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Transparency and Disclosure

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Papers on Selected Topics in Protecting the Tax Base of Developing Countries

September 2014

Transparency and Disclosure

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Transparency and Disclosure

Diane Ring

1. Introduction

1.1 BEPS and Tax Information.

Across the globe, countries increasingly express the concern that they are facing serious financial challenges from base erosion and profit shifting. Without a stable and adequate tax base, countries lose the financial capacity to provide infrastructure, social services and development opportunities important to their citizens. In response, the G20 and OECD organized the BEPS Project. Much of the project is focused on substantive law—the rules and practices that can allow a country’s tax base to be eroded and profits shifted out of the country. But the project recognizes that substantive tax rules alone are not sufficient to guarantee a country’s tax base. Without adequate transparency and disclosure of tax information to the taxing authorities, even the most carefully designed substantive tax rules will fail to protect the base. Thus, an important part of the BEPS work targets the more administrative issues of transparency and disclosure. Ultimately, the goal is to ensure that tax authorities have adequate and appropriate access to information necessary for the effective administration of the tax law. As part of this mission, the BEPS project includes the development of standards for information reporting by multinational enterprises—“country-by-country reporting.” (See 3.3.2).

1.2 Broader Context for Tax Information Issues.

The BEPS work on transparency and disclosure is not occurring in a vacuum. Existing tools offer tax administrators different avenues for accessing information. Such tools include: bilateral tax treaties (based on the UN and/or OECD Model Treaties), TIEAs (tax exchange information agreements often based on the OECD Model), regional agreements, and the work of the Global Forum on Transparency and Exchange of Information. (See 5.2, 5.3, 5.5, 5.6) Additionally, there are new developments taking place outside the formal BEPS project, some initiated by individual countries, others the work of regional networks or other international bodies, including: IGAs (intergovernmental agreements) (4.5), automatic exchange of information agreements, the common reporting standards (CRS) for automatic exchange (4.3), and increased attention to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (5.4).

1.3 Scope of the Paper.

The purpose of this paper is to provide developing countries with an overview of both the new developments in transparency and disclosure as well as existing options for obtaining information. Some of the new developments remain in progress and final recommendations have not yet been made. But the examination provided below of the key goals, concerns, advantages and disadvantages of various options (including existing methods and newly proposed ones)

should help countries evaluate their own circumstances and determine which options make the most sense for them in their effort to curb base erosion and profit shifting. Given the newness of certain proposals (e.g., actions taken under the BEPS project, including country-by-country reporting), this paper will devote more attention to reviewing the anticipated content and implementation of these options with which countries may be less familiar.

1.4 Pervasive Questions in Transparency and Disclosure.

Regardless of the specific mechanism for providing information to tax administrators, a number of universal questions arise: (1) what type of information must be provided, (2) how difficult will it be for the taxpayer to provide that information, (3) how will the information be provided, (4) what kind of technology and infrastructure will be needed by the taxpayers and the country to implement this system, (5) to whom will the information be distributed, (6) what are the permissible uses of the information, (7) does the country have the capacity to meaningfully use the information, and (8) how will data protection and taxpayer privacy be ensured? The success, failure, and impact of a given regime for providing tax information will depend significantly on the responses to these identified concerns. That said, there is no single appropriate response to these questions. By examining each of the new emerging information regimes, as well as the existing ones, against the backdrop of these questions, a country can determine its own most effective path toward appropriately protecting its tax base.

2. Transparency and Disclosure in the Current Tax World

2.1 Overview.

Recent efforts to ensure that countries have access to information needed to meaningfully and effectively implement their tax laws have focused on the goals of “transparency” and “disclosure.” These terms appear in the BEPS Action Plan (July 2013) and a variety of related documents and commentaries. These two terms are distinct from the related phrase “exchange of information;” thus, it can be useful to specify their meaning. All three play a critical role in guaranteeing that countries have the needed information.

2.1.1 Transparency: This term reflects that idea that a country needs to understand how a taxpayer is conducting its business, is structuring its operations, and is making investments in the country. To achieve this level of understanding, it may be necessary for the country to have a solid grasp of the taxpayer’s activities, transactions and business structure beyond the borders of that jurisdiction.

2.1.2 Disclosure: This term captures the idea that a country will need access to the information necessary to provide transparency regarding the taxpayer’s activities.

- 2.1.3 Exchange of Information: This phrase refers to the process (and mechanism) by which a country can obtain information regarding a taxpayer or the taxpayer's transactions, typically from another country. The most well-known mechanisms for exchange of information are bilateral tax treaty provisions based on Article 26 of the UN and the OECD Model Income Tax Treaties, discussed in 5.2.

2.2 **Current Need for Information.**

As noted above, and discussed more extensively in 5.1, the demand for taxpayer information by taxing authorities is not new. However, the current lack of transparency that many countries face (due in part to insufficient disclosure), has become a significant problem. The growth in cross border commerce by MNEs, both foreign and domestic, has created a crisis in information for several reasons:

- 2.2.1 Cross Border Tax Planning. Taxpayers with cross border activities can engage in a wider array of tax planning techniques which can lead to base erosion and profit shifting. Substantive tax law changes that are designed to eliminate various arbitrage opportunities are one tool for attacking this problem. But substantive tax reform is insufficient given that arbitrage may be difficult to identify and fully eradicate. Adequate disclosure remains vital for the needed transparency regarding taxpayer activities.
- 2.2.2 Volume of Cross Border Business. Both the number of taxpayers engaging in cross border business and the volume of business they conduct have been increasing. Thus, the scale of the base erosion and profit shifting at stake is significant. Correspondingly, the amount of information that countries' must access, process, and evaluate to stem the loss of tax base is also quite large. Mechanisms for providing information to countries must be tailored to promote the goal of transparency and understanding.
- 2.2.3 Role of Developing Countries in the Global Economy. Developing countries have experienced significant growth in inbound investment by foreign multinationals as well as outbound activities of their own multinationals. Income generated by these MNEs forms a critical portion of the tax base, and as noted in 2.2.1, is especially susceptible to base erosion and profit shifting tax planning.

For all countries facing such base erosion and profit shifting from multinationals, the ability to access and use tax information is vital. But developing countries may find that they encounter serious barriers to securing needed information, as compared to other jurisdictions. Not only do developing countries often experience a number of domestic constraints on their ability to access and use taxpayer information (see 2.2.4.2), they may also find it more difficult to obtain information from other jurisdictions (see

2.2.4.3). Additionally, to the extent that foreign multinationals pose a greater information transparency and disclosure risk than domestic ones, developing countries face a distinct challenge. They typically have a substantial amount of inbound investment relative to outbound and therefore have more foreign multinationals taxpayers than domestic ones.

2.2.4 Informational Challenges for Developing Countries. As noted in 2.2.3, developing countries are especially dependent on corporate taxation of MNEs for their tax base. To the extent MNEs are able to engage in successful base eroding and profit shifting transactions, developing countries typically have fewer alternative tax bases upon which to draw (e.g., individual taxes, consumptions taxes).¹ Thus, BEPS problems can be particularly significant to these jurisdictions. The costs of BEPS to developing countries may be more severe and the impediments to overcoming BEPS may also be greater for these jurisdictions. Developing countries may experience a number of hurdles to securing information, transparency and disclosure from multinational businesses. A review of these barriers directs attention to the changes that may be needed and allows reform proposals to be measured against this list of challenges to see where and how much they can help. The impediments can roughly be grouped into three categories: (1) domestic law, (2) domestic enforcement, and (3) international support.

2.2.4.1 Domestic Law Impediments. Some countries already have in place domestic law reporting requirements that provide relevant taxpayer information. Such reporting requirements can include the taxpayer's obligation to provide information regarding: (1) foreign related entities and related party transactions, (2) foreign financial assets and accounts, (3) discrepancies between tax reporting and accounting treatment; and (4) certain kinds of tax shelters or otherwise suspect transactions and structures. This information can be useful in helping a country determine whether to initiate an audit, and where and how to direct their attention in an audit. To the extent that developing countries typically do not have such reporting regimes in place, changes to domestic law reporting requirements may be one step in the process of enhancing transparency and disclosure. The final recommendations that ultimately emerge from the BEPS Project regarding Action Items 12 and 13 may play a guiding role for countries that are just starting to institute such reporting requirements. (See 3.3, 3.4).

The work of the Global Forum on Transparency and Exchange of Information identifies other fundamental domestic law features that can inhibit (or conversely facilitate) transparency. The Global Forum's Peer Review process is intended to provide a mechanism for assessing a country's compliance with "the international standard of transparency and exchange of information."² (See 5.5). In evaluating a jurisdiction along these measures, the Global Forum

¹ See, e.g., OECD, Part I of a Report to G20 Development Working Group on the Impact of BEPS on Low Income Countries (July 2014) at 11.

² Global Forum on Transparency and Exchange of Information for Tax Purposes, *Tax Transparency 2014: Report on Progress* (November 2013) at 17.

reviews a number of key dimensions of the domestic law critical to transparency. One set of factors looks to the *availability* of information on the following topics: (1) ownership and identity information for entities and structures; (2) accounting records; and (3) banking information for account holders. Another set of factors looks at the rules and procedures governing *access* to that information. The expectation is that the designated tax authorities in the country (the competent authority) have the power under domestic law to obtain that information and provide it in under an exchange of information mechanism, while respecting taxpayer rights.³ Although the focus of the Peer Review process and recommendations may be directed toward enhancing exchange of information with other countries, many of the same rules, practices and procedures that enable a country to participate actively in information exchange would improve the country's ability to implement its own tax system and limit base erosion and profit shifting. The same availability of and access to information that enables a jurisdiction to be a global partner in sharing information with other countries would facilitate its tax enforcement and revenue collection. Thus, engagement with the Global Forum work may be useful for developing countries, regardless of the amount of taxpayer information sought from their jurisdiction. See 5.4.

2.2.4.2 Domestic Enforcement Impediments. All countries face the question of whether their administrative system is effective in using the information available. However, developing countries may face barriers to deriving maximum benefit from the information that they do currently possess (or that they may be able to acquire in the immediate future).⁴ These barriers can include: (1) limited audit staff; (2) audit staff without the required training and experience (e.g., an ability to review foreign language documents, a detailed understanding of transfer pricing and tax law); (3) regular attrition of highly trained staff; (4) technological limitations regarding the ability to receive, manage, store and work with different types of data; (5) inadequate system for identifying and matching taxpayers; and (6) an existing culture of limited tax compliance.

Any recommendations about how to increase access to information and improve transparency and disclosure (e.g., recommendations pursuant to BEPS Action Items 11, 12, and 13) should be evaluated against the backdrop of these domestic enforcement impediments. For example, transparency and disclosure recommendations that could ease any of the current impediments might be particularly attractive to developing countries, even if other options would be more effective for developed economies. To the extent a particular recommendation would yield more limited benefits for a developing country due to domestic enforcement constraints, adoption of that recommendation might be paired with a concrete support plan designed to build the tax

³ Global Forum on Transparency and Exchange of Information for Tax Purposes, *The Global Forum on Transparency and Exchange of Information for Tax Purposes: Information Brief* (November 2013) at 6-7.

⁴ See generally, OECD, Part I of a Report to G20 Development Working Group on the Impact of BEPS on Low Income Countries (July 2014).

administration's capacity to effectively use the information to curb base erosion and profit shifting in their jurisdiction.⁵

2.2.4.3 **International Impediments.** A country's success in tackling BEPS will depend in part on its ability to actively engage with the international community and obtain information from other jurisdictions. The most obvious examples of such engagement arise under Article 26 Exchange of Information provisions in bilateral tax treaties (based on the U.N. and the OECD Models) and under Tax Information Exchange Agreements ("TIEAs" such as those based on the OECD Model). See 5.2 and 5.3. Therefore, the more limited a country's network of bilateral treaties and TIEAs, the more constrained the country may be in gathering needed information. Relatedly, bilateral tax treaties and TIEAs whose terms impose significant barriers to exchange (such as the level of information that the *requester* must provide, or the nature of the tax violation in the requesting state) effectively reduce the value of these agreements as meaningful tools for developing countries.

International mechanisms for sharing information across borders are important in their own right as independent and currently existing tools for responding to BEPS problems. But the availability of these mechanisms may also be important in the future as the BEPS Project moves toward recommendations and action. Depending on how various Action Items related to transparency, disclosure and information are designed, a country's ability to benefit fully from the BEPS recommendations could depend on the country's treaty network. For example, if the information gains anticipated from Action Item 13 (e.g., a country-by-country reporting template) require a country to obtain that information from the MNE parent's home jurisdiction, the question of "mechanism" would arise. If the envisioned mechanism is an existing treaty exchange of information provision, then developing jurisdictions, particularly those with more limited treaty networks (tax treaties and TIEAs) would find it harder to obtain the information and proceed with their efforts to stop base erosion and profit shifting. This issue is widely acknowledged, and is discussed more extensively in 3.3.

2.3 Response to Increased Need for Information.

The global tax community's focus on base erosion and profit shifting has included recognition of the centrality of information to tax administration. As discussed in 3.1, the G20 and the OECD both supported the BEPS action plan, including its attention to transparency, disclosure and information. The plan operates against the backdrop of existing mechanisms for the provision of information (see 4.1, 5.1). The value added by the BEPS plan derives from its focus on the information-driven crisis points in base erosion and profit shifting. It targets the gaps created by the current system of providing information to tax authorities that leave countries susceptible to

⁵ See, e.g., C20 Position Paper Background: Governance (7 August 2014) at 6 (encouraging research regarding the cost/benefit tradeoff for automatic exchange of information and the impact on developing countries), available at <http://www.c20.org.au/resources/>.

base erosion and profit shifting through related party transactions, transfer pricing and cross border arbitrage.

