effect in July 2014. From a policy perspective, the main aim of FATCA is not to raise additional tax revenues but rather to deter and discourage future tax evasion (Dizdarevic, 2011:2984-2985). Put simply, in the light of the requirements imposed upon banks and other financial institutions, US taxpayers would lose the incentive to engage in offshore activities in attempts to hide their wealth out of the IRS's sight.

From a public international law perspective, the basic problem of FATCA is that it is blatantly extraterritorial in application (Mukadi, 2012:1231; Essers, 2014:59). It essentially represents an exertion of US law into the jurisdictional realm of foreign countries, without their consent. Accordingly, the US has been criticized as taking on a one-sided initiative against tax evasion, instead of opting for the co-operative route with the participation of other countries (Holm, 2014:449). In addition, important questions have been raised with regard to the conflicts between FATCA and domestic laws on data protection (Tello, 2014:92).

Debates have also raged over the ability to enforce FATCA effectively, as well as over its potential negative effects on the US economy (Blank and Mason, 2014:4-5). Critics have pointed to its high compliance and administrative costs (Blank and Mason, 2014:5). On the one hand, the IRS would have to increase human resources, improve information technology, infrastructure, analyse new data and link it with client profiles in original databases in order to enable complete and reliable data (Gupta, 2013:38). On the other hand, particularly high compliance costs, related to engagement of additional human resources and the upgrade of due diligence processes, would arise for financial institutions operating in multiple jurisdictions. It was apparent that FFIs would have to adjust their processes and enhance computer systems, educate potential investors on disclosure requirements, maintain centralized customer databases and regularly update relevant information.

Moreover, FATCA has been perceived as discouraging investment in US assets, thus impeding the growth of the US economy. With the intention of saving money intended for due diligence processes and updating their operating systems in accordance with the FATCA provisions, FFIs may avoid investments in US assets (stocks, bonds), which may lead to reduction of stock indices in the US and other financial markets. Furthermore, investment already made in the US may be liquidated. It should also be noted that the number of US citizens renouncing their US citizenship has reached the highest rates ever since the introduction of FATCA¹.

¹ Annual number of requests in 2011 was 1,781. Further 2,999 requests were made in 2013, which represents a 221% increase in comparison to 2012 (932 requests). The year 2014 brought even higher number of citizenship renouncement (3,415) and in 2015 there were approximately 4,300 expatriations (Forbes, 2016). However, expatriations may also be attributed to causes other than FATCA, such as specific features of determining tax liabilities of the US citizens.

Finally, some FFIs responded to the commitments imposed by FATCA by refusing to serve US account holders in order to avoid problems with the IRS (Holm, 2014:466).

2.2.2 Enhancement of FATCA on the inter-governmental level

The above described criticism of FATCA urged stakeholders, particularly multi-national financial institutions (MFIs) and foreign governments, to embark upon a quest to create a system incorporating its basic principles, but leaving out the most burdensome rules, such as the withholding regime (Grinberg, 2013:332). This process of the “globalization” of a unilateral US instrument can be mostly attributed to the complementary interest shared by the US and other countries in curbing international tax evasion, confirming the predictions that the adoption of FATCA will result in a “domino effect” (Mukadi, 2012:1233). The decisive moment in this respect was the release of a G5 Joint Statement (US, France, Germany, Italy, Spain and the UK) in 2012, announcing that FATCA compliance will be provided by a framework for inter-governmental AEOI on pertinent financial accounts (Grinberg, 2013:332; Essers, 2014:60).

Accordingly, the legal basis for the implementation of FATCA was found in special intergovernmental agreements (IGAs) that resolve the problem of incompatibility of national laws with FATCA. Put simply, the solution was found in the “routing mechanism”, which entails that FFIs do not report relevant information directly to the IRS, but rather to their local tax authorities, who will further engage in the exchange of information with their US counterparts (Oberson, 2015:157). Two types (so-called Model 1 and Model 2) of IGAs have been prepared by the US Treasury and have been accordingly used in negotiations with other countries (Gupta, 2013:223-224). Each of the models has a sub-version, targeted at countries which have concluded neither a double tax treaty nor a special Tax Information Exchange Agreement (TIEA) with the US. Model 1 IGA is the only one incorporating the concept of reciprocal information exchange. Therefore, it has been selected as a template for the creation of the OECD’s Global Standard (see below, section 3).²

3 OECD’S COMMON REPORTING STANDARD AS A SYMBOL OF THE NEW ERA OF INFORMATION EXCHANGE

In 2013 the G20 countries committed to the OECD’s proposal for a model of AEOI to be implemented on a global basis (the OECD’s Global Standard). The OECD made it clear at the outset that its intention was to set a minimum standard for AEOI, without the intention of restricting the existing models (OECD, 2014:10). The highlight of this initiative came in 2014, when the OECD released the document titled “The Standard for Automatic Exchange of Financial Account Information” (Oberson, 2015:184).

