Building a better working world

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Transparency in tax: Purpose and measures

The meaning of "transparency" is "easy to perceive or detect". When it comes to "tax jargon", "tax transparency" means putting pressure on "all countries" to move towards exchanging information automatically with their treaty partners" by using an appropriate standard.

After the 2008 economic crises, countries especially developed ones started searching for new ways to reach out new "tax revenues". Because, the main reasons for the new tax paradigm are as follows:

- Budget deficits,
- Public interest on taxation issues of Multi National Enterprises (MNEs),
- Common perception of lack of contribution to tax revenues by MNEs,

In today's environment, both in developed and developing countries' tax administrations see that there is not much room to generate "additional indirect taxes", but there may be more room for "direct taxes". Therefore, the G20 in 2009 announced that the "era of bank secrecy was over" has been followed by other initiatives mainly under "tax transparency".

Moreover, public interest regarding "taxation" has gained momentum in recent years. According to the United Nations' Expert Report, more than 300 leading economists and lawyers appealed to Governments to work for "fiscal transparency" in May 2016. They expressed the view that "tax havens" served no economic purpose and that they should end.

With the support of the OECD and G20, the Global Forum on Transparency and Exchange of Information for Tax Purposes ("the Forum") main priority is to have "tax transparency standards". Therefore, the Forum promotes the implementation of internationally agreed standards on exchange of information for tax purposes. In addition to "the agreed standards on exchange of information" for tax purposes, it also works "beneficial ownership information "in the tax area to improve the effectiveness of which is based on the Financial Action Task Force (FATF) standard.

Transparency measures in tax

The Global Forum on Transparency and Exchange of Information for Tax Purposes defined two internationally agreed standards on exchange of information for tax purposes:

- Exchange of Information on Request (EOIR).
- Automatic Exchange of Information (AEOI).

In addition to EOI, there are other transparency measures as follows:

- Base Erosion and Profit Shifting (BEPS) Action 13 and Automatic Exchange of Country by Country Reporting.
- Effective us of beneficial ownership information.

EOIR is an exchange of information on a specific case being requested of one Competent Authority from another Competent Authority because the information is clearly related to the tax laws and regulations of the requesting country. The requesting country might ask an information i.e. financial, legal (substance), accountancy or ownership (beneficial owners). Even if the requesting country already has the information, the requesting country in no circumstances can deny it on the grounds of banking secrecy. However, the requesting country should guarantee full confidentiality in the handling of the information that transmitted by EIOR. 139 members have committed to implementing the international standard on EOIR.

On the other hand, AEOI is an automatic way of chancing information and means a periodic and systematic exchange of information on a nonspecific case being requested of one Competent Authority from another Competent Authority based on international treaties and other agreements. In this case, paying entities or institutions collect the information at the source and transmit it in accordance with standardized and secure protocols between Competent Authorities. On the other hand, 100 countries and jurisdictions have committed to implementing the standard (Common Reporting Standard) on AEOI.

For AEOI purpose, OECD developed and approved the Common Reporting Standard ("CRS") to meet the G20 request. CRS covers a variety of "financial institutions" including not only traditional banks but also custodial institutions, certain insurance companies and investment vehicles i.e. funds.

Additionally, the standard also covers variety of customers i.e. individuals, entities, trusts and a requirement to look-through certain entities to report the beneficial owners. Finally, the information subject to exchange includes variety of financial account information for those customers i.e. as account balances and investment income.

According to the OECD Secretary's General Report of December 2018 to the G20 Finance Ministers in Buenos Aires, more than 85 countries have initiated more than 4500 reciprocal "AEOI" exchanges under CRS.

Transparency in transfer pricing: CbC reporting

BEPS actions covers to "automatic exchange in transfer pricing", which the action 13 called "Country-by-Country Reporting". According to the action 13, the participating tax authorities will automatically exchange key indicators i.e. such as profits, taxes paid, employees and assets of each entity of Multinational Enterprise Groups with each other.