However, the BEPS setting is not the only context in which global tax actors continue to examine how tax administration can be strengthened through transparency and disclosure. In some cases, individual countries have taken action that has triggered a more global response. For example, the United States' implementation of the FATCA (Foreign Account Tax Compliance Act) regime which requires foreign financial entities to disclose information regarding U.S. taxpayers to the U.S. tax authorities or face penalties, has led to the signing of IGAs (intergovernmental agreements), (see 4.5). Additionally, other countries increasingly seek to secure similar commitments for taxpayer information from foreign financial entities. In still other cases, international bodies are promoting enhanced access to information through automatic information exchange (see 4.2), and/or through the expansion of the Multilateral Agreement on Mutual Assistance in Tax Matters (see 5.3).

Thus, while the need to acquire information is as old as the international tax system, the current climate for tax administration differs from the past. The scale of information needed, its complexity, and its importance have all grown dramatically. Although traditional information-based tools for facilitating tax compliance remain relevant and valuable, close examination of the ways in which transparency and disclosure can be enhanced is a critical topic for countries to tackle now. To that end, section 3 of this paper reviews and analyzes the BEPS Project's work on transparency and disclosure. Section 4 then undertakes a similar examination of new developments in information gathering occurring outside of the BEPS Project. Finally, section 5 provides context for the new reforms and recommendations by revisiting more familiar tools and techniques currently available for enhancing transparency and disclosure.

As the review of each new and old information-related provision and practice reveals, there are no simple solutions to the complexity of today's information rich (and information dependent) environment. There may be substantial agreement on the importance of transparency and disclosure as broad concepts, but the effort to translate those principals into specific practices and regimes unmask the challenges and concerns outlined in 1.4. Countries' assessment of the right balance and mix among these risks, trade-offs and benefits may vary depending on their domestic infrastructure, their economic position, their existing network of tax agreements and tools, and their substantive tax system.

2.4 Summary of the Current Tax Environment and Its Connection to Transparency and Disclosure:

Multinationals with significant cross-border business activities form an important part of today's economy for all countries. The growth in cross-border commerce has increased the opportunity for tax planning and correspondingly increased countries' need for taxpayer information.

Developing countries may confront a number of challenges as their tax administrators seek the information necessary for effective enforcement of the tax laws. The challenges include: (1) domestic law impediments (inadequate required reporting by multinationals regarding assets, accounts, and transactions); (2) constrained domestic enforcement (due to limited audit staff, inexperienced staff, attrition of trained staff, insufficient technological capacity to receive, manage and store data, and to link taxpayers to data); and (3) international impediments (limited treaty network and high treaty thresholds for requesting information). The BEPS project recognizes the centrality of tax information to meaningful tax administration and the Action Items discussed below explicitly seek to increase both the quality and the availability of relevant information. But in addition to the BEPS project, transparency and disclosure is the subject of other international efforts to curtail base erosion and profit shifting, including the rise of IGAs, the support for automatic exchange of information, and expanded treaty networks.

3. BEPS and Transparency and Disclosure

3.1 Overview of BEPS Action Items Related to Tax Information, Transparency and Disclosure.

The BEPS Action Plan released in July 2013 included two significant action items related to the increased provision of information to countries by taxpayers:⁶ (1) Action Item 12: Requiring taxpayers to disclose their aggressive tax planning arrangements; and (2) Action Item 13: Re-examining transfer pricing documentation (including establishment of a common reporting template, referred to as “country-by-country reporting”).

Currently, the most serious attention is being directed at Action Item 13 (transfer pricing and related issues), which includes the proposal for country-by-country reporting. This proposal, which has been ranked as of “high” relevance to developing countries,⁷ is discussed extensively in 3.3. The companion information-reporting provision, Action Item 12 (aggressive tax planning), has a target deliverable date of September 2015 on the BEPS Action Plan timetable, and should likely be the subject of increased public discussion over the coming year. Action Item 12, reported as being of “medium” relevance to developing countries,⁸ is more briefly considered below in 3.4.

⁶ Other Action Items may, in a more limited manner, enhance transparency and disclosure through mechanisms not based on taxpayer provision of information. For example, Action Item 5 (“Countering harmful tax practices more effectively, taking into account transparency and substance”) focuses in part on “including compulsory spontaneous exchange on rulings related to preferential regimes.”

⁷ OECD, Part 1 of A Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries, (July 2014) at 31 (Annex A).

⁸ OECD, Part 1 of A Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries, (July 2014) at 30 (Annex A).

One additional Action Plan topic, Action Item 11, seeks to improve countries’ (and the global tax community’s) understanding of the “scale and economic impact” of BEPS by establishing “methodologies to collect and analyse data on BEPS and the actions to address it.” This Item, which has been listed as of “high” relevance for developing countries,⁹ has a target delivery date of September 2015, and is considered below in 3.2.

3.2 Action Item 11: Collect and Analyze BEPS Data.

Although Action Items 12 and 13 share the common mission with Item 11 of helping countries more effectively address BEPS problems through improved knowledge and understanding, their focus and “solution” are different. Action Items 12 and 13 target specific taxpayer conduct through enhanced reporting requirements for actual taxpayers. Both Actions Items 12 and 13 anticipate changing the kinds of information that taxpayers must provide to countries. The new information presumably would enable a country to more effectively and accurately evaluate a multinational taxpayer and identify conduct that is creating base erosion and profit shifting (either by aggressive planning, or by cross border related party transactions and structures). In that way, Action Items 12 and 13 function more as a support to and enhancement of the audit function.

3.2.1 Goals of Action Item 11. In contrast to Items 12 and 13, Action Item 11 targets a more systemic goal – obtaining a comprehensive, overall picture of the BEPS problem. Action Item 11 is expected to “[d]evelop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.” For example, Action Item 11 would seek to calculate the effects on overall tax receipts, total employment, geographic location of employment, investment in physical capital, investments in knowledge-based capital, tax competition, etc.¹⁰ Once data and methodologies are in place to “measure” the problem, Action Item 11 anticipates developing indicators and tools to monitor the success of BEPS actions taken by countries.¹¹

The focus is not only on what is happening within a given country due to BEPS, but also the “spillover” effects on other jurisdictions as well. This newly collected information is expected to help policymakers and countries evaluate all of the changes implemented pursuant to the BEPS plan. Thus, Action Item 11 will provide key diagnostic tools for determining whether the implementations of steps under other BEPS Action Items are meeting their goals.

⁹ OECD, Part 1 of A Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries, (July 2014) at 30 (Annex A).

¹⁰ OECD, *Request for Input, BEPS Action 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it*, (4 August 2014) at 3.

¹¹ OECD, *Request for Input, BEPS Action 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it*, (4 August 2014) at 3.

3.2.2 Data Collection under Action Item 11 and Its Impact: Some of the data will be collected on an aggregate basis (such as “FDI and balance of payments data”), but the BEPS Action plan also anticipates that taxpayer level data (financial statements, tax returns) will play an important role. We can anticipate that the taxpayer-level data portion of Action Item 11 will raise many of the same questions and concerns as Items 12 and 13. Thus, the examination of these questions in 3.3 in the context of country-by-country reporting should be relevant and helpful to the Action Item 11 discussion that is anticipated. Future data collection and reporting under Action Item 11, though potentially influential in the longer term, will have less immediate relevance for developing countries seeking to protect their tax bases.

3.3 Action Item 13: Transfer Pricing Related Documentation.

3.3.1 Overview. Action Item 13 responds to the determination that transfer pricing is a crucial facet of BEPS and that tax administrators face a serious problem in responding to these BEPS issues because of information asymmetry between tax authorities and taxpayers. Tax authorities need the ability to evaluate an MNE’s global value chain and obtain detailed data on the structure of its activities, operations, and intra-group transactions. Taxpayers, too, may find current transfer pricing regimes unsatisfactory to the extent that varying transfer pricing documentation standards and practices across countries place an unnecessary and unproductive burden on reporting taxpayers.¹²

Action Item 13 calls for a re-examination of transfer pricing documentation, with attention to two potentially competing goals: enhancement of transparency for tax administration and sensitivity to taxpayer compliance costs. But perhaps more importantly, Action Item 13 seeks the establishment of rules that would require an MNE to “provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.”¹³ This reporting template concept is known as “country-by-country reporting.”

The prospect of a new reporting format with new information raised a number of questions that have dominated the discussion of country-by-country reporting. Briefly, the issues can be broadly identified as (1) the kind of information required, (2) the burden on taxpayers, (3) permitted recipients of the information and permitted uses of the information, (4) countries’ ability to use the information, (5) protection of taxpayer data, and (6) delivery mechanism.¹⁴

3.3.2 OECD Introduction of Action Item 13. In January 2014 the OECD released a Discussion Draft on transfer pricing documentation and country-by-country (“CbC”) reporting (Action Item

¹² OECD, *Action Plan on Base Erosion and Profit Shifting* (July 2013) at 22-23.

¹³ OECD, *Action Plan on Base Erosion and Profit Shifting* (July 2013) at 23.

¹⁴ See, e.g., OECD, *Memorandum on Transfer Pricing Documentation and Country by Country Reporting* (3 October 2013).

13).¹⁵ The Discussion draft identified the three core goals for transfer pricing documentation: (1) risk assessment: “provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment;” (2) appropriate taxpayer pricing practices: “ensure that taxpayers direct sufficient attention to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises and in reporting the income derived from such transactions in their tax returns;” and (3) audit support: “provide tax administrations with the information that they require in order to conduct an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction.”¹⁶

With respect to these goals, the Discussion Draft sought input regarding (1) whether the BEPS work on this Action Item should include additional forms and questionnaires (beyond the CBC template) and (2) the appropriate rules for the production of information and documents held by related parties outside the jurisdiction of the taxing authority undertaking the audit inquiry. The expected content of the country-by-country reporting template is discussed in more detailed below in 3.3.3.2.

3.3.3 Discussion Draft Plan for Transfer Pricing and Country-by-Country Reporting. The Discussion Draft envisioned a standardized reporting system for taxpayers, which has since been formalized to have three components: (1) the Master file, (2) the Country-by-Country template, and (3) the Local File.

3.3.3.1 Master File. This master file would contain “standardized information for all MNE group members.” The goal of this information would be to provide a “reasonably complete picture of the global business, financial reporting, debt structure, tax situation and the allocation of the MNE’s income.”¹⁷ The information to be provided would cover five categories: (1) group organizational structure, (2) description of business or businesses, (3) the intangibles held by the group, (4) intercompany financial activities, and (5) the MNE’s financial and tax positions.

The relative brevity of the description of the master file belies the number of complicated choices and options imbedded in its design. The Discussion Draft flagged many of them. The preliminary decision is whether to have MNEs prepare the file for the group as a whole or by line of business, depending which would be most useful for tax administrators. Reporting by business line raised two observations—the potential for flexibility in sharing different business line information with different countries and also the concern that countries would be unable to ascertain that the MNE had fully reported all income and activities. It has been emphasized that

¹⁵ OECD, *Public Consultation: Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (30 January 2014).

¹⁶ OECD, *Public Consultation: Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (30 January 2014) at 2.

¹⁷ OECD, *Public Consultation: Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (30 January 2014).

the master file information is intended to provide a high level risk overview and should be used consistent with that function (and, for example, not replace actual audits and more detailed taxpayer specific analysis and inquiry).

3.3.3.2 CbC Template. The CbC template is expected to require taxpayer reporting on the following seven items: (1) revenue, (2) earnings before taxes, (3) cash tax, (4) current year tax accruals, (5) stated capital and accumulated earnings, (6) number of employees, and (7) tangible assets.¹⁸ This information would be provided on a country-by-country basis (as opposed to entity-by-entity).

The template would be accompanied by a list of all group entities and permanent establishments, by country, along with business activity codes identifying their major activities. Taxpayers will have the flexibility to use either statutory account data or financial statement reporting packages to complete the template, *if* data usage is applied consistently across the group and across years. Information contained in the country-by-country template would provide tax authorities with a clearer picture of the relationship between reported profits, taxes paid, and the underlying details of economic activity (e.g., tangible assets, employees, employee expense) .

Several questions pertaining specifically to the CBC template have been raised:

- (a) *Accounting approach*: Whether the template should use:
 - i. Bottom-up reporting: using local statutory accounts to build the file (the current recommendation), or
 - ii. Require/permit top-down allocation of the group’s consolidated income among the countries?
 - iii. And, how the choice between the two may impact the calculation of compliance costs or the determination that additional requirements would be needed?
- To provide further clarity regarding the impact of these choices and decisions, the Draft reported that Working Party (WP) 6 currently believes that if top-down reporting were adopted, it should reflect the earnings and revenue from cross-border related party transactions but should eliminate revenue and transactions as between related parties in the same country.
- (b) *Burden and regulation*: Is a requirement of consolidated reporting within each country unduly burdensome on taxpayers? Under the top-down model of allocating the MNE’s

¹⁸ The reporting items were reduced to seven from an original suggested 17 in the January 2014 Discussion Draft, following extensive taxpayer comments. See, e.g., Bell, “Country-by-Country Template Won’t Require Entity-by-Entity Financial Details, Andrus Says,” BNA TRANSFER PRICING REPORT (April 10, 2014) available at <http://www.bna.com/countrybycountry-template-wont-n17179889500/>; see also OECD Update on BEPS Project – Webcast Powerpoint (April 2, 2014) available at <http://www.oecd.org/ctp/OECD-BEPS-Webcast-2April.pdf>.

income across countries, would additional guidance on appropriate sourcing, characterizing income, and allocating deductions be required?