² Conversely, Model 2 IGA was perceived as unsuitable for global cooperation due to its limited scope and provisions according to which financial institutions provide information on US customers to US tax authorities. Hence, the usage of the Model 2 IGA has been limited to countries with strong privacy and banking secrecy laws (Somare and Wöhrer, 2014:396-397).

3.1 COMPONENTS OF THE OECD'S GLOBAL STANDARD AND ITS IMPLEMENTATION

The OECD's Global Standard actually consists of two main components: 1) the Model Competent Authority Agreement (Model CAA), which is essentially a template for a legal instrument enabling AEOI between participating countries; and 2) the Common Reporting Standard (CRS), which lays down reporting and due diligence requirements in respect of specific categories of financial accounts, in a fashion similar to FATCA (see above, section 2.2.1). Accordingly, it should be noted that the Model CAA is primarily addressed to participating tax authorities who want to regulate their mutual AEOI relationships, whereas the CRS is primarily aimed at banks and other financial institutions upon which the reporting and due diligence obligations are imposed (McGill, 2016:2).

Akin to the role played by IGAs for FATCA enforcement (see above, section 2.2.2), the CAA links the legal basis for inter-country exchange of information (i.e. Multilateral Convention) with the CRS (Oberson, 2015:197). While the CAA is drafted as a reciprocal agreement, it may also provide for a non-reciprocal exchange, considering that some countries may not be interested in receiving information (Radcliffe, 2014:162). In a classic reciprocal scenario, each party must annually exchange the obtained information with other competent authority on an automatic basis. The information is to be exchanged within nine months from the end of the calendar year to which it relates (Oberson, 2015:199). As per section 4 of the Model CAA, if the "requesting state" receives incomplete or incorrect information, it has to notify the "requested state" to take appropriate measures to address the errors or non-compliance. Unlike FATCA, the Model CAA does not envisage withholding obligations, placing some doubts over enforcement of the Global Standard (Oberson, 2015:200-201). However, it should be noted that the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes (below, the Global Forum) has been entrusted with the task of monitoring and reviewing the Global Standard in the form of peer-reviews (Radcliffe, 2014:162).

In order to give effect to the Global Standard, each participating country has to fulfil certain legal requirements. First, for the conclusion of CAA there has to be a legal basis for inter-governmental information exchange, such as Art. 26 of a bilateral tax treaty that replicates the OECD Model (see above, section 2.1). The most suitable legal basis for the operation of CAA is probably provided by the Multilateral Convention (see above, section 2.1), that has a global reach, allows for all forms of administrative cooperation and contains rules on confidentiality and the proper use of information (OECD, 2014b:13). In order for information to be exchanged automatically under the Multilateral Convention, a separate agreement between the competent authorities is required. Accordingly, the CAA fulfils the function of activating and operationalizing AEOI between the parties (OECD, 2014b:13; Dourado, 2015:1854; Oberson, 2015:188). Second, the CRS is legally binding upon "reporting financial institutions" only if it is implemented into domestic law of each participating state (Dourado, 2015:1856).

Hitherto around 100 countries around the world have publicly committed to the implementation of the Global Standard. Notably, the US is not among participating jurisdictions and this does not seem likely to change in the foreseeable future. As the US representatives officially explained to the OECD, their country will insist on administering AEOI as envisaged in FATCA and in IGAs signed with other countries (Parillo, 2015:727). It is not entirely clear whether this entails the US being treated as a “non-participating jurisdiction” for CRS purposes, since the OECD has repeatedly acknowledged that the adoption of its Global Standard has been made possible by FATCA. In any case, interaction between FATCA and the CRS breeds some uncertainty and adds complexity in determining financial institutions’ legal responsibilities (see below, section 4.1.).

