

Tax Havens, Tax Evasion and Banking Secrecy

Gist of the News

According to *Bloomberg.com* on October 29, 2014:

Governments around the world closed in on tax evaders with an automatic data-sharing agreement that broadens efforts by the U.S. and the five biggest European Union economies to more than 50 countries and territories.

Finance ministers signed the agreement in Berlin today in a signal of global determination to capture tax revenue, after the U.S. pursued banks such as Credit Suisse Group AG (CSGN) for helping Americans cheat on their taxes and German authorities bought CDs containing stolen bank data.

“Tax evasion is a scourge across the world and can only be tackled with a global solution,” U.K. Chancellor of the Exchequer George Osborne said at a news conference with his counterparts from Germany, France, Italy and Spain. “We expect this will provide tax authorities across the world with the details of billions of pounds of assets held overseas.”

The pledges mark the biggest step yet in the global effort spurred by the financial crisis in 2009 to identify undeclared funds hidden from government coffers. All major financial centers committed to start exchanging data by 2018 and holdouts are being urged to join, according to a joint statement e-mailed by the German Finance Ministry.

“It’s really the beginning of the end” of bank secrecy, Pascal Saint-Amans, head of the Organization for Economic Cooperation and Development’s center for tax policy and administration, said in a phone interview yesterday.

While the Paris-based OECD doesn’t have a global estimate of undeclared funds, voluntary disclosure initiatives by 20 countries have generated 37 billion euros (\$47 billion) in revenue since 2009, Saint-Amans said.

To understand the important economic and legal repercussions of this new development, we need to respond to following four questions:

1. What are the main features of the agreement signed in Berlin on October 29, 2014 (the “Berlin agreement”)?
2. What are the legal precursors of this agreement, especially as far as the American tax law is concerned?
3. What is the scope of the Berlin agreement? Would it remain limited to the OECD countries or would it become a globally standard-setting text?
4. Would Iranian banks also be “encouraged” to adopt and respect the rules included in the Berlin agreement?

Main features of the Berlin agreement

The Statement of the Outcome of the 7th Meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes published by the OECD refers to the following major outcomes of the meeting:

- a. The commitments by an overwhelming majority of Global Forum members to implement the new standard on Automatic Exchange of Information (AEOI) by 2017 or by end 2018 accompanied by an expression of support for its members, in particular developing countries, to participate in the new, transparent EOI environment;
- b. The adoption, in principle, of revisions to the Terms of Reference, which will now include a requirement to maintain *beneficial ownership information*, to ensure that *the standard on exchange of information on request* continues to reflect the evolution of the dynamic EOI environment; the changes will be applicable to the next round of reviews for EOI on request (starting in 2016); and
- c. Pledging greater support to developing countries including through facilitating their participation in AEOI and the launch of the Africa Initiative – a 3 year project to raise awareness and build the tools to foster effective EOI – led by African members and the Chair of the Global Forum with the collaboration of the Global Forum, ATAF, CREDAF, the OECD and the World Bank Group (*emphasis added*).

According to another report of the OECD:

The agreement consists of 8 sections:

- Section 1 contains the definitions of the terms used in the agreement.
- Section 2 sets out the information to be automatically exchanged.
- Section 3 sets out the timing and method of the automatic exchange of information.
- Section 4 outlines how the parties to the agreement will work together to ensure compliance with the agreement.
- Section 5 sets out provisions to ensure confidentiality and the safeguarding of the data.
- Section 6 sets out the process to consult on ensuring the smooth operation of the agreement and to amend the agreement.
- Section 7 sets out the subsequent notifications required under the agreement and how the agreement is then subsequently brought into effect.
- Section 8 sets out the role of the Secretariat.

To grasp the gist of these developments, we need to define few technical terms used in the Statement, including the Automatic Exchange of Information (AEOI), the “beneficial ownership information”, and “the standard on exchange of information on request”.

Automatic Exchange of Information (AEOI)

According to *webdms.ciat.org*, Automatic Exchange of Information is:

...the Systematic and periodic transmission of bulk taxpayers-information between EOI partners:

- Without prior request;
- At regular intervals.

Beneficial ownership information

In his brief report titled “Beneficial Ownership in the OECD Model Tax Treaty”, M.L.L. van Bladel dissects the above term to two parts. First, he focuses on “ownership” and then he tries to determine the borderlines of the term “beneficial ownership”. He explains that ownership can be divided into two types: legal and economic. His definition of the legal ownership is lucid:

Legal ownership of an asset means that the legal person or individual (“Person”) claiming legal ownership is regarded to be the legal owner under the (civil) laws of the country in which the Person and/or the asset is located. Under the civil laws of most countries, legal ownership will be assumed for a Person who has “possession” of the asset. “Possession” of the asset means either physical possession or official registration of the asset in the name of a Person.

To better clarify the differences between legal and economic ownership, van Bladel explains that the latter term refers to the benefits that owners get from the property as well as the risks of the property that they can transfer to another person.