- (c) *Taxes*: Should withholding tax paid be reported? Would that be particularly burdensome for taxpayers?
- (d) *Cross-border related party payments*: Should there be aggregate reporting of related party cross-border payments? How detailed? Would it be a significant burden if taxpayers were required to report intra-group interest, royalties, and services fees?
- (e) *Nature of business activities*: Would any business sectors require special treatment? Would this reporting be a significant burden on taxpayers? Are there other types of information for assessing economic activity that would be useful?

The template information offers countries the ability to assess the transfer pricing and base erosion risk they face with the multinational (and thus where and how to audit). But anticipating a serious concern of taxpayers, the Draft cautions against countries effectively by-passing detailed audit work and using the CBC data to assert transfer pricing adjustments.

3.3.3.3 Local File: The third element in the Action Item 13 package of transfer pricing information is the “local file.” The expectation is that the local file would include more jurisdiction-specific information that would complement the master file in helping the country ensure that the taxpayer complied with the arm’s length principle and transfer pricing rules in its major transactions connected to that jurisdiction. Broadly, the local file would include more detailed information regarding relevant transactions between the MNE’s entity in the local jurisdiction and its related entities in other countries, such as financial details of the transactions, a comparability analysis for pricing, and “selection and application of the most appropriate transfer pricing method for the fiscal year in question.”¹⁹

The Discussion Draft attached an Annex which delineated the anticipated local file information. The information is grouped into three categories:

Local entity: The first is information regarding the local entity itself: its management structure, organization chart, identification of individuals to whom the local management must report (and the jurisdiction of their principal offices), and any recent participation by the local entity in a business restructuring.

Financial accounts: The second category seeks financial information important to the application of transfer pricing analysis: the local entity’s annual financial accounts (audited if available); schedules showing how financial data that was used in the transfer pricing method is linked to

¹⁹ OECD, *Public Consultation: Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (30 January 2014) at 6.

the annual financial statements; summary schedules of the financial data of the comparables and the source of that data.

Controlled transactions: The third category is information regarding controlled transactions involving the local entity. A more specific list of information is enumerated here, which goes to the core of how the taxpayer applied the transfer pricing rules:

- *description of the transactions (e.g., services, purchase of goods, loans, etc.) and the context in which that transaction took place (e.g., business activity, financial activity, cost contribution arrangement)

- *aggregate charges for each category of transactions

- *identity of the related parties involved and the nature of their relationships

- *functional analysis of the taxpayer and the related entities regarding each category of controlled transactions (functions performed, assets used, assets contributed, intangibles involved, risks born, and changes compared to prior years).

- *identification and description of controlled party transactions that might impact the transaction in question

- *specification of the most appropriate transfer pricing method by category, the reasoning for the selection, which entity is the tested party (where relevant) and why, and assumptions made in using the method

- *if use of multi-year analysis, an explanation of why

- *information regarding comparables, how selected, search strategy, application of method, and relevant financial indicators used in the analysis

- *any adjustments to comparables, to the tested party

- *conclusions regarding the arm's length status of related party transactions based on application of the selected method.

3.3. 4 Implementation Issues under BEPS Action Item 13.

Documentation and burden: Taxpayers are expected to price at arm's length based on contemporaneous information, prior to engaging in the transaction, with confirmation completed before filing the tax return. But the Discussion Draft urges countries to consider the burden on the taxpayers when making documents requests. For example, taxpayers that can reasonably demonstrate the absence of comparables (or their absence at an appropriate cost) should not be required to bear such a burden. At present, the Draft Discussion specifically does not recommend that transfer pricing documentation be certified by an outside auditor.

Timing: Given the diversity in countries' expectations regarding when documentation should be available (when return filed, by time of audit) and how long taxpayers should have to respond to requests, the suggested best practice is for taxpayers to have both the master file and the local file ready by the time the tax return for the relevant year is filed (unless the jurisdiction practices contemporaneous auditing, which would require the information prior to the filing of the return).

In countries for which final statutory financial statements and related country-by-country reporting data are not available until after the tax return is due, the best practice would allow for completion of the country-by-country template by one year after the last day of the MNE parent's fiscal year.

Materiality. Conscious of the need to balance the competing interests of countries (seeking access to transfer pricing information) and taxpayers (seeking a “reasonable” documentation burden), the Discussion Draft recommends documentation requirements with materiality thresholds based on the “size and nature of the local economy, the importance of the MNE group in that economy, and the size and nature of local operating entities, in addition to the overall size and nature of the MNE group.”²⁰ For example, many jurisdictions offer simplified transfer pricing documentation rules for small and medium sized enterprises. Nonetheless, such smaller business would be expected to provide data and documentation regarding material cross-border related party transactions when requested and also to complete the country-by-country template.

Document Retention: Again, balancing taxpayer burdens and a country's need to access information, the Draft recommends tax administrators take into account the difficulty in locating documents from prior years, and should make such requests only when there is a “good reason” relating to a transaction under review. To assist in the balance of burden and need, taxpayers should be permitted to store the documentation in a manner they find appropriate (electronic, paper, etc.) so long as it can be produced in a useable form to the tax authorities.

Documentation Updates. Both the master file and local file should be updated annually, although in many cases information (e.g., functional analysis or description of business) may not change. The Discussion Draft offers a recommendation – but specifically seeks comments on it – that where operating conditions are unchanged, the tax administration may permit taxpayers to update their database searches for comparables in the local file every three years. Financial data, however, for the comparables would be updated annually.

Language. The expectation is that the master file would be prepared and submitted to jurisdictions in English. However, at a minimum, the local file should be prepared in the relevant local language. To the extent the tax authorities need translation of portions of the master file, they can make that request to taxpayers, providing adequate time to secure the translation.

Penalties. The Draft cautions against the imposition of documentation-related penalties (civil or criminal) where taxpayers have made a reasonable, good faith effort, and/or do not have access to the information. But it is not a good defense to documentation-related penalties to contend that some other related party bears the group responsibility for documentation. The decision not to

²⁰ OECD, *Public Consultation: Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (30 January 2014) at 7.

impose these penalties would not forestall a jurisdiction from making the underlying transfer pricing adjustment in order to bring taxpayers into compliance with the arm's length principle. Two strategic observations regarding documentation-related penalties may guide countries thinking about designing a penalty regime:

- (1) Differences among countries penalty regime may influence whether a taxpayer “favours” one jurisdiction over another in pricing. For example, if one jurisdiction imposes stronger penalties (compliance and/or underlying substantive pricing penalties) than another, the taxpayer may be more inclined to shift resources (and even transfer pricing profits) to the jurisdiction with the stronger penalty regime, so as to avoid the imposition of large penalties.
- (2) A documentation regime that includes benefits for compliant taxpayers may increase taxpayer's actual compliance with the documentation rules, which is a good outcome for the country. For example, if taxpayers who meet documentation requirements receive some measure of penalty protection (substantive penalties) or a shift in burden on some or all issues, there is an added taxpayer incentive for up-front conformity with the documentation requirements.

Confidentiality. As the prospect of increased disclosure of information becomes more likely, taxpayers have expressed greater concern regarding confidentiality. The Draft urges tax administrations to protect taxpayers from: public disclosure of trade secrets, scientific secrets, and other confidential information. The need for protection should lead countries to carefully consider their requests for such information and to provide assurances to the taxpayer regarding confidentiality. To the extent public court proceedings or judicial decisions will entail some measure of disclosure, confidentiality should be reserved to the extent possible and disclosure should be as limited as possible.

Implementation:

- (1) *Changes to domestic law:* Tax law, including transfer pricing rules, are a function of domestic law. Thus, in order to achieve the benefits of increased uniformity under Action Item 13 (as well as wide-spread adoption of best practices advocated by the Discussion Draft), countries will need to make changes to their own domestic law. Thus, for example, countries would need to enact transfer pricing and documentation rules that required their locally based MNE affiliates to produce information required for the master file, local file and the country-by-country template (as detailed in the three Annexes attached to the Discussion Draft). Given the general importance of consistency, and the need for master file information to be consistent across jurisdictions, countries should review their own domestic rules. The goal would be domestic rules that require production of information for the master file that conforms

to the Discussion Draft Annex (detailing the information in both the master file and the country-by-country reporting template).

- (2) *Reporting oversight*: As part of the effort to ensure consistency, the Draft recommends that the master file and the country-by-country template be completed under the supervision of the MNE parent corporation and then be shared with each country in which the MNE has an affiliated taxpayer. Each jurisdiction could obtain the master file from the local entity in its jurisdiction. If that request is not met, the local jurisdiction could request the master file from the MNE parent's jurisdiction pursuant to a treaty based exchange of information provision.
- (3) *Delivery mechanism*: The Draft recommends that the MNE parent make the master file and the CbC template available to the local affiliates who will then share it with their local taxing authorities. But the Draft notes other possibilities and requested comments. Other delivery mechanism options for the master file and CbC template include: (1) direct local filing of the information by the MNE local affiliate; (2) filing of the information with the MNE parent jurisdiction, which would then share it with the local affiliates' jurisdictions through a treaty information exchange mechanism; or (3) some combination thereof. Given that access to this new reporting format and information is at the heart of BEPS Action Item 13, many countries have strongly advocated that the delivery mechanism should be uncomplicated and widely available. See 3.3.6.2.2. Taxpayers, though, have repeated their concerns that the delivery mechanism should include appropriate safeguards ensuring the protection of their information.

3.3.5 General Questions Regarding Proposed Action Item 13 Recommendations.

3.3.5.1 Taxpayer Burden. On balance, the current Draft Recommendations regarding Action Item 13 (see 3.3.3) reflect the concerns raised by multinational taxpayers and their advisers. Primarily these concerns centered on an overarching theme that documentation was much more difficult than the OECD and governments understood. Taxpayers enumerated a variety of challenges or barriers to their immediate, low-burden compliance with the master file, CbC template, and local file approach. These difficulties included: existing reporting systems not aligned to the requested information; different reporting and measurement approaches within different parts of a multinational and across multinationals; difficulty in securing the information in a timely fashion; need to re-work data from affiliates into a consistent reporting format; cost of gathering requested data; burden from uncertainty in definitions and applications (e.g., what counts as an employee). Not surprisingly, given these articulated objections, taxpayers raised the most questions about the CbC template.

Despite this general critique, taxpayers seem to vary considerably in their response to the release of the recommendations under Action Item 13. MNEs have pursued one or more of the following steps: (a) reported that their operations are significantly out-of-step with the kinds of data sought; (b) used the OECD comment period to press for modifications; (c) tested their ability to comply with the master file, CbC template, local file structure; and (d) explored new information management systems to facilitate their compliance with anticipated reporting requirements. Some taxpayers may already be collecting much of the master file and template information in order to comply with existing, country specific reporting requirements imposed by jurisdictions already requiring reporting on the worldwide activities of its MNEs, including information on certain foreign subsidiaries.

3.3.5.2 Delivery Mechanism. Among the most controversial issues raised by the Action Item 13 steps is the question of *how* the required information (master file, template, local file) will be delivered. For example, will taxpayers only be required to file the information with the jurisdiction of the multinational's parent corporation – with the expectation that countries will request the information via treaty information exchange provisions? If so, what kind of showing, or demonstration of need for the information would be required? Alternatively, would taxpayers be required to directly file in each jurisdiction in which they are a taxpayer (e.g., an affiliate or a permanent establishment)? Would some but not all information be filed directly with the local affiliate's taxing jurisdiction?

Taxpayers have generally urged that required filings be made to the country of the MNE's parent corporation. The primary argument advanced for the single central filing (at least of the master file and the CbC template) is the concern that some jurisdictions might not adequately protect information. If the data is provided only to the parent jurisdiction and then shared via treaty request, there would be additional protection because countries requesting pursuant to a treaty must ensure and commit to specified confidentiality requirements.

The significance of this taxpayer concern turns on two points: the legitimacy of the concern over protection of taxpayer information, and the sensitive nature of the data. First, appropriate protection of taxpayer data is an accepted norm, although there are differences in exactly what is protected, when and how. Model exchange of information provisions (e.g., Article 26 of the UN Model Treaty or the OECD Model Treaty) reference the expectations regarding taxpayer privacy, and expound further on the application of this standard in the accompanying commentaries. However, sharing the master file and CbC template via treaty poses challenges for requesting jurisdictions, particularly developing countries. See 3.3.6.

Second, regardless of the broader subject of taxpayer privacy, to the extent information in the master file and the CbC template is generally publicly available for these multinationals, the argument in favor of filing those documents *only* with the parent's jurisdiction may be

weakened. For example, in the case of publicly traded entities, how much of the information is publicly reported in compliance with securities (or other) regulations? Are there other public sources for that information? If so, how much weight should be given to arguments about uncertain protection of the data? Alternatively, should the public availability of data be less relevant in the debate if the “public” information is cumbersome to gather? This argument would be grounded on the assumption that difficult to assemble data is in reality “less public” and thus there is a real impact on these taxpayers if their well-organized reporting to the tax authorities is inadvertently made public. Should privately-held multinationals be treated differently if their publicly available entity information is more limited?

The importance of this issue to both countries and taxpayers has led the OECD to defer a recommendation on the delivery mechanism in order to provide more time to evaluate concerns and consider possible options. A recommendation on the delivery mechanism(s) is anticipated by January 2015.

3.3.5.3 Use of Information. Related to the delivery mechanism concern (3.3.5.2) is the separate question of which files a country may access and what it may appropriately do with the information? Taxpayers typically have several concerns about what jurisdictions might do with information compiled by taxpayers.