3.2 COMMON REPORTING STANDARD: A CLOSER LOOK

The CRS, a key element of the OECD’s Global Standard, sets out reporting and due diligence requirements with regard to specific types of accounts (“reportable accounts”). These obligations fall on the shoulders of “reporting financial institutions”, which encompass a wide range of financial institutions and investment entities (e.g. brokers, collective investment vehicles, certain insurance companies) (Oberson, 2015:189). Reporting financial institutions are obliged to collect information and report the collected information to their local competent authorities who will then exchange the information with other jurisdictions (Knobel and Meinzer, 2014:16). With the aim of preventing taxpayers from circumventing the model by shifting assets to institutions or investment products not covered by the model, the scope is set widely not only in relation to the definition of reporting financial institutions, but also in two further dimensions (OECD, 2014b:12). First, relevant information to be reported is defined very broadly, covering different types of investment income (e.g. interest, dividends) as well as addressing situations in which a taxpayer attempts to hide capital. Second, “reportable accounts” encompass not only accounts held by individual taxpayers, but also accounts held by interposed legal entities or arrangements (e.g. shell companies, trusts, etc.). In essence, this means that financial institutions are required to “look through” the often complex ownership structures to find beneficial owners (Oberson, 2015:189).

These core CRS requirements have to be translated into the domestic law of participating jurisdictions. In doing so, each state not only has substantial leeway in choosing implementation techniques (e.g. primary legislation, administrative guidance, etc.), but also in deciding on the level of detail that will be contained in its domestic rules on reporting, due diligence and other CRS requirements (OECD, 2015a:10-11). Moreover, participating jurisdictions are free to cherry-pick among a number of optional CRS provisions/definitions, depending on the specifics of their domestic legal framework (OECD, 2015a:11-17). Even more importantly, individual countries may embark upon an even more ambitious approach, imposing additional due diligence requirements on financial institutions, with the aim of enhancing the effectiveness of the regime (OECD, 2014b:284-300). Thus, it is

evident that the legal nature of the CRS breeds local idiosyncrasies, which raises serious concerns for reporting financial institutions (see below, section 4.1).

Finally, it should be noted that the CRS (see section IX) requires each participating jurisdiction to ensure, within its domestic legal framework, effective compliance with its basic requirements. For this purpose, a number of rules and administrative procedures must be translated into domestic law, e.g. an anti-avoidance rule or penalty regime for non-compliant financial institutions (OECD, 2014b:207-211). Different local approaches will arise also in this regard, since every country will first compare its existing legal framework with CRS requirements and then adapt it as may be necessary (OECD, 2015a:23; Radcliffe, 2014:166).

4 ASSESSMENT OF THE CRS: DO POTENTIAL BENEFITS OUTWEIGH THE COSTS?

This section addresses the most vexing problems associated with the introduction of CRS and its implementation around the globe, which may compromise the attainment of legitimate policy goals that underlie the OECD's approach in the area of tax transparency and administrative co-operation.

4.1 COMPLEXITY AND INCOHERENCE OF THE REGULATORY FRAMEWORK

As may be inferred from the analysis presented in previous sections, the OECD's Global Standard is extremely ambitious when juxtaposed to the institutional arrangements for AEOI that dominated in the preceding period and are also widely used today (see section 2.1). First, it largely embraces core elements of FATCA, which are indeed revolutionary (see section 2.2). Second, it is fully based on the premise of multilateralism, establishing a system of universal principles and rules to be implemented across national borders (see section 3.1).

Accordingly, considerable caution is advised for all stakeholders when assessing the benefits of this new regime. More precisely, one should not underestimate potential costs to be incurred by stakeholders due to the rising complexity of the regulatory framework(s). This is indeed a familiar concern from a policy standpoint: it is well-established in the tax literature that policymakers' pursuit for solutions which are deemed "first-best" in the light of normative precepts like equity and/or efficiency usually come at the expense of simplicity of the tax system (Kaplow, 1999; Krever, 2003; Rosen, 2008:368-369), which conversely is a value in itself (Stiglitz, 2000:497; Hyman, 2011:425). For the purpose of the ensuing analysis we adhere to the view that compliance costs serve as key evidence of the level of tax complexity (Krever and Mellor, 2015:1).

In light of the mechanics of information exchange envisaged in the Global Standard (see above, section 3) it is perfectly clear that the additional cost linked with the complexity of the new regime is not an issue for the taxpayers, since their role in the international information exchange is merely "passive". Conversely, significant cost is expected to be borne both by tax authorities and by banks and

other financial intermediaries (Grinberg, 2013:366-367; McGill, 2016:sec. 1). In this respect particular attention should be drawn to the costs arising due to existence of multiple instruments regulating AEOI, as well as inconsistencies between them (Oberson, 2015:247).