After making a clear distinction between the legal and economic ownership, van Bladel sets to define the beneficial ownership:

Beneficial Ownership has been introduced in the OECD model treaty after recognizing that allocating treaty benefits to mere legal owners (“agent” or “nominee”) who do not have any economic interest in an asset (which economic interest has been allocated to a non-treaty eligible person) would surpass the purpose of the treaty. Therefore, Beneficial Ownership requires 100% legal ownership and a certain degree of economic risk. Especially the term Beneficial Ownership has been introduced in the OECD-model treaty to try to eliminate the avoidance of (withholding) taxes through structured transactions (*emphasis added*).

The concept of “economic risk”, therefore, plays a major role in establishing whether a person enjoys beneficial ownership of a property or not.

Standard on exchange of information on request

The book published by the OECD titled “Standard for Automatic Exchange of Financial Account Information in Tax Matters” states that the following indicia will determine whether it would be required to report on a new or an existing bank account or not:

- 1) High value of the account;
- 2) The account holder’s residence status;
- 3) The account holder’s residence address and mailing address;
- 4) The account holder’s telephone number(s);
- 5) Whether there are standing instructions to transfer funds in the account to another account;

- 6) Whether there is a current “in-care-of” address or “hold mail” instructions for the account holder; and
- 7) Whether there is any power of attorney or signatory authority for the account.

If any or some of the above indicia are associated with an account, then the Reporting Financial Institution must treat the account as a Reportable Account with respect to each Reportable Jurisdiction.

Legal basis of the Berlin agreement

The sources mentioned above enumerate the following texts that shape the legal basis of the Berlin agreement:

- 1) The EOI article of bilateral tax treaties;
- 2) 2011 EU Directive on mutual assistance;
- 3) Nordic Convention;
- 4) Article 8 of the Convention on mutual assistance in tax matters;
- 5) Memorandums of Understanding (MOUs) entered into by some of the OECD members to define scope of AEOI , standards to use, etc.; and
- 6) The 2010 U.S. Foreign Account Tax Compliance Act (FATCA), which tightens reporting requirements for non-U.S. financial accounts.

The most important legal text in the above list is the FATCA. American tax authorities have made it clear to their partners and counterparts that the standards set by the FATCA must be respected by them. *Bloomberg.com* reports on this issue:

The five biggest EU economies -- Germany, France, the U.K., Italy and Spain -- agreed last year to exchange data among themselves along the lines of FATCA.

“We want to say that tax evasion will no longer be tolerated,” German Finance Minister Wolfgang Schaeuble said at the news conference. “It’s about fairness” and “in this globalized world we need new global standards,” he said.

Berlin agreement is becoming global

The Berlin agreement is a standard-setting text for the international banking and taxation law. *Bloomberg.com* reports that the following countries have joined the agreement’s pledge to automatically exchange data collected by financial institutions:

- most EU countries,
- Liechtenstein,
- Mexico,
- Argentina,
- South Korea;
- Bermuda;
- The Cayman Islands; and
- The Isle of Man.

Further, more than 40 countries have agreed to adopt the standard starting in 2017. Others, including Switzerland, Brazil, Canada, China, Hong Kong, Monaco and Russia have committed to start in 2018, according to OECD documents.

Bloomberg.com adds that while Switzerland isn't an early adopter, its government has a mandate to negotiate with the EU. Ministers of the OECD member countries have expressed confidence that the Swiss will join.

Euronews.com also reports that Singapore will join the Berlin Agreement from beginning of the year 2018.

Iranian authorities and the Berlin agreement

What would be the position of the Iranian banks, the legislative power (the *Majlis*), and in general the economic policy-makers of this country vis-à-vis the Berlin agreement? Their response to this question depends heavily on whether the Berlin agreement will become a globally-accepted legal text or not. The OECD, according to *Bloomberg.com*, gives a clear response to this question:

OECD Secretary-General Angel Gurría has stated that the OECD and partner countries are also working on plans for a global exchange of information to combat tax-avoidance strategies used by companies such as Google Inc. (GOOG), Apple Inc. and Yahoo! Inc. Multinational companies hold an estimated **\$2 trillion** in low-tax jurisdictions, OECD Secretary-General Angel Gurría has said (*emphasis added*).

Conclusion

Tax evasion has had serious negative impacts on the economy of developed and developing countries, especially since 2008 when the last recession cycle started. Tax evasion is also related to various security-related illegal activities including money laundering, financing of terrorist activities, etc. For all of these reasons, members of the OECD have established new standards to facilitate access to banking accounts of all of those who may be involved in these activities. This new trend is becoming global. The Iranian legislator (the *Majlis*) and the economic and legal policy-makers of this country need to learn more about this trend and eventually adopt new rules to adapt themselves to the requirements of the new standards set by the OECD. International lawyers involved in Iranian legal issues, therefore, must look into the potential measures to be adopted internationally and/or domestically in order to prepare themselves for handling their future cases efficiently.

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