Replace audit: One concern articulated by taxpayers is that countries, particularly those that may be resource constrained, will use the master file and the template data as the basis for an actual transfer pricing allocation. For example, if such a jurisdiction draws the conclusion that inadequate income (and thus tax) is being reported in its jurisdiction relative to the value chain, functions, and reporting of income worldwide, the tax authorities might simply stop at that stage and make a transfer pricing adjustment. The OECD has stated that the purpose of the master file and the template is to facilitate risk assessment and decisions about where to allocate audit resources – not to replace the audit. However, the spring 2014 revisions to the January Discussion Draft (see 3.3.4) include an even more explicit statement that the master file and CbC template are understood to be high-level and not expected to displace audit of the taxpayer.

Shift to Formulary: Relatedly, taxpayers are also concerned that countries may use this information (master file and template) to shift informally to a formulary approach to transfer pricing, despite formally being committed to an arm’s length approach. In part, countries might be inclined to use the information in this way if they find it difficult to locate comparables for the traditional application of the arm’s length method. Again, developing countries in particular, may face this challenge. See 3.3.6. Although substantive reforms to transfer pricing rules are not part of Action Item 13, this taxpayer concern reveals the connection between administration, documentation and substantive law.

Assist Beyond Transfer Pricing: Should countries use some of this high-level information, in particular the CbC template, to assist more broadly in efforts to combat base erosion and profit shifting? The OECD’s plan to treat the template as separate supports the view that the template can and should play a broader role in helping jurisdictions make their high-level assessments of risk. The final form of the template and the specific columns of information provided will impact how countries can effectively use the filings to reach beyond transfer pricing concerns to other causes of base erosion.

Format and Function: Taxpayers have raised a variety of questions regarding exactly how to properly report data, especially under the CbC template. Examples include how to handle various accounting differences within the multinational group, how to define “employees,” and how to treat permanent establishments. Depending on the intended and appropriate uses of the data, it may be possible to determine the best, or the appropriate responses, to these questions. For example, the decision to require reporting only the number of employees and not their compensation likely reflected a conclusion that the burden of trying to ascertain what counts as compensation for all employees across entities and jurisdictions was not necessary for a high-level risk assessment given the burden it might impose. “Numbers of employees” in each jurisdiction might be an adequate and less burdensome measure of the MNE’s presence in a country. Similarly, the flexibility permitted in sourcing financial data presumably reflected the view that a steady comparative picture of the MNE’s activities across countries and years was the core of the high-level risk assessment intended by the master file and template. However, the decision as to whether to report information bottom-up, or top-down, (see 3.3.3.1.1.), has been viewed by some as critical to the template’s meaningful role in providing even a high-level risk assessment. Under this view, bottom-up reporting would effectively replicate the base erosion and profit shifting already in place and thus fail to signal the real risk to the tax authorities; only top down reporting would be able to reveal even the high-level risk of BEPS problems for the jurisdiction.

3.3.5.4 Data Protection. In addition to the concern expressed by countries regarding *how* the master file and template will be reported and shared, see 3.3.5.2., is the general focus on data protection. As discussed in 3.3.5.2, a recommendation that MNEs file the information only with the parent jurisdiction and sharing it only with countries committed to data protection consistent with the model treaties, provides a measure of certainty regarding data protection. As the OECD explores various alternatives for filing and sharing this information, taxpayers will continue to press for assurances of confidentiality.

In the context of BEPS, it is useful to note that data protection has a special meaning beyond the typical concern that countries might either carelessly allow public access to private commercial or tax information, or intentionally share information with state-owned competitors or with favored domestic competitors. The increased public awareness of the role and conduct of

multinationals in the economy and the related BEPS issues has led to calls for *public* disclosure of some, or all, of the information that would be provided by businesses to tax authorities under the BEPS initiatives.²¹ Under the view that citizens should be able to assess and evaluate their own government’s conduct with MNEs, and should be able to ensure that the country and the fisc are properly protected, public release of some or all of the master file and template data would likely be sought. Although the OECD has repeatedly asserted that this information is intended only for the governments and only for the purposes of making risk assessments for BEPS, taxpayers remain concerned that once the information is compiled and organized, there will be strong pressure at least in some countries for disclosure.

3.3.5.5 Independent Country Action. One important and parallel thread in the entire BEPS process is the distinct possibility that countries may pursue unilateral responses to their BEPS problems. Such action could be in advance of broad agreement on BEPS steps or contemporaneous with it. Additionally, as noted above in 3.3.5.1., some countries already impose fairly extensive reporting obligations on their own multinationals, as well as other entities doing business in the jurisdiction. The risk or possibility of independent unilateral action by countries on BEPS problems is relevant throughout the debates over specific BEPS recommendations. For example, in measuring and evaluating the burden imposed on taxpayers by the requirements under the master file, CbC template, and local file, it is fair to consider the *reduction* in burden that corporations may experience through such a unified and streamlined reporting system. Similarly, taxpayers themselves may reassess their resistance to the OECD BEPS project given the risk of multiple, country-specific reporting requirements that might arise should the BEPS project not move forward with some success. Such individual country requirements seem all the more possible given that countries could use the Action Item 13 proposed master file and template as a baseline in crafting their own reporting legislation. This “risk” of independent action by countries may be greatest with respect to those jurisdictions that have some leverage in the market. In contrast, a developing country that perceives itself as having more limited negotiating power vis a vis multinationals may be less inclined to impose independent reporting requirements perceived as “unfriendly” to business. Effectively countries could be competing on their relative lack of disclosure. Those developing countries might find it advantageous if a uniform standard of reporting is broadly adopted (along the lines of BEPS Action Item 13).

There is, however, another completely separate dimension of independent country action in the context of the BEPS project: how will countries effectuate their support for and participation in the BEPS recommendations? Presumably, a multilateral commitment mechanism of some type will be needed. Additionally, countries will need to modify their domestic law consistent with

²¹ See, e.g., C20 Position Paper Background: Governance (7 August 2014) at 5 (advocating a “commitment to make public country-by-country reporting the global standard” on the view that “[e]nsuring this information is made public would enable tax administrators in the poorest countries to easily access this information and address base erosion and profit shifting”).

the various accepted recommendations that emerge from the multi-stage BEPS process. These realities are not unique to Action Item 13. But the effort to resolve the delivery mechanism question (for the master file and template) will be one important piece of the BEPS implementation process.

3.3.6. Developing Country Issues Regarding Action Item 13.

Although all countries share many of the same concerns, questions, and goals regarding the reporting recommendations under Action Item 13, developing countries may have a distinct perspective. Both in terms of the overall mission of Action Item 13 and the implementation-specific decisions, developing countries should evaluate the BEPS project against their own circumstances.

3.3.6.1 Overall Perspective. The broad mission of Action Item 13 to improve countries' risk assessments for BEPS (through the master file and CbC template) and to facilitate transfer pricing audits (through the local file) is likely important to developing countries with limited audit and other resources. First, to the extent developing countries must decide where to direct their most sophisticated audit resources, they would want to identify their most serious base erosion and profit shifting problems. A high-level assessment tool (master file and template) delivered by each MNE operating in the jurisdiction would provide the country with a solid basis for making that preliminary risk assessment and assigning audit resources.

Second, if the package (the master file, template, and local file as detailed by Action Item 13) becomes the standard for MNEs, then developing countries will be able to rely on a unified format as they make both high-level risk assessment decisions and as they evaluate taxpayer specific transactions among related entities. Both their own MNEs, as well as foreign multinationals conducting business in their jurisdiction, will be utilizing the same format and standards, producing more uniform information that may be more readily subject to comparison. Again, for a jurisdiction with limited resources, this enhanced uniformity in reporting (assuming it carries the requisite content) should allow the tax administration to more effectively process and evaluate the information – and train new tax professionals.

Third, assuming broad support for Action Item 13 recommendations is ultimately achieved, and that this support is manifest in some type of commitment across countries, then developing countries should benefit from the “global” obligation imposed on MNEs to prepare this information. If many countries, including countries with more enforcement resources, will be seeking the information, presumably taxpayers will more readily comply. Moreover, this compliance would likely be not just in name (e.g., providing documents labeled “master file” and “template”) but also in spirit (providing materials meeting the expectations articulated for each of these documents). Thus, use of the BEPS process to enhance information reporting and document production by MNEs offers certain advantages for resource-constrained jurisdictions.

3.3.6.2 Implementation-Specific Perspective. Although the driving purpose behind Action Item 13 would be compatible with and help facilitate most developing countries' audit and enforcement goals, the details regarding the actual implementation of Action Item 13 are critical to their real world impact. Both the final content of the master file, CbC template, and the local file, and the manner in which this information is provided to countries ultimately determine whether the potential value of Action Item 13 is realized.

3.3.6.2.1 Content. Several of the design questions that have arisen in the context of crafting the master file, template and local file may be particularly relevant for developing countries.

Reporting entities. First, given that developing countries may find they have many permanent establishments operating in their jurisdiction, it will be important to clarify how that kind of presence in a jurisdiction will be handled for reporting purposes. Presumably, to the extent that the CbC reporting is country-based, the data from the permanent establishments should be picked up. But clarification on this point may be valuable. For example, the enumerated listing of entities operating in the jurisdiction should include not only local subsidiaries of the foreign multinational, but also the foreign corporations with a permanent establishment in the jurisdiction.

Accounting. Second, as initially noted above in 3.3.3.1.1, and 3.3.5.3, countries in general, but developing countries especially, might prefer the top-down allocation of group income to the extent they are concerned that use of the local statutory accounts to construct a bottom-up reporting may disguise underlying BEPS problems. If the local statutory accounts reflect inappropriate pricing and profit shifting, that reality might be built into the template responses and effectively obscure the base erosion and profit shifting. This concern is not unique to developing countries. But the template may play a more pivotal role in developing countries tax enforcement process if they lack other reporting mechanisms or information that could signal a risk for base erosion and profit shifting with a particular taxpayer.

Verification. Third, although there is attention to the source of data used in constructing the files, there has been less attention to verification of the information. Of course, verification of data is always an issue for tax authorities. If there are expectations regarding a country's ability to verify information it would be useful to outline that more specifically. This concern may be most prominent in the local file context because that information would likely be circulated to a more limited pool of tax authorities. In contrast, the master file and template would likely receive wider circulation (although, as noted, the delivery mechanism will not be determined until January 2015). It is not clear, though, whether a jurisdiction that finds the master file or template inaccurate would be expected to unilaterally share that information with other countries in possession of the file or template.

Language. Fourth, the current proposals anticipate that the master file (and the template) would be prepared in English but that the local file would be prepared in the local language of the jurisdiction. Certainly, it is likely to be more efficient for the developing country that the master file be in English as compared to the language of the MNE’s parent jurisdiction (assuming that language is not English). However, the personnel constraints that developing country tax administrations face include the limited pool of English-speaking tax professionals with sufficient international tax training to effectively review the files, make risk assessments, and then pursue taxpayer audits where appropriate. If more information is made available in the language of the developing country, the number of tax professionals in government available to work on audits, reviews, and examinations may increase.

Burden. Fifth, the dominant taxpayer critique of the Action Item 13 reporting (master file, template, and local file) has been that of the burden it imposes on taxpayers. See 3.3.5.1. Although the question of burden is important, and requested information should be useful and reasonable in context, the balance of benefit and burden may look different from a developing country perspective. Taxpayers have urged that they not be asked to provide difficult to gather data that a country will be unable to use. This objection is not leveled solely at developing countries, but it is one that is heightened where a country has limited resources and is ultimately constrained in its ability to meaningfully process information. However, despite this claim, which might suggest that the benefits to developing countries would be less than the burden to the taxpayer, a broader look at the benefits and burden question might produce a different conclusion. Developing countries are often understood to be highly dependent on income taxes, specifically corporate income taxes, for their revenue base. There are a number of factors contributing to this fiscal picture and although it may shift in the long term, at present there is a serious cost to the fiscal welfare and stability of these countries when they are unable to collect corporate income tax otherwise due. Additionally, developing countries have fewer internal resources to engage in extensive monitoring and reviewing of multinational taxpayers and their tax planning. Thus, the benefit to these jurisdictions in having MNEs provide relatively uniform, comprehensive information of both a qualitative and quantitative nature that assists in risk assessment and in audit is distinctly valuable. That said, the BEPS project is a group effort by countries to respond to base erosion and profit shifting. However, in making a group-wide assessment of the burden imposed on taxpayers by Action Item 13 as compared to the benefit for tax administration, it will be important to bear in mind that the benefit should not be measured solely from a developed country perspective.²²

²² Various international groups have urged that the BEPS Project appropriately incorporate the views and needs of developing countries. See, e.g., C20 Position Paper Background: Governance (7 August 2014) (recommending “an inclusive and transparent process that ensures developing countries benefit from these tax reforms,”); G20s Leaders’ Declaration (5-6 September 2013) at 13 (“Developing countries should be able to reap the benefits of a more transparent international tax system, and to enhance their revenue capacity, as mobilizing domestic resources is critical to financing development.”).

3.3.6.2.2 Delivery. Just as the question of to whom information will be provided and how, is very significant for taxpayers, it is equally critical to developing countries. As suggested in 3.3.6.1, Action Item 13 will play little meaningful role if countries cannot predictably and effectively access the information in the master file, template, and local file. Given that many of the key advantages of this information package for developing countries derive from the resource-savings opportunities it provides (see 3.3.6 above), it is important that countries have easy access to the information in a timely fashion. To the extent that the delivery mechanism imposes costs, the value of the entire process for developing countries is diminished.