4.1.1 Financial institutions' perspective: increased compliance costs

Taking a bird-eye view on the matter, it is visible that a multinational financial institution (MFI) will in all likelihood have to comply with at least three AEOI models: 1) the FATCA model, which regulates their relationship with US tax authorities; 2) a system based on EU DAC; 3) a multilateral framework modelled in accordance with OECD's Global Standard. The biggest issue at hand is how these overlapping models fit together, not only when it comes to resolving potential conflicts in application (Altenburger, 2015), but even more importantly as regards to disparities between the specified rules and standards for collection, storage and transmission of data (Vainstendael, 2014:1152; McGill, 2016: sec. 5.1). The former aspect has been particularly underscored by the financial institutions themselves, within the public debate on global implementation of FATCA (Grinberg, 2013:348-349) and in subsequent discussions on the implications of the introduction of the CRS.

On the face of it, the OECD's CRS replicates the system set up by international agreements adopted for FATCA purposes (Model 1 IGAs): under both systems financial intermediaries are obliged to perform due diligence during collection of data about specific account holders, implement processes for efficient data storage and finally report relevant information to respective tax authorities. However, there are some marked differences as regards specifics of these obligations, making it clear that the CRS is much more than a global "extension" of FATCA (KPMG, 2014:2).³ Some of the most important discrepancies directly cause increased compliance costs for financial institutions.

First, the scope of due diligence and reporting procedures under the CRS is significantly broader than that under FATCA. Not only does the CRS require that these procedures are implemented in relation to tax residents of more than 100 participating countries, but it does not employ FATCA-like exemptions for low-value accounts (KPMG, 2014:25). Second, on a more technical level, forms that are used under the FATCA-based framework are of no use for CRS purposes (McGill, 2016:sec. 5.1). Instead, the CRS relies upon a specific self-certification mechanism in order to identify reportable accounts. Third, there is some inconsistency between the CRS and FATCA as regards the classification of financial and non-financial entities (OECD, 2015a:20). Notably, the CRS classifies investment entities (e.g. trusts, investment funds) resident in a non-participating country as "passive non-financial entities", meaning that reporting financial institutions are required to document and report on their beneficial owners (see above, section 3.2). Conversely, under FATCA and Model 1 IGA such investment entities man-

³ A detailed comparison between FATCA and the CRS is laid out in OECD, 2015a:87-101.

aged by a MFI are classified as financial institutions and there are no look-through requirements (Parillo, 2015:728). Against the background of the ambiguous status of the US as a (non-)participating country for CRS purposes (see above, section 3.1), it is apparent that a number of MFIs will face a conundrum in entity classification and determination of ensuing responsibilities (KPMG, 2014:28). Fourth, unlike under FATCA, the CRS does not require financial intermediaries to withhold tax on certain US payments made to non-compliant persons and entities. While the fact that this important “punitive” feature of FATCA is missing under the CRS may come as a relief for MFIs, they still need to be extremely wary of the prospect that countries take diverse approaches to enforcement of CRS requirements (see above, section 3.2).

An inevitable outcome of this lack of AEOI standardization on a global scale is the increase in compliance costs for banks and other financial intermediaries. The burden will be higher, both in absolute and in relative terms, for the biggest MFIs operating in the majority of countries around the world, as they would have to meet terms with a number of local regulatory variances, thus multiplying the total compliance cost (Grinberg, 2013:350; KPMG, 2014:2). Arguably, such concerns may be mitigated to a certain extent by technological advancements (McGill, 2016:sec. 7), since IT systems supporting due diligence and reporting processes can be amended to capture all features envisaged under both CRS and domestic legislation. In this respect it should be noted that the importance of common or compatible technical solutions for reporting and exchanging information in line with the CRS has been recognized by the OECD (2014b:14). While such an approach may reduce overall compliance costs in the future, it entails significant investments in technology-based solutions for financial institutions in the short run (KPMG, 2014:3).