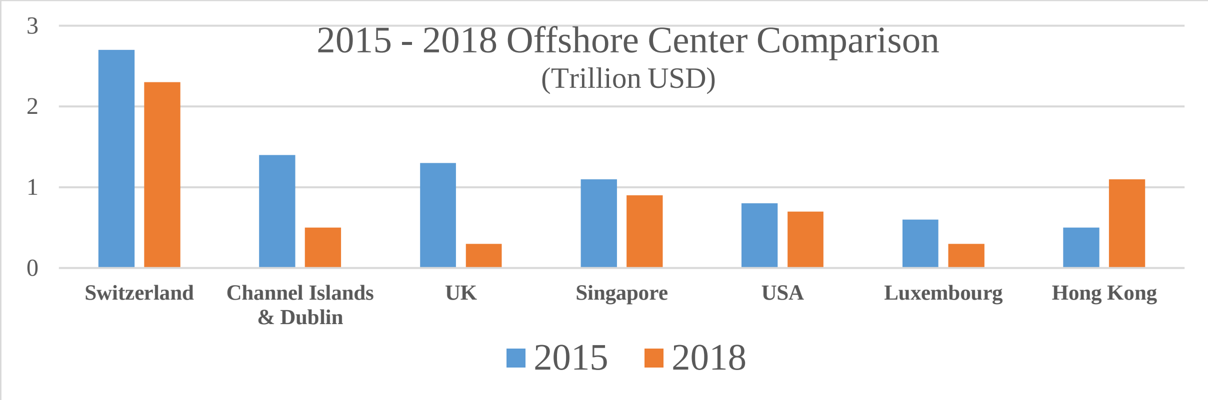
By using these key indicators, tax authorities can make risk assessments not only for the transfer pricing arrangements but also BEPS-related risks to evaluate a tax audit basis. Action 13 is one of the minimum standards of BEPS and Turkey committed to implement the minimum standards of the BEPS including the action 13.

According to OECD, there are over 2000 bilateral exchange relationships activated with respect to jurisdictions committed to exchanging CbC reports as of April 2019. Countries continue to negotiate arrangements for the exchange of CbC reports.

Off-shore centers before & after AEOI?

In recent years, offshore financial centers have increased and these centers continue to grow. According to BCG's Global Wealth Report 2018, global off-shore wealth amounted to US $ 8.3 trillion in 2017 with a growth of 6% compared to the previous year. In the next 5 years, the average of offshore wealth is expected to grow by around 5%.

The comparative data of year 2015 and 2018 are as follows:



According to the report, historically offshore centers have been preferred for tax advantages. However, the regulations that entered into force in the last 10 years have reduced offshore interest. “Tax transparency regulations” are the most important factor in decreasing this interest.

The above table explains why the German government in the past years had purchased the financial account information of German citizens in Swiss banks. After AEOI, the wealth in major offshore centers decreased around 27% from 8,4 trillion USD in 2015 to 6,1 trillion USD in 2018 and AEOI may have an impact on this decrease.

Expectations from automatic exchange of information

AEOI will globally contribute to the integrity of the international financial and tax systems. In addition to that it will also support other global transparency agendas i.e. anti-money laundering and anti-corruption.

According to the OECD Secretary’s General Report of December 2018 to the G20 Finance Ministers in Buenos Aires, countries have already collected approximately 93 billion EUR in unbudgeted tax revenue because of voluntary disclosure programs and other similar initiatives from 2009 to June 2018 due to the first exchanges with AOEI.

How can tax functions respond?

The ancient Chinese curse is “May you live in interesting times” and the meaning of “interesting” is used for “volatility, turbulence and uncertainty”. In today’s environment, taxpayers live in interesting times and they are surrounded by “transparency”, “regulation”, “anti avoidance rules” and “disclosures” in everywhere.

As a result of these developments, company shareholders, board of directors and beneficial owners, should closely follow the regulations on “tax transparency”. In a world that is increasingly transparent in terms of taxation, senior management is required to transform management approaches to adapt to “tax regulations to meet the changing needs of their business. Therefore, tax transparency should be considered as part of the company's strategy and risk management.

Information is a treasure that grows with sharing.

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