For example, if the master file and template is provided only to the MNE parent's jurisdiction, with the expectation that other countries can seek that information through an exchange of information request, several barriers are created. First, the developing country must pursue the process of requesting the information, presumably pursuant to a treaty (bilateral treaty or TIEA). This step requires the efforts of a tax professional sufficiently familiar with the process, the rules, and possibly a foreign language. Second, it is not clear what information the requesting jurisdiction must provide to make this request. One of the long standing problems with treaty-based exchange of information provisions has been the requirement imposed on requesting jurisdictions to provide upfront details regarding the underlying taxpayer and the matter being investigated. This requirement would contradict one of the core functions of Action Item 13 – allowing countries to make more meaningful BEPS risk assessment early in the process. Yet depending on the precise treaty provision under which the country is making the request for information, they might need to know much more information in order to request the master file and template. Not only would this be difficult to accomplish in some cases, it will inevitably require more audit resources just to secure the information intended to provide the risk assessment tools. Developing countries will be able to take these steps for fewer taxpayers, thus decreasing the beneficial impact of Action Item 13.

Second, tax administrations generally are seeking to make the audit process more contemporaneous. Working through a treaty mechanism to obtain the master file and template, particularly if the requesting country must provide detailed supporting information, would only extend the audit process.

Third, developing countries are less likely to have MNEs with the parent located in their jurisdiction. As a result, a much larger portion of their enforcement work to combat BEPS would require the preliminary step of seeking master files and templates from other countries. In contrast, developed countries typically have more multinationals headquartered in their jurisdictions and would (under a system of filing only in the parent country) have the information automatically available. Moreover, these developed countries would likely be especially, though not exclusively, interested in base erosion and profit shifting on the part of their own major

multinationals. Thus, although all countries would (under this approach) be required to seek information via treaty, the burden would be most significant for developing countries which are resource constrained, are dependent on corporate income taxes, and have few domestic multinationals.

3.3.6.2.3 Domestic. The proposed steps under Action Item 13 raise several questions for countries to consider from a domestic perspective. As with some of the observations above, although these points may not apply uniquely to developing countries, they may resonate strongly with developing countries. First, assuming the countries adopt the recommendations under Action Item 13 in some final form, domestic legislation would be required to fully implement the recommendation. To the extent countries have not yet implemented significant reporting requirements for MNEs they would likely need to do so now. Given the importance of obtaining the information, developing countries would want to ensure their ability to enact the required legislation.

Second, taxpayers have expressed the concern that countries, especially developing countries, may be inclined to by-pass a real audit, and use the master file and CbC template to impose a transfer pricing adjustment based on a more formulary approach. Some taxpayers have urged that the OECD secure commitments from countries affirming that they will not forgo the arm's length method, even informally. It is unclear what such a commitment would look like and whether and how the final recommendations under Action Item 13 would incorporate it. But it does make sense for jurisdictions, including developing countries, to review their own positions and commitments on the subject.

Third, taxpayers have also repeatedly raised confidentiality as an objection to widespread filing of the master file and CbC template. Regardless of the delivery mechanism(s) identified in January 2015, countries receiving access to information will likely be expected to demonstrate their ability and willingness to comply with norms of confidentiality and privacy regarding taxpayer information. If a country's current domestic law is not consistent with the typical expectations reflected in, for example, the UN and OECD Article 26, the country may wish to preemptively re-visit the changes that would necessary to domestic law for compliance.

Fourth, Action Item 13 itself does not impose documentation or transfer pricing penalties. That remains the province of the individual countries. The Discussion Draft recommends against documentation penalties for good faith compliance that falls short of the required disclosures. But the Discussion Draft anticipates the need for both documentation and mispricing penalties in some cases. As countries examine their own documentation and substantive pricing penalties, it is important to bear in mind the risk that taxpayers will "favour" jurisdictions with more severe penalties: taxpayers might devote more resources to documentation compliance in such jurisdictions and, where in doubt on pricing, shift profits to the jurisdiction with higher penalties

(to avoid the imposition of such penalties). Given that developed countries frequently have well-established transfer pricing documentation and substantive penalties regimes, developing countries should carefully evaluate their own penalty regimes with these observations in mind.

3.3.6.3 Options. Assuming that developing countries secure workable access to the master file and the CbC template under the final delivery mechanism, there remains the question of how they can best use this information. Given the resource constraints faced by many developing countries, targeted capacity building might enhance these countries' ability to use the information received from all three formats (master file, CbC template, and local file) in a strategic manner. For example, training for developing country tax auditors could focus on the information included in these files and how to use that information to make overall risk assessments, and where appropriate to pursue taxpayer level audits. Using "case studies" of hypothetical taxpayers with corresponding master files, templates and local files would help developing countries not only receive the information but begin to use it effectively and more immediately to tackle base erosion and profit shifting.²³ Real-time technical assistance and capacity building could also be pursued through the "Tax Inspectors Without Borders" program²⁴ currently being piloted by the OECD, which provides expertise to developing country tax administrations during the course of real-time audit and enforcement.²⁵ The G20 has noted its support for this program.²⁶

3.3.7 Summary of Action Item 13: The BEPS Project's Action Item 13 addresses the challenge of transfer pricing documentation and the need to understand a multinational's activities across the globe. The Action Item introduces three new reporting mechanisms: (1) the Master file (standardized information for the entire MNE group regarding business activities, finance, debt structure, taxation and allocation of income); (2) the Country-by-Country Reporting template (a template completed by each multinational providing data on a country-by-country basis on seven key questions); and (3) the Local file (jurisdiction-specific information on the local entities, their financial accounts, financial data of comparables for transfer pricing analysis, and detailed information on related party transactions).

²³ See, e.g., African Tax Administration Forum, A Practical Guide on Information Exchange for Developing Countries (2013) at 46-47 (outlining an abbreviated version of the case study concept in the context of requesting information).

²⁴ See generally, OECD website at <http://www.oecd.org/tax/taxinspectors.htm>.

²⁵ OECD Task Force on Tax and Development, Final Report on the Feasibility Study into the Tax Inspectors Without Borders Initiative (5 June 2013) at 1 ("Experts would be deployed to work directly with local tax officials on current audits and audit-related issues concerning international tax matters, and to share general audit practices. In addition to improvements in the quality and consistency of audits and the transfer of knowledge to recipient administrations (tax administrations seeking assistance), broader benefits are also anticipated including the potential for more revenues, greater certainty for taxpayers and encouraging a culture of compliance through more effective enforcement.), available at http://www.oecd.org/ctp/tax-global/TIWB_feasibility_study.pdf.

²⁶ G20 Leaders' Declaration (St. Petersburg, September, 2013) at 13 ("we welcome the OECD Tax Inspectors without Borders initiative, which aims to share knowledge and increase domestic capacities in developing countries in the tax area.").

The goal of this reporting is to assist countries in (1) risk assessment; (2) enforcing transfer pricing requirements; and (3) audit. The proposed reporting under Action Item 13 has raised a number of implementation issues: (1) burden on the taxpayer, (2) the timing of when information must be provided, (3) scaling documentation requirements to reflect the materiality of the taxpayer and the transactions (based on the size and nature of the local economy, and the size and nature of the MNE and its activities both globally and locally), (4) expectations regarding document retention and updates, (5) language requirements for reporting, (6) nature and impact of documentation penalties, (7) confidentiality, and (8) actual implementation (domestic law changes, oversight of taxpayer reporting, mechanism for delivering information (centralized to MNE parent, locally, or other options). Among some of the most important concerns that have emerged regarding the design and implementation challenges are: (1) *burden*: the gap between how MNEs manage their group reporting and the expectations under Action Item 13; (2) *delivery mechanism*: the need to ensure taxpayer confidentiality while also ensuring meaningful access to reported information especially by developing countries; (3) *use of information*: expectation that template not lead countries to by-pass audit and directly impose a transfer pricing adjustment, and expectation that countries not abandon arm's length approach.

Developing countries may want to devote particular attention to a few key issues in Action Item 13: (1) the broad goal of Action Item 13 (to improve information necessary for tax authorities to make valid risk assessments) may be especially valuable to resource constrained developing countries which must decide where and how to allocate scarce audit resources; (2) relatedly, if the Action Item 13 reporting package (Master file, CbC template, and Local file) become the MNE standard, the increased reporting uniformity should also help developing countries conserve and best direct their tax and audit resources; (3) choice of reporting language can also directly impact developing countries' ability to access information, thus reporting at least the local file in the local language may be very important; (4) if MNE's provide the information directly to the parent's home jurisdiction with the expectation that other countries then request some or all of the information, the actual availability of the data will be diminished for developing countries that have a smaller treaty network and/or limited tax enforcement staff to make the treaty-based inquiries for all information sought; (5) ability to ensure confidentiality under domestic law; and (6) the capacity building support that would benefit the developing country in making the most of information available under the Action Item 13 reporting package.

3.4. Disclosure of Aggressive Tax Planning: BEPS Action Item 12.

Action Item 13 is not the only part of the BEPS project seeking increased information from taxpayers. Action Item 12 targets aggressive tax planning arrangements and seeks taxpayer disclosures regarding these structures. As noted in 3.1, this topic has a delivery date of September 2015 and will likely receive more scrutiny in the coming year.

3.4.1 Goals of Action Item 12. Based on the view that countries can more effectively tackle base erosion and profit shifting if they receive timely and relevant information, Action Item 12 seeks to require disclosure regarding aggressive planning. Paralleling the work currently being undertaken for Action Item 13, the work for Item 12 will include the design of a reporting standard and a mechanism for sharing information among taxing jurisdictions. Many of the same concerns raised under Action Item 13 for both taxpayers and governments will also arise including: taxpayer burden, consistency, country-specific needs, value of qualitative and group-wide information. The BEPS Action Plan anticipates that the recommendations under Action Item 12:

will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of “tax benefit” in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.²⁷

Given the thematic and structural overlap between Action Item 12 and Action Item 13, the conclusions reached regarding questions such as taxpayer burdens and the format for delivering the master file and CbC template under Action Item 13 will likely impact the future recommendations under Action Item 12.

Although all countries should be concerned about the impact of aggressive tax planning structures and transactions on their tax base, many developing countries may find that their more immediate BEPS threat come from “straightforward” profit shifting. In that case, the recommendations under Action Item 13 may have more significant, immediate relevance to such countries. That said, if developing countries currently experiencing base erosion and profit shifting through more traditional transfer pricing mechanisms successfully curb this loss of tax revenue, they may find that taxpayers shift to more sophisticated techniques for reducing their tax bill. At that point, Action Item 12 would take on a greater role in developing countries’ response to base erosion and profits shifting.

3.5. Summary of the BEPS Project and Transparency and Disclosure:

The BEPS Action Plan includes two Action Items directly bearing on transparency and disclosure. Action Item 12, which will be delivered in 2015, seeks to require disclosure of aggressive tax planning. Many of the issues and concerns that have emerged in the formulation and evaluation of Action Item 13 over the past year will likely become important again in the

²⁷ OECD, Action Plan on Base Erosion and Profit Shifting (July 2013) at 22.

context of Action Item 12. Perhaps of greater importance for developing countries now are the recommendations under Action Item 13 pertaining to documentation of transfer pricing and the multinational group. This Action Item has been the subject of extensive debate and comment and its three part reporting package (Master file, CbC template, and Local file) could play a very significant role in developing country tax enforcement. Additionally, Action Item 11 might play a role in the future to the extent that its anticipated collection of broad level data regarding the success of strategies targeting base erosion and profit shifting provides guidance on future reform.

4. Other New Developments in Transparency and Disclosure.

4.1 Overview.

The BEPS project is the most expansive effort to address base erosion and profit shifting, including through transparency and disclosure. But it is not the only venue for such action. Other work on transparency, disclosure, and exchange of information is taking place at the national, regional, and global level – including at the OECD. A review of these efforts helps provide a more complete picture of the tools being developed to enhance countries’ ability to enforce their tax laws in a global economy.

4.2 Automatic Exchange of Information.

4.2.1 Overview. Before the BEPS project began, countries were struggling with the question of how to improve access to taxpayer information and thus improve tax enforcement. Although global taxpayers are not new and exchange of information provisions have existed in bilateral tax treaties for decades, the explosion of cross border commercial activity and investment by businesses and individuals has increased tax authorities’ need for information location outside their jurisdiction. Existing exchange of information provisions in bilateral tax treaties were insufficient, in part because they generally call for exchange of information upon request. But that process can be slow, burdensome, and difficult for requesting countries (see 5.2). Many in the international tax community advocated for automatic exchange of information – a process and commitment between or among jurisdictions to regularly send a country specified types of tax-related information regarding that country’s taxpayers. Others though resisted on various grounds including: domestic traditions of bank secrecy, administrative burden, recipient’s inability to meaningfully process large quantities of information, and privacy concerns. Perhaps less often acknowledged is the tax competition reason to resist automatic exchange of information. Countries which impose low taxes on outsiders investing in or through their jurisdiction would see little upside to helping the home country impose tax and thereby negate the “value” of “investing” in that low tax jurisdiction.

4.2.2 Current Practices. At present, neither the UN nor the OECD Model Treaty version of Article 26 (Exchange of Information) requires automatic exchange (see 5.2). However, the UN

Commentary offers alternative Article 26 language that would include automatic exchange of information as part of the states' commitment.²⁸ The OECD Commentary for Art. 26 similarly considers automatic exchange of information as one of mechanisms available for countries to adopt.²⁹ The OECD Model Tax Information Exchange Agreement, which formally uses the on-request mode of exchanging information, envisions in its Commentary that countries could use the document for automatic exchange of information subject to agreement by the two states.³⁰ The Multilateral Convention on Mutual Administrative Assistance in Tax Matters provides for automatic exchange of information between members pursuant to terms mutually agreed to by those states. (See 5.4).