4.1.2 Tax authorities’ perspective: administering the new arrangements for AEOI

On the other side of the same coin, the complexity of the new global AEOI architecture – with the CRS at the heart of it – may pose quite a burden on tax authorities, which are required to collect a massive load of relevant information from local financial intermediaries, as well as to exchange this information, largely in a reciprocal manner, with their foreign counterparts. As is the case with any comprehensive usage of information transmitted from third party intermediaries to the tax authorities, the success of these new arrangements will largely depend on the quality of systems in place for electronic reporting and matching of data with tax authorities’ own records (OECD, 2015b:307). Doubts have been expressed in the literature as to the capacity of tax authorities, particularly those of developing countries, fully to capitalize on the AEOI developments due to institutional and/or technical constraints, putting an additional strain on their already limited resources (Grinberg, 2013:347-348; Mosquera Valderrama, 2015:sec. 5.3.1.3.; McGill, 2016:sec. 7). As noted in the OECD’s report on the role of capacity building in a tax administration, various instruments for provision of technical assistance and capacity building should be established to ensure that developing countries effec-

tively implement the new Global Standard for AEOI (OECD, 2016:23-24). In this respect, promising steps have already been taken under the auspices of the OECD's Global Forum and other international organizations (Grinberg, 2013:359; OECD, 2016:23-32).

To sum up, the potential of the CRS to act as a powerful anti-tax evasion tool, thus having positive revenue effects for participating governments, may be seriously hindered by existing administrative constraints and by the outlay of resources respective revenue bodies have to make in order to assure effective implementation of a global AEOI framework. Accordingly, assertions that developed countries would benefit the most from the CRS seem quite convincing (Mosquera Valderrama, 2015:sec. 5.3.1.3.).

4.2 PROTECTION OF TAXPAYERS' RIGHTS

Taxpayers, apart from being obliged to pay taxes, are information holders and as such they have to report, determine, compute and pay taxes. Their duties increase domestically and internationally with the global development of information exchange and in those procedures their interests are protected by various rights contained in domestic or international instruments. Taxpayer rights include the right to a fair process in the exchange of information proceedings, basic privacy protection and procedural rights. Oberson (2015:209) notes that "the more global the exchange of information, the greater risk of breaches of confidentiality, privacy and secrecy provisions or even abuse in the use of data obtained."

Oberson (2015:211) analyses the scope of taxpayers' rights and summarizes a minimum standard consisting of the right to be informed and heard, the right of appeal, the right to pay an exact amount of tax, the right to certainty, the right to privacy and the right to confidentiality and secrecy. Another limitation is that information does not have to be supplied to another jurisdiction if its disclosure is contrary to the *ordre public* (public policy) of the supplying state, which is the term relating to, e.g. proceedings which would result in imposition and execution of death penalty, torture or other violations of human rights as well as tax investigations motivated by political, racial or religious prosecution (OECD, 2014a).

The role of exchange of information is to prevent double taxation, which is in the interest of taxpayers, as well as to combat tax evasion and tax avoidance, which is in the interest of the states. The protection of taxpayers' interests is crucial because the exchange of information relates to personal data and potentially confidential information. Therefore, the governments have to take into account the interests of taxpayers when fulfilling obligation to exchange information (Oberson, 2015:212). Taxpayers as well as tax administrations have a legal right that the exchanged information remain confidential. Financial information is sensitive and it should be handled appropriately. International exchange will be trustworthy only if the information is used and disclosed in accordance with the legal instruments allowing the exchange (OECD, 2014a).

Oberson (2015:213) points out that in exchanging information with contracting states, certain rules should be followed. A requesting state should make an effort to collect information under the domestic law before turning to a foreign state (principle of subsidiarity). Furthermore, the competent authorities of the contracting states are obliged to exchange information which is foreseeably relevant for implementation of international law instruments, in which “foreseeably relevant” provides for the widest possible extent of exchange of information, but rules out “fishing expeditions”. Finally, competent authorities must keep information received through exchange of information as confidential, taking into account domestic laws on secrecy in tax matters as well as protection provided by international law.

Baker and Pistone (2015:59) warn that the growth of AEOI in recent years will cause large amounts of financial data about taxpayers to flow between tax authorities. The importance of security of the data will therefore be more significant than in the case of exchange of information upon request. In applying this method of exchange of information, it might be impractical to inform each taxpayer of the exchange so it will be sufficient that the taxpayers are informed by financial institutions that the information provided to them may be subject to the automatic exchange (Baker and Pistone, 2015:64).