The European Union's Administrative Cooperation Directive requires mandatory automatic exchange of information, effective 1 January 2015. The Directive mandates automatic exchange of information in specified categories: employment income, directors' fees, life insurance products, pension, ownership and income from immovable property. The EU Savings Directive generally requires member countries to report interest income paid to an individual beneficial owner resident in another member state.

4.2.3 Challenges. Successful "automatic exchange of information" requires several elements: (1) a common standard regarding information reporting, (2) due diligence by financial institutions, (3) an exchange process, (4) a legal framework through which to execute the exchange, and (5) compatible technical systems.³¹ Primary challenges with moving from the idea of automatic information exchange to the reality of widespread committed implementation have included: historic bank secrecy provisions, disagreement on the types information, reciprocity, confidentiality, taxpayer identification, data security, format and feasibility. The first challenge, bank secrecy, has been under attack since approximately 2009. Over the past five years, most countries have substantially limited or eliminated domestic rules on bank secrecy that barred their own financial institutions from providing client information (to the local government or foreign governments) and/or barred the country from providing that information to another country pursuant to an exchange of information request.

4.2.4 OECD, G20 and Automatic Exchange. The remaining challenges have been the focus of global work over the past two years. As of April 2013, the G20 formally supported the "progress made towards automatic exchange of information which is expected to be the standard, and urged all jurisdictions to move towards exchanging information automatically with their treaty

²⁸ UN Model Treaty Commentary, Article 26, Paragraph 29.2, 30.

²⁹ OECD Model Treaty Commentary, Article 26, Paragraph 9, 9.1.

³⁰ OECD Model Tax Information Exchange Agreement Commentary, Article 5, Paragraph 39.

³¹ OECD, Automatic Exchange of Information: What it is, How it works, Benefits, What remains to be done (2012), available at <http://www.oecd.org/ctp/exchange-of-tax-information/automaticexchangeofinformationreport.htm>.

partners, as appropriate.”³² The G20 gave the OECD a mandate to prepare standards and guidance on automatic exchange of information. In February 2014, the OECD released the first part of this project, the “Standard for Automatic Exchange of Financial Account Information: The Common Reporting Standard,”³³ which the G20 approved: “We endorse the Common Reporting Standard for automatic exchange of tax information on a reciprocal basis and will work with all relevant parties, including our financial institutions, to detail our implementation plan at our September meeting.”³⁴

As a follow-up to its February 2014 document, the OECD released its more comprehensive “Standard for Automatic Exchange of Financial Account Information in Tax Matters” in July 2014.³⁵ This July OECD report includes: (1) the text of a Model Competent Authority Agreement (“CCA”) for automatic exchange of certain tax information, (2) the Common Reporting Standard (“CRS”), and (3) Commentary intended to facilitate uniform implementation of the agreement and standard. Exchange of information under this system requires that each country take two basic steps.

First, countries must implement any domestic law changes necessary to (1) require financial entities to gather and report the designated information, and (2) ensure appropriate protection of taxpayer data. Second, countries (through their competent authorities) must agree to exchange on an automatic basis and must set the terms of that exchange (e.g., the Model Competent Authority Agreement). The report urges that this agreement be executed under the legal framework of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (see 5.4) because the convention allows for more than one country to enter into such competent authority agreement, potentially reducing the amount of negotiating a country must do. Alternatively, the competent authority agreement could be executed under two countries’ bilateral tax treaty.

Much of the discussion and debate surrounding implementation of automatic exchange of information concerns the same questions that arose in considering the work under BEPS Action Item 13 – the information to be provided, the level of burden imposed, the usefulness of the information, and the protection of taxpayer data. One notable difference is that automatic

³² Communiqué Meeting of Finance Ministers and Central Bank Governors Washington, 18-19 April 2013, available at <http://g20.org/documents>.

³³ OECD, Standard for Automatic Exchange of Financial Account Information (February 2014), available at <http://www.oecd.org/ctp/exchange-of-tax-information/automatic-exchange-financial-account-information-common-reporting-standard.pdf>.

³⁴ Communiqué Meeting of Finance Ministers and Central Bank Governors Washington, 18-19 April 2013, available at https://www.g20.org/sites/default/files/g20_resources/library/Communique%20Meeting%20of%20G20%20Finance%20Ministers%20and%20Central%20Bank%20Governors%20Sydney%202022-23%20February%202014_0.pdf.

³⁵ OECD, Standard for Automatic Exchange of Financial Account Information in Tax Matters (21 July 2014), available at <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm>.

exchange of information places the reporting burden on third party financial entities, not the taxpayer.

To the extent that the recommendations regarding automatic exchange of information in the July 2014 OECD report form the baseline for automatic exchange of information relationships, developing countries must carefully evaluate whether its contents and structure would adequately meet their informational needs for the foreseeable future. Below in 4.3 the Common Reporting Standard and the Model Agreement are outlined briefly and then analyzed from a developing country perspective.

4.3 Common Reporting Standard (“CRS”) and Model Competent Authority Agreement (“CAA”).

4.3.1 Overview. The underlying goal of the OECD automatic exchange of information project is to put in place a system that: (1) enables the sharing of taxpayer information that is necessary to effective tax enforcement, and (2) does so in a manner that is sufficiently uniform and standardized that information can be efficiently provided, shared and processed. The OECD commented that it drew “extensively” on the intergovernmental response to the U.S. financial reporting requirements (the Foreign Account Tax Compliance Act, or “FATCA”) in designing the CRS. (See 4.5 for further discussion of the intergovernmental agreements). Under this system, certain financial entities have an obligation to report specified information on account holders to the tax authorities in the financial entity’s own jurisdiction. That jurisdiction would then share the account information with the country in which the account holder is a resident. The expectation is that the emerging standard and system would be a minimum standard of sharing information between jurisdictions. Countries could, of course, decide to exchange additional information. By spring of 2014 over 65 countries expressed commitment to implement automatic exchange.³⁶ In March 2014, more than 40 countries formally agreed to early adoption of the Common Reporting Standard developed by the OECD, with implementation expected in 2017.³⁷

4.3.2 CRS. The Common Reporting Standard details the entities that must report, the type of information to be reported, the types of accounts for which information must be reported, and the due diligence required of the reporting financial entities.

Reporting Entities: Under the CRS, the following types of financial institutions are required to participate in reporting financial information of taxpayers: custodial institutions, depository

³⁶ See OECD discussion and listing available at <http://www.oecd.org/tax/exchange-of-tax-information/automaticexchange.htm>.

³⁷ Joint Statement by the Early Adopters Group (March 2014) available at <http://www.oecd.org/tax/transparency/AEOIjointstatement.pdf>.

institutions, investment entities, and specified insurance companies (unless there is low risk of evasion).

Information Provided: The types of financial information to be provided by the reporting financial entities include: interest, dividends, account balance or value, income from certain insurance produces, sales proceeds from financial assets, and other income generated by assets held in the account or payments made with respect to the account.³⁸

Covered Accounts: The accounts (“reportable accounts”) for which reporting must be made by the reporting financial entities include accounts held by individuals *and* entities (including trusts and foundations). To limit evasive tax planning, the reporting financial entities must look through passive entities and report on the controlling persons. In terms of providing identifying information regarding the account, the financial entity must report the “name, address, jurisdiction(s) of residence, TIN(s) and date and place of birth (in the case of an individual) of each Reportable Person that is an Account Holder.”³⁹

Due Diligence: To ensure meaningful and effective provision of information, reporting financial entities must perform a specified level of due diligence aimed at securing accurate information regarding the identity of the account holder. Different standards of diligence are applied depending on when the account was created, its contents, its value, and other information known to the financial entity.

4.3.3 CAA. The Model Competent Authority Agreement is drafted as a bilateral agreement between two jurisdictions to commit to the automatic exchange of financial account information. (A model multilateral CAA is provided in Annex 1 of the July 2014 Document). Pursuant to the agreement, the countries agree to have domestic rules requiring financial institutions to report accounts and follow due diligence procedures consistent with Common Reporting Standard and the terms of the specific CAA. Additionally, the signatories confirm that they have: (1) the appropriate safeguards to protect the confidentiality of taxpayer data, and (2) the infrastructure necessary for effective exchange (including mechanisms for “timely, accurate, and confidential information exchanges, effective and reliable communications, and capabilities to promptly resolve questions and concerns about exchanges or requests for exchanges.”).⁴⁰

³⁸ OECD, Standard for Automatic Exchange of Financial Account Information in Tax Matters (21 July 2014) at 15, available at <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm>.

³⁹ OECD, Standard for Automatic Exchange of Financial Account Information in Tax Matters (21 July 2014) at 29, available at <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm>.

⁴⁰ OECD, Standard for Automatic Exchange of Financial Account Information in Tax Matters (21 July 2014) at 21-22, available at <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm>.

4.3.4 Developing Country Analysis.

4.3.4.1 Overview. A range of developing countries have expressed interest in automatic exchange of information. Income tax evasion poses a serious fiscal challenge for many developing countries which rely substantially on the income tax base. Current methods for obtaining information located outside the jurisdiction can be costly or unavailable. Treaties generally permit exchange of information only on request (a process that can be burdensome in time, money and expertise). Moreover, many developing countries have a more limited treaty network (even including TIEAs), and may not have treaties with key tax haven jurisdictions (used by their residents in evading the developing country income tax). Thus, some developing countries are among those who have committed to early adoption of the Common Reporting Standard. (4.3.1)

4.3.4.2 Advantages of the CRS and CAA. The overall automatic exchange of information project advances the potential for meaningful income tax enforcement. Widespread dissemination of relevant taxpayer information to the appropriate taxing authorities enhances real enforcement and more broadly signals to taxpayers the risks of tax evasion. As noted above (4.3.4.1) current information exchange mechanisms can be too burdensome to serve as a regular component of tax enforcement. Automatic, bulk provision of the enumerated information in the CRS would significantly reduce the costs of acquiring that information compared to existing mechanisms. Additionally, the automatic nature of the delivery reduces the opportunity for pressure, leverage, and corruption in tax administration.

The scope of taxpayers whose accounts are covered by the CRS further increases the value of the information exchange. The decision to include entities and not just individuals, and to reach trusts and other often opaque holding structures, expands the coverage of this automatic exchange of information system beyond that of some other programs.

4.3.4.3 Limitations of the CRS and CAA. The advantages described above of the CRS and CAA essentially reflect the reduced costs and difficulties of acquiring information *as compared* to obtaining it via an existing bilateral treaty. But the ability to participate in the CRS and CAA is currently contingent on (1) meeting the standards necessary to commit to providing, not just receiving information (required reciprocity), and (2) getting key jurisdiction to sign a CAA (participation).

4.3.4.3.1 Reciprocity. The CAA is premised on reciprocity between or among signatories. Although countries may sign a CAA in advance of being ready to participate, the agreement only takes effect when they are in fact prepared to reciprocally share information.⁴¹ The only option

⁴¹ See, e.g., Model Competent Authority Agreement, Section 7, available at <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm>.

for non-reciprocal participation in the CRS and CAA is provided for countries which do “not need to be reciprocal” (e.g., because one of the jurisdictions does not have an income tax).⁴² This has been characterized by some commentators as intended to facilitate automatic exchange of information *from* tax havens. There is no current model or provision allowing for non-reciprocal automatic exchange of information with (or more precisely, *to* a developing country (i.e. providing information to that developing country without receiving information in return). The absence of such an alternative may render the current CRS and CAA out of reach of developing countries that cannot currently commit to and meet the standards for domestic collection of the required tax information (i.e. the domestic law provisions and enforcement of data collection from reporting financial entities) and the processing and transmission of the information (inside the tax administration). These developing countries though would benefit from the receipt of information under automatic information exchange. The only requirement they would need to meet is the protection of taxpayer data. Even if the developing country were not yet able to make maximum use of the bulk data it receives, the country could nonetheless begin to improve tax enforcement with the information.

If non-reciprocity with developing countries were permitted, it could be managed in a gradual manner. The country could commit to meeting established benchmarks for domestic information collection and processing. While the country was meeting the benchmarks, it could receive information under the CRS and CAA, with the end goal being full and reciprocal participation. The loss for the other country during this period of time would likely be minimal. Developing countries are typically not the financial destinations of major tax evaders, and developed countries would likely receive little significant information from this automatic exchange of information. Thus, the cost of helping developing countries improve tax collection while building their internal capacity to fully participate in automatic exchange should not be unduly high.

4.3.4.3.2 Participation. Even with adequate infrastructure to participate in automatic exchange of information under the CRS and CAA, developing countries must actually be able to persuade countries to sign these agreements. The bilateral version offered as the main example of a CAA would be less effective for many developing countries. It would have to be negotiated on a bilateral basis with each country and could only be completed with current treaty partners (bilateral tax treaties or TIEAs). The alternative, multilateral, version of a CAA provided in Annex 1 of the July 2104 OECD Document would be executed on the legal basis of the

⁴² See Nonreciprocal Model Competent Authority Agreement, in OECD, Standard for Automatic Exchange of Financial Account Information in Tax Matters (21 July 2014) Annex 2 at 223, available at <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm>.

Multilateral Convention on Mutual Administrative Assistance in Tax Matters.⁴³ This multilateral version would offer two key advantages to developing countries – only a single agreement to negotiate and a wide pool of potential signatory partners. There are, however, three problems.