As examined above (section 3), implementation of the CRS is based on a specific instrument of international law which allows AEOI, such as a Multilateral Convention or a bilateral tax treaty. Therefore, confidentiality and data protection within the CRS framework is based on this instrument (Oberson, 2015:219). Both bilateral tax treaties and the Multilateral Convention contain provisions on the confidentiality of information exchanged and limit the persons who have access to the information as well as purposes for which the information may be used (OECD, 2014b:13).

Under Section 5(1) of the Model CAA all information exchanged is subject to the confidentiality rules and other safeguards provided for in the above mentioned international 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. Therefore, the importance of the confidentiality and data safeguards has been recognized within the new global model of AEOI. It has to be noted that jurisdictions provide for different rules on protection of personal data of taxpayers – the data subject’s right to information, access correction and the oversight mechanism. The state supplying information may specify in the agreement the safeguards which have to be respected in accordance with its national law. The receiving state’s obligation is to provide practical implementation and respecting of the safeguards, which have to be in compliance with its own national law as well as domestic law of the state supplying information (OECD, 2014a).

Moreno González (2016:147) notes that the efforts in international and supranational taxation aimed at improving the exchange of information among tax administrations have not been accompanied by corresponding improvement of the protection of taxpayers' rights and the personal data obtained through that process.

5 CONCLUSION

A serious crisis, it has been said, should never go to waste, which may be applied to the issues explored in this paper. Indeed, a major shift in the framework for international exchange of information occurred in the aftermath of the latest global economic crisis. It has to be acknowledged that until fairly recently the veil of bank secrecy protected taxpayers from having their assets and income revealed to the revenue bodies of the states of their residence. Insufficient mechanisms for the exchange of information with other countries, or the utter absence of them, was thus recognised as a crucial element in characterizing a tax system as “harmful” or even giving a country the label of tax haven. Ground-breaking work in the post-crisis period has been undertaken mainly by the OECD, with the strong support by G20 countries and EU member states, bringing about a new paradigm in this area. A considerable degree of caution is, however, advised in the analysis of the effects of this global initiative for tax transparency, since some recent estimates find that around USD 7.6 trillion or 8% of global households' total financial wealth is still hidden in tax havens (Zucman, 2015:35).

The crucial impetus towards a global system of automatic exchange of information (AEOI) was the adoption of FATCA in the US. Its basic features were adopted and, *mutatis mutandis*, incorporated in the OECD's Global Standard for AEOI, released in 2014. This paper has devoted particular attention to the Common Reporting Standard (CRS), as a key component of the Global Standard. The CRS comprises a two-tier system of annual reporting of data about account holders and due diligence procedures necessary to identify reportable accounts.

The matter of CRS implementation still remains open as the first exchanges are planned for 2017. Against this backdrop, we highlighted some concerns regarding the functioning of the new system. Pertinent compliance costs will definitely be substantial and this burden will be borne both by tax administrations and financial institutions. Attention was drawn to the problem of incoherence between the CRS and other AEOI systems currently in force, such as FATCA. Accordingly, it was argued that the CRS is much more than a global “extension” of FATCA. From the perspective of reporting financial institutions, the biggest concern is that it is unlikely that any two countries will implement the CRS in the same manner in their domestic law, bringing about additional costs in order to comply with all the local variances. Likewise, tax authorities will have to invest additional resources in order to effectively implement the new system and reap its potential benefits. In this regard developed countries – having sophisticated tax administrations – are in a far better starting position than developing countries.

Another vexing concern relates to the protection of taxpayers' rights within the AEOI procedures. We emphasized that the information exchange under OECD's Global Standard must abide by the safeguards relating to the data to be exchanged, the procedures used as well as the access to the data exchanged and the use to which it can be put. Often sensitive data should be handled confidentially while respecting data protection standards set out by the international tax law instruments as well as domestic laws of both countries involved in the exchange. However, it seems that we are still very much in uncharted waters with regard to the status of taxpayers' rights within global AEOI architecture and the issue has been given serious attention only fairly recently, in both academic and policy circles.⁴

In conclusion, the "brave new world" of tax transparency symbolized by the CRS is, and will remain in the foreseeable future, yet another battlefield between conflicting tax policy norms (e.g. tax equity, simplicity, protection of human rights, etc.). In our view, its ultimate success or failure will be dictated by the aptness of multilateral responses to the most pressing problems at hand.

Disclosure statement

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⁴ For an overview see, e.g. Baker and Pistone (2015:59-65); André Rocha (2016:502-503).

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