First, with the availability and prominence of the bilateral version there may be inadequate motivation for many countries to pursue the multilateral. Second, even if some countries do participate in a multilateral CAA, it is not clear that they would be required to invite a developing country to sign. Specifically, some developing countries that have been unable to sign treaties with tax havens may be concerned that tax havens will also refuse to participate in a CAA with them. Yet these havens are key jurisdictions from which a developing country may need to acquire tax information, and unlike developed countries the developing country may have little leverage to persuade or entice the tax havens' participation. Finally, unlike the U.S. FATCA regime which inspired the CRS and CAA, it is not clear what sanctions would apply to nonparticipants. The absence of sanctions may be a concern for developing countries that are trying to get tax havens to join them in a CAA.

4.4 Industry Specific Reporting Requirements (Natural Resources, Financial Services).

Industry specific country-by-country reporting has been also been a focus of increased transparency for countries. For example, United States securities law regulations now require extractive industries to report various payments made to foreign governments by businesses engaged in extractive industries (exploration, extraction, processing, and export of oil, natural gas, or minerals, or the acquisition of a license to engage in such activity). These payments, which must be reported on a country-by-country basis, include⁴⁴ “taxes, royalties, fees (including license fees) production entitlements, bonuses, and other material benefit.” Implementation of these new requirements (enacted into law in 2010), however, awaits Securities and Exchange Commission implementing regulation.

On a more global scale, the Extractive Industries Transparency Initiative (EITI) seeks to promote a two pronged reporting approach for transparency in extractive industries⁴⁵ under which businesses report what they pay to each jurisdiction, and the governments report what they receive.⁴⁶ However, work on industry-targeted disclosure has not been limited to extractive industries. The European Union's Capital Requirements Directive IV (CRD IV) seeks disclosure by covered financial institutions of information on a country-by-country basis including: profit or

⁴³ OECD, Standard for Automatic Exchange of Financial Account Information in Tax Matters (21 July 2014) at 215, available at <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm>.

⁴⁴ U.S. Securities Exchange Act of 1934, Section 13(q).

⁴⁵ EITI Fact Sheet 2014, available at http://eiti.org/files/2014-03-26%20Factsheet%20English_0.pdf.

⁴⁶ EITI Countries and Country Reports, available at <http://eiti.org/countries>.

loss before tax, tax paid, subsidies received, average number of employees.⁴⁷ EU Member states must domestically enact rules to require the reporting.⁴⁸

In some cases, efforts to combat corruption prompted the push for transparency and disclosure initiatives. Where transparency and disclosure serves an anti-corruption role, the public release of disclosed information can be important. Not surprisingly, the nature and scope of any public disclosure of taxpayer data has generated debate and objection in the business community.

Although the issue of public disclosure of taxpayer information has been raised by some advocates in the BEPS context, the OECD does not anticipate that Action Item 13 files would be made available to the public. But corruption concerns have surfaced as a possible factor in some countries' limited collection of income tax, and public disclosure of at least some information in the master file, template, and/or local file could play a role in improving tax enforcement.

4.5. Intergovernmental Agreements (“IGAs”) and Related Developments.

In 2010, the United States enacted the Foreign Account Tax Compliance Act (“FATCA”).⁴⁹ Prompted by the number of U.S. taxpayers using off-shore financial accounts to avoid U.S. income tax, the new legislation effectively requires a wide range of financial institutions (foreign and domestic) to provide data to the United States regarding U.S. taxpayers who hold accounts at those institutions. The FATCA legislation imposes due diligence and reporting burdens on these third party entities, and failure to comply can result in negative U.S. tax consequences for the financial institutions' own U.S. source income.

In an effort to streamline compliance for foreign financial entities required to report under FATCA, and to address various disclosure and confidentiality concerns, a number of countries entered into intergovernmental agreements (“IGAs”) with the United States that provided specific guidance on the type of information that their own domestic financial institutions would gather on U.S. taxpayers and detail how that information would be provided to the United States.⁵⁰ These IGAs were negotiated under the legal framework of each country's existing tax bilateral tax treaty with the United States. With the increasing number of IGAs being signed with the United States, other countries have expressed interest in receiving the same type of tax-

⁴⁷ See, e.g., <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0338:0436:EN:PDF>

⁴⁸ See, e.g., United Kingdom reporting rules came into effect in January 2014, with the first reporting required 1 July 2014. See Final UK regulations available at <http://www.legislation.gov.uk/ukxi/2013/3118/made>; see final UK guidance available at <https://www.gov.uk/government/publications/capital-requirements-country-by-country-reporting-regulations-2013-guidance/capital-requirements-country-by-country-reporting-regulations-2013-guidance>.

⁴⁹ U.S. Internal Revenue Code Sections 1471-1474.

⁵⁰ Ultimately, the United States provided two model intergovernmental agreements that formed the basis of its negotiations with other countries, IGA Model 1 and Model 2.

related information on their own residents' foreign financial accounts, and have pursued a broader IGA format.⁵¹

4.6 Summary of Other Developments in Transparency and Disclosure:

In addition to the BEPS project, there are several other global efforts to limit base erosion and profit shifting. The OECD and G20 have been advocating introduction of automatic exchange of information including a “Common Reporting Standard” for the information that should be exchanged. The OECD released its comprehensive standard in July 2014 (including the CRS itself), a Model Competent Authority Agreement, and a Commentary (to facilitate uniform implementation). The CRS specifies which financial entities must report taxpayer information, which information must be reported, and which accounts are subject to reporting. Exchange of information as a tool for transparency and disclosure avoids the burdens of pursuing exchange on request. But it still requires an agreement the exchange. The proposal to implement a multilateral CAA through the Multilateral Convention on Mutual Administrative Assistance in Tax Matters avoids the need to enter into many bilateral arrangements. This would be an advantage for countries with few current treaties and limited resources for tax administration. However, even this path (use of the Multilateral Convention) does not guarantee that crucial jurisdictions would agree to join a developing country in exchange of information. Another barrier for developing countries is the “reciprocal” nature of the CCA. Exchanges would only start after both countries could fully under the agreement. Phasing in reciprocity would allow developing countries to receive valuable tax information and tackle base erosion now as they build their internal capacity to comply with all of aspects of the CAA. Other potentially interesting initiatives for transparency and disclosure include: (1) efforts such as the Extractive Industries Transparency Initiative which encourages industry-based reporting of tax payments (with both business and government reporting payments and receipts); and (2) bilateral and regional efforts to replicate the kind of information exchange being promised under IGAs that have been signed in the wake of the new U.S. reporting requirements for financial entities.

5. Existing Mechanisms Supporting Transparency and Disclosure.

5.1 Overview.

Despite the significant attention directed at transparency and disclosure in recent years, the concepts are not new to the tax system. For example, tax treaties have included exchange of information provisions for decades, which though more limited in scope and effect than some of

⁵¹ See, e.g., Letter (9 April 2013) signed by finance ministers of France, Germany, Italy, Spain, and the United Kingdom announcing their pilot program to automatically exchange information, a “multilateral exchange facility,” available at <http://taxnews.lexisnexis.co.uk/TaxNewsLive/Members/BreakingNewsFullText.aspx?id=4335&css=1&xml=0>. The signatories encouraged other EU member states to join them in their pilot program based on IGAs signed with the United States pursuant to FATCA.

the transparency and disclosure projects currently underway, nonetheless sought to enhance a tax administration's access to vital taxpayer data. A brief review of these existing mechanisms which support and facilitate tax transparency and disclosure provides: (1) a better understanding of what may be needed in *new* mechanisms, and (2) the role that these current agreements or structures can play in supporting any new developments in transparency and disclosure.

5.2 Model Treaty Article 26.

Both the UN Model Treaty and the OECD Model Treaty include an Article 26 Exchange of Information provision that outlines the primary terms governing exchange of information between the two signatories: the duty to exchange, the duty to protect taxpayer information, the grounds upon which a request for information can be declined, and the grounds which do not form an appropriate basis for refusal to exchange information. Although the UN and OECD version of Article 26 (and their respective Commentaries) do differ in some regards, their common features are reflected in many countries own bilateral tax treaties and on balance share several common deficits. Moreover, as referenced below, both treaties have made changes to Article 26 in an effort to increase the likelihood of meaningful exchange of information.

5.2.1 Standard Governing Requests. As noted earlier, neither the UN nor the OECD Model Article 26 requires automatic exchange of information. Thus, countries requesting information must meet certain thresholds for documenting their request (i.e. no “fishing expeditions”). This step limits jurisdictions to requesting information only about taxpayers and activities for which they *already* have some knowledge. Moreover, the specific threshold requirements imposed by existing bilateral tax treaties impact the likelihood that information can be requested. Recent changes to the UN Model Article 26 decreased the impact of these “thresholds.” For example, changes to the UN Model Treaty Art. 26(1) in 2011 sought to extend the scope of exchange of information by providing that information should be exchanged if it is “foreseeably relevant for carrying out the provisions of the Convention or to the administration or enforcement of domestic laws of the contracting States.” The phrase “foreseeably relevant” replaced the earlier term “necessary.”⁵² The Commentary to UN Model Treaty Article 26 does offer some alternative language for the new phrase “foreseeably relevant,” but these options are intended to allow treaty partners to choose language that they find clear in specifying the goal of “effective” exchange of information.⁵³

Despite the expanded scope of Art. 26 exchange of information under the “foreseeably relevant” language, it is important to note that automatic exchange of information entirely eliminates even a broad test for demonstrating the connection between the requested information and the taxing

⁵² The UN Commentary for Art. 26 characterized the change to “foreseeably relevant” as one that was not substantive. Rather, it was intended to “remove doubts” and “clarify” the prior language. Paragraph 4 of the Commentary on Article 26 of the United Nations Model Convention.

⁵³ The OECD Article 26 also uses the phrase “foreseeably relevant.”

authorities' investigation. The automatic receipt of specified bulk data effectively would place no such constraints on jurisdictions seeking information in the designated categories. Additionally, the current, "on request" process requires an allocation of the requesting country's potentially limited resources, which would be alleviated under automatic exchange of information.

5.2.2 Bank Secrecy. Historically, states have declined to comply with a request for information under Article 26 on the grounds that compliance would violate domestic law, specifically, bank secrecy rules. To the extent many countries had such domestic law provisions severely limiting (often under significant penalty) at financial institutions ability to share information with the government regarding a client, and/or limiting the government's ability to share such information with another country, domestic law regularly trumped the operation of Article 26. In 2011, Article 26 was revised to provide that certain domestic laws may not be used as a defense to complying with an exchange of information request. Thus, the new language in Article 26(5) states: "In no case shall the provision of paragraph 3 [outlining appropriate grounds to refuse a request] be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person."⁵⁴

5.2.3 Information Sought Not Needed by Requested State. Another 2011 change to Article 26 sought to eliminate an additional argument that a state might use to decline to provide requested information – that the state asked to produce the information has no need or use for the information itself in administering its tax law. Article 26(4) now provides that: "If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes." Anticipating that some States might try to argue that they are not legally capable of providing information that they do not need for a tax purpose (despite the language in Article 26(4)), the UN Commentary for Article 26 offers alternative treaty language. This alternative phrasing requires that each contracting State must undertake to ensure that its competent authority will have the requisite power under domestic law to secure the information needed for tax treaty information exchange purposes. In some cases, domestic legislation, rulemaking or administrative changes may be necessary to ensure that power.⁵⁵

5.2.4 Format. Article 26 exchange of information provisions do not require information be provided in a certain format. But if there is more uniformity in the content and format of information provided by taxpayers to the government, then increasingly, a requesting state government might receive information in a desired format. For example, the recommendation under BEPS Action Item 13 would notably enhance transparency and disclosure by requiring

⁵⁴ The OECD Model Treaty Article 26 also bars refusal on the ground of bank secrecy.

⁵⁵ Paragraph 26.3 of the Commentary on Article 26 of the United Nations Model Convention.

that *taxpayers* collect, generate, and provide information in a specified format to the tax authorities. This rule, implemented in each jurisdiction through domestic legislation (the master file, template, local file reporting requirements), would shift the burden to the taxpayers, who have a distinct ability to access their own information. To the extent that reporting for the master file, template and local file is fairly uniform and consistent over time, across countries, and across taxpayers, then the information may be easier for tax authorities to use. For resource constrained developing countries, this uniformity could facilitate training and decrease audit burdens.

5.2.5 Treaty Article 26 Summary. Existing bilateral tax treaties do remain a relevant tool in encouraging transparency and disclosure. First, they can provide the legal basis or framework for an agreement between competent authorities to exchange information on an automatic basis (as could TIEAs or the Multilateral Convention, see 5.2, 5.4). Second, they may explicitly permit requests regarding persons neither resident, nor engaged in economic activity, in the state from which information is sought. An automatic exchange of information arrangement would be unlikely to include data regarding such persons. Third, the “residual” ability under an Article 26 provision to seek information upon request remains useful if a country finds that it requires information beyond the scope of that provided automatically.

Although bilateral treaty provisions based on the UN or OECD Model Art. 26 are inadequate to meet the full range of transparency and disclosure needs of tax administrations today, they continue to provide possible access to information not likely available through automatic exchange of information or through the taxpayer reporting envisioned by the Action Item 13 recommendations.

5.3 Tax Information Exchange Agreements (“TIEAs”).

These stand-alone agreements, typically negotiated between countries that have not negotiated a bilateral tax treaty, focus exclusively on exchange of information. The expectation is that even countries that have do not have a bilateral treaty may still seek to exchange tax information. The TIEA provides the legal basis and structure for doing so. The OECD Model TIEA, not surprisingly, is very similar to Article 26 of the OECD Model Treaty (and the UN Model). The primary differences between the OECD Model TIEA and Article 26 include: (1) TIEAs can be bilateral or multilateral; (2) TIEAs focus on exchange “upon request”; (3) TIEAs cover specific taxes; and (4) TIEAs provides more detail regarding the information that the requesting state must provide to initiate its request.

For countries pursuing increased transparency and disclosure in tax, TIEAs provide a legal framework and context for countries to agree to exchange information automatically. That is, although TIEAs call for exchange “upon request,” they permit contracting states to expand their cooperation through agreement by the competent authorities. Thus, just like comprehensive

bilateral treaties with Article 26, TIEAs can serve as the legal foundation for countries to commit to automatic exchange. To the extent that some developing countries have a more limited network of comprehensive tax treaties but do have a network of TIEAs, this role for TIEAs could become important.

5.4 Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

This Convention, which originally was developed by the OECD and the Council of Europe in 1988, was amended in 2011 to welcome all countries as participants. At present over 60 countries have signed the convention, including developing countries. To apply, the Convention must be signed and ratified by a country – and countries can make individual reservations to the basic terms of the Convention. As a result, reliance on the Convention depends on whether the countries in question have ratified it and whether they have made any relevant reservations to significant terms. But, as a multilateral framework, the Convention offers a potentially valuable legal foundation for countries looking to pursue enhanced transparency and disclosure among a group of nations in a relatively simultaneous and efficient way.

With respect to exchange of information, the Convention includes a comprehensive consideration of (1) prerequisites to exchange, (2) what can be exchanged, and (3) the mechanism for exchange.⁵⁶ As drafted, the Convention envisions exchange of information on request, spontaneously, and automatically (according to procedures and terms mutually agreed to by two or more parties).⁵⁷ The Commentary to the Convention emphasizes the value of standardization in automatic exchange, noting savings in time and workload, but observes that these advantages accrue primarily when large numbers of countries participate in the standardization process. The current work on the CRS and CAA for automatic exchange of information could provide the formal structure and standardization that could then be implemented via the framework of the Convention, with the advantages and concerns for developing countries noted in 4.3.4.3.

5.5 Regional Agreements.

In addition to bilateral tax treaties, TIEAs, and the Multilateral Convention on Mutual Assistance in Administrative Tax matters, there are regional agreements which could serve as the legal basis and framework for exchange of information among the signatory states. Examples of such regional agreements include: (1) 2008 WAEMU (West African Economic Monetary Union) Income and Inheritance Tax Convention (Article 33); (2) the SAARC (South Asian Association Matters for Regional Cooperation) Limited Multilateral Agreement on Avoidance of Double Taxation and Mutual Administrative Assistance (Article 5); and (3) the Agreement Among the Member States of the Caribbean Community (CARICOM) for the Avoidance of Double

⁵⁶ Convention on Mutual Administrative Assistance in Tax Matters, Articles 4, 5, and 6.

⁵⁷ Convention on Mutual Administrative Assistance in Tax Matters, Article 6.

Taxation and the Prevention of Fiscal Evasion (Article 24). However, a major limitation of regional agreements is their membership. Both the requesting state and the country from which it is seeking information must be members of the applicable regional agreement. To the extent a country's taxpayers conduct business or hold their assets and accounts in other jurisdictions, the regional agreements offer little assistance. Moreover, their relatively abbreviated exchange of information provisions do not detail the expectations regarding the delivery mechanism for information and do not call for automatic exchange.

5.6 Global Forum on Transparency and Exchange of Information.

5.6.1 Overview. In the late 1990s, many countries became concerned with the effects of tax havens and preferential tax regimes which impeded effective tax enforcement by virtue of their lack of transparency and their lack of information exchange. As a response, the predecessor of the current Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") was formed in 2000 under the auspices of the OECD. The Global Forum has 122 members (August 2014),⁵⁸ including developed and developing countries, OECD and non-OECD members.

The Global Forum has pursued two projects relevant to transparency and disclosure: (1) the development of the Model Tax Information Exchange Agreement (TIEA), see 5.2, and (2) the development and implementation of the Peer Review process (assessing countries' legal and regulatory framework essential to transparency and exchange of information). The Peer Review process, which began in 2009, is undertaken in two phases (Phase 1 and Phase 2, though they can be combined). The review evaluates a country by reference to its capacity to and actual performance in providing information upon request. Thus, the Peer Review process explores the degree to which a country is compliant with commitments under treaty provisions comparable to Article 26 of the UN or OECD Model Treaties, or the Model TIEA.

The Peer Review process examines a country's domestic laws and practices along a number of dimensions to assess whether: (1) the ownership and identity of entities and arrangements are available to the competent authority, (2) reliable accounting records are maintained for such entities, (3) account holder banking information is available, (4) competent authority has power to obtain and provide information pursuant to an exchange of information request, (5) appropriate safeguards apply to persons in the requested country, (6) all relevant partners are covered by the jurisdiction's network of information exchange mechanisms, (7) adequate confidentiality mechanisms exist to protect information received, (8) the rights and safeguards of taxpayers and third parties are respected, and (9) information is provided in a timely manner for requests made under its exchange of information mechanisms.

⁵⁸ The Global Forum on Transparency and Exchange of Information for Tax Purposes: Information Brief (November 2013) at 2.

Input is sought from all members of the Global Forum during the process of reviewing a specific country.⁵⁹ Members complete an extensive questionnaire about their own practical experience in working with the country under review. The review is performed by an assessment team (two expert assessors from peer jurisdictions, along with a coordinator from the Global Forum Secretariat). The team's report is presented to the 30-member Peer Review Group (PRG), and upon approval becomes a formal report of the PRG. At that stage, the entire membership of the Global Forum is asked to approve the report. To date, over 100 countries have participated in the Peer Review process and been the subject of a completed and published report. As part of the review process, recommendations are made to countries for ways in which to improve their ability to participate and cooperate in exchange of information. Over 80 countries have introduced or proposed domestic law changes in order to implement the more than 400 recommendations that have emerged from the Peer Review process.⁶⁰

5.6.2 Developing Countries and the Global Forum. From the perspective of a developing country, a number of observations can be offered regarding the work of the Global Forum. First, the promotion of TIEAs can be beneficial to jurisdictions not currently in a position to negotiate many bilateral treaties. Second, to the extent the Peer Review process improves the general transparency of other jurisdictions' domestic banking, tax, and regulatory rules, developing countries may gain. Assuming developing countries would have had little leverage to instigate these transparency changes on their own, they may now find that their information requests made to other jurisdictions are more efficiently managed.

Third, a Peer Review of a developing country itself may provide support for the tax administration's internal efforts to encourage and effectuate domestic law (and practice) changes consistent with active participation in exchange of information. This will be most true where the developing country receives any needed and requested technical assistance on the more detailed facets of managing information and requests.⁶¹ Fourth, the current benchmark for the Peer Reviews is exchange upon request (which still imposes burdens on developing countries, see 4.3.4.1). But the domestic law and infrastructure standards that the Peer Review process promotes would also be essential if and when countries ultimately adopt some version of automatic exchange of information. Finally, to gain the maximum benefit from other countries' enhanced compliance, developing countries need to be in a position to request information (until automatic exchange takes hold) *and* to make effective use of such information. Additional work by the Global Forum in providing this assistance to developing countries, consistent with the G20's emphasis on ensuring that all states benefit from improved exchange of information,

⁵⁹ The Global Forum on Transparency and Exchange of Information for Tax Purposes: Information Brief (November 2013) at 6-7.

⁶⁰ The Global Forum on Transparency and Exchange of Information for Tax Purposes: Information Brief (November 2013) at 4.

⁶¹ See, e.g., Global Forum on Transparency and Exchange of Information for Tax Purposes, Tax Transparency 2013: Report on Progress, at 23 (outlining technical assistance opportunities).

would help guarantee that developing countries are not just providers of information but also knowledgeable “consumers” of exchanged information.⁶²

5.7 Summary of Existing Support for Transparency and Disclosure:

Transparency and disclosure is not new to international tax. Article 26 of the U.N. and the OECD Model Treaties calls for exchanging information “upon request” and in recent years, changes made to the provision enhance the likelihood that effective and useful information exchange can take place. Among the most important reforms were: (1) elimination of domestic bank secrecy rules as a justification for denying a request for information; (2) reduction of the threshold that the requesting State must meet to demonstrate that the information requested is “foreseeably relevant for carrying out the provisions of the Convention or the administration or enforcement of domestic tax laws of the contracting States;” and (3) elimination of the argument that requested information need not be provided because the requested State does not need the information. Additionally, the work of the Global Forum on Transparency and Exchange of Information, particularly the Peer Review Process, has the potential to help countries seeking to improve their own transparency and disclosure laws (which will improve both their own enforcement capacity and their ability to participate globally in the transparency and disclosure projects). Moreover, to the extent the Peer Review Process improves the transparency and disclosure capacity of countries from which a developing country is seeking information, the developing countries need not expend resources to encourage such reform in its partners.

6. Summary Observations Regarding the Role of Tax Transparency and Disclosure in Preventing Base Erosion and Profit Shifting.

Base erosion and profit shifting are critical problems for all countries, but especially developing countries that rely significantly on the corporate income tax. Although many reforms will be important to a successful global response to this challenge, increased transparency and disclosure regarding multinational businesses are essential. Countries face a number of barriers to achieving this level of transparency and disclosure. First, domestic law may not currently require adequate reporting regarding financial accounts, cross-border related party transactions, foreign financial

⁶² See, e.g., Communiqué G20 Meeting of Finance Ministers and Central Bank Governors Moscow, July 20, 2013 (“All countries must benefit from the new transparent environment and we call on the Global Forum on Exchange of Information for Tax Purposes to work with the OECD task force on tax and development, the World Bank Group and others to help developing countries identify their need for technical assistance and capacity building.”) available at http://en.g20russia.ru/events_financial_track/20130719/780961553.html; Global Forum on Transparency and Exchange of Information for Tax Purposes, Tax Transparency 2013: Report on Progress, at 25 (outlining technical assistance opportunities).

assets, and foreign business activities. The final recommendations emerging from the BEPS Project, in particular those grounded in Action Items 12 and 13, may prove especially useful as guides for countries exploring domestic reform. Additionally, the Global Forum on Transparency and Disclosure's Peer Review Process provides a mechanism for both assessing and facilitating domestic improvements in transparency and disclosure.

Second, countries may face domestic enforcement impediments to their effective acquisition and use of information. Developing countries that are resource-constrained (e.g., limited audit staff, limited international tax expertise, limited technological resources) might find it difficult to seek and acquire the information necessary to effectively audit all of the major multinational businesses operating in their jurisdiction. To the extent proposed reforms can ease any of these constraints or burdens, the reforms may be particularly useful to developing countries. Conversely, if reforms require resources or treaty relationships not currently available to many countries then their formal adoption will likely have less impact on resource-constrained states.

Third, effective responses to base erosion and profit shifting will require engagement with the broader tax community. Information can be sought directly from taxpayers, but often important information will be needed from other countries. Thus, the crucial question is whether a state has treaty relationships (bilateral, TIEA, or other) with the countries from which it is most likely to need information. If the transparency and disclosure reforms rely less on bilateral relationships, and more on multilateral approaches, jurisdictions with more limited treaty networks can more readily enjoy the benefits of the new reforms.

Among the most prominent proposals for transparency and disclosure reform currently underway are the documentation reforms of BEPS Action Item 13 (focused on improved reporting for transfer pricing documentation and the global activities of a multinational group). The proposed reporting package under Action Item 13 includes: (1) Master file (standardized global information regarding the multinational group); (2) Country-by-Country template (which reports seven information items on a country by country basis for the group, along with identifying information on entities operating in each jurisdiction); and (3) Local file (more country-specific detail regarding activities, assets, income and related party transactions). The reporting package is anticipated to help tax administrators assess risk and focus audit efforts. This assistance is especially valuable for resource constrained-countries seeking to allocate scarce audit resources to their more serious and relevant base erosion and profit shifting problems. A number of important issues continue to be debated regarding Action Item 13. For example, depending on how the information is delivered it may be more or less accessible to jurisdictions. If the Master file and Country-by-Country template are only provided to the residence jurisdiction of the MNE's parent (to then be shared via exchange of information requests), developing countries with limited treaty networks, or limited resources to pursue treaty requests, or both, would face a burden retrieving the information. At the same time, taxpayers have voiced concerns over their own potential documentation burden, the risks of inadequate data protection, and the possibility that countries will use the information in unintended ways (e.g., as a replacement for audit).

Of course, the BEPS project is not the sole avenue for potential reform in transparency and disclosure. The OECD and G20 have advocated for increased use of automatic exchange of information. To further this goal, in 2014 the OECD released a proposed Common Reporting Standard (“CRS”), a Model Competent Authority Agreement, and a Commentary for automatic exchange of information. As with the work under Action Item 13, reforms that increase uniform provision of information more directly to states can be distinctly advantageous for developing countries trying to maximize the impact of their available tax administration resources. A critical question will be the legal framework under which the automatic exchange would occur. A multilateral mechanism for sharing information (that included countries from which information would likely be sought) would best serve states with limited treaty partners. But allowing developing countries temporary access to automatic exchange on a non-reciprocal basis would allow these countries to start tackling base erosion immediately, with relatively little risk to other countries.

Finally, countries can continue to explore the use of existing bilateral treaties and TIEAs to seek taxpayer information. The U.N. and OECD Model Treaties both incorporate new standards that reject bank secrecy as a ground for refusing to share information and reduce the requesting State’s burden to show the precise use of the information sought.

Ultimately, transparency and disclosure of information remain vital to the effective enforcement of tax laws in a global economy. All countries should be attentive to the existing techniques for obtaining needed information, and should evaluate active reform proposals for their relevance, effectiveness, and required capacity building. Transparency and disclosure have center stage in international tax policy reform and the goal is to ensure that the outcomes of this focus meaningfully reduce the base erosion and profit shifting faced by jurisdictions around